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Resources, Community, and
Economic Development Division

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January 30, 1998 .

The Honorable Jerry Lewis
Chairman
The Honorable Louis Stokes
Ranking Minority Member
Subcommittee on VA, HUD, and
Independent Agencies
Committee on Appropriations
House of Representatives

The Honorable Rick Lazio
Chairman, Subcommittee on
Housing and Community Opportunity
Committee on Banking and Financial Services
House of Representatives

Subject: Welfare Reform: HUD's Preliminary Estimate of the Financial Impact of Welfare Reform on HUD's Programs

The House report accompanying the fiscal year 1998 appropriations law for the Department of Housing and Urban Development (HUD) directed GAO to study the effects of welfare reform on public housing authorities' (PHA) operating costs and on the income levels of PHA residents. You asked us, as part of our study, to provide information on how HUD developed its preliminary estimate that welfare reform would increase the cost of HUD's budget by nearly $2.3 billion over 6 years, from fiscal year 1997 through fiscal year 2002.[1] This report provides information on the methodology that HUD used to develop its preliminary estimate.

In summary, HUD used estimates derived from a model that measures the impact of welfare reform developed by the Urban Institute, together with budget

[1]As part of our response to the appropriations law's directive, we are currently working on two additional studies of the potential effects of welfare reform on PHAs and HUD.

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estimates from the Congressional Budget Office (CBO), to develop a preliminary estimate of expected increases in the Department's subsidies for public and assisted housing due to anticipated losses in tenants' incomes. HUD is no longer standing behind this estimate because of the difficulties in predicting how states will implement their welfare reform plans, how welfare recipients will respond to welfare reform, and other factors.

BACKGROUND

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193) significantly changed the nation's social welfare system. Through the act, the Congress transformed one of the nation's largest social welfare entitlement programs–Aid to Families With Dependent Children–into a block grant to states called Temporary Assistance for Needy Families (TANF). The act established a 5-year lifetime limit for individuals on the receipt of TANF benefits, stipulated that recipients participate in work activities, tightened the eligibility standards for receiving Supplemental Security Income, and strengthened the procedures for collecting and disbursing child support payments. The act has provisions for terminating benefits for families who fail to comply with work, child support, and other requirements under the new law. Each state is required to develop a plan, which must be reviewed by the Secretary of Health and Human Services, indicating how it will implement provisions of the act pertaining to the TANF block grant.

Welfare reform may have a financial impact on HUD because the Department provides operating subsidies to PHAs when their revenues, which come primarily from tenants' rents, do not cover their expenses. In addition, HUD subsidizes tenants' rents through its Section 8 programs. The impact of welfare reform on PHAs' operating subsidies will depend on many factors, including the percentage of tenants who rely on welfare and the proportion of their income that is derived from welfare benefits, the variation in states' welfare reform plans and strategies for implementing them, and the percentage of current welfare recipients who move into the labor force. If tenants' incomes decrease under welfare reform, PHAs' revenues will also decrease, and PHAs may need larger operating subsidies from HUD. If Section 8 tenants' incomes decrease under welfare reform, HUD's obligations to landlords will increase. Although HUD has the discretion to choose the level of funding for PHAs' operating subsidies,[2] it must provide the rental assistance needed to satisfy its Section 8

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[2]In fiscal year 1997, HUD covered 95 percent ($2.9 billion) of PHAs' operating losses.

obligations.[3]

Alternatively, the incomes of PHA tenants could increase under welfare reform, resulting in higher revenues for the PHAs and a smaller need for operating subsidies from HUD. Similarly, if Section 8 tenants' incomes increase under welfare reform, the tenants would pay a larger portion of the rent and HUD would pay less.

HUD'S PRELIMINARY ESTIMATE

In October 1996, HUD's Office of Policy Development and Research developed a preliminary estimate that welfare reform would increase the costs of the Department's programs by nearly $2.3 billion over 6 years, from fiscal year 1997 through fiscal year 2002. This preliminary estimate, based on the assumption that HUD would subsidize the same number of households in the future as it has in the recent past, included $700 million for PHAs' operating subsidies, $1.152 billion for tenant-based Section 8 assistance, and $408 million for project-based Section 8 assistance.

In a draft January 1997 report, HUD stated that because of the enormous flexibility states have in implementing the new law, any specific estimate of the impact of welfare reform on its outlays is extremely speculative at this time.[4] Moreover, during our review, we found that HUD is no longer standing behind its estimate because of the difficulties in predicting how states will implement their welfare reform plans, how welfare recipients will respond to welfare reform, and other factors. Therefore, HUD is not planning to develop future estimates of the impact of welfare reform on its programs. Accordingly, as agreed with your offices, we described the steps that HUD took to develop its

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[3]Section 8 assistance may be "tenant-based" or "project-based." Eligible tenants must pay the highest of 30 percent of their adjusted income, 10 percent of their gross income, or the portion of their welfare assistance designated for housing. HUD's subsidy covers the portion of the rent not covered by the tenants' payment. HUD enters into contracts with PHAs to administer the tenant-based Section 8 program. Similarly, HUD–or PHAs on behalf of HUD–enters into contracts with property owners for subsidized housing under the project-based Section 8 program. Under both types of contracts, HUD agrees to provide subsidies and cover other administrative costs for a year or more.

[4]The Impacts of Federal Welfare Reform on HUD Public and Assisted Housing: An Initial Assessment (Draft), HUD, Office of Policy Development (Jan. 21, 1997).

preliminary estimate (see enc. I), but we did not evaluate HUD's methodology.

AGENCY COMMENTS

We provided HUD with a draft of this report for its review and comment. HUD provided written comments (see enc. II) that characterized the report as a fair and accurate summary of the methods used by its Office of Policy Development and Research in attempting to form a preliminary estimate of the impact of welfare reform on HUD's expected subsidy requirements. HUD also suggested wording to clarify its rationale for using fiscal year 2000 as the reference year for its analysis. We incorporated this wording into the report where appropriate.

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To conduct our review, we examined HUD's documentation of its welfare reform analysis and interviewed agency officials. We also interviewed representatives from CBO and the Urban Institute. We conducted our review from September 1997 through January 1998 in accordance with generally accepted government auditing standards.

If you or your staff have any questions about this report, please call me at (202) 512-7631. Major contributors to this report were Amy Abramowitz, DuEwa Kamara, and Chuck Wilson.

Judy England-Joseph
Director, Housing and Community
Development Issues

Enclosures - 2

METHODOLOGY FOR HUD'S PRELIMINARY ESTIMATE OF THE FINANCIAL IMPACT OF WELFARE REFORM ON ITS PROGRAMS OVER 6 YEARS

The Department of Housing and Urban Development (HUD) developed its preliminary estimate of the impact of welfare reform on its programs--nearly $2.3 billion--by (1) estimating the impact of welfare reform in its first full year of implementation, (2) estimating the impact of welfare reform for the years before and after the first full year of implementation, and (3) allocating its total estimate of the impact of welfare reform across its housing assistance programs. To accomplish this analysis, HUD used estimates derived from a model that measures the impact of welfare reform developed by the Urban Institute, together with budget estimates from the Congressional Budget Office (CBO), to generate expected increases in HUD's subsidies due to net losses anticipated in the incomes of tenants living in public and assisted housing.

HUD ESTIMATED THE IMPACT OF WELFARE REFORM DURING THE FIRST FULL YEAR OF IMPLEMENTATION

HUD began its analysis by estimating the impact of welfare reform on its housing programs for fiscal year 2000, which HUD considered to be the first full year of the legislation's implementation (i.e., the reference year).[1] To develop this estimate, HUD obtained data from the Urban Institute showing the potential changes in family incomes resulting from welfare reform. These data were generated by the Urban Institute's Transfer Income Model 2 (TRIM2),[2] which HUD then regarded as the only available analytical tool for measuring the net impact of welfare policy changes on incomes. The data provided to HUD included anticipated changes in family incomes from earnings, child support, Aid to Families With Dependent Children (AFDC), and Supplemental Security Income (SSI) for children and adults. The data were provided in a format that divided the U.S. population into quintiles by income. The incomes of most HUD-assisted renters fall into the two lowest quintiles.

Table I.1 shows the data from the Urban Institute on anticipated changes in income for all U.S. households, both with and without HUD assistance, in the two lowest income quintiles. HUD used these as estimates of anticipated income changes in the reference

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[1]States are prohibited from providing federal dollars to most families who receive cash assistance for more than 5 years after the effective date of the Temporary Assistance for Needy Families (TANF) block grant program (July 1, 1997, or earlier at each state's option).

[2]TRIM2 is a microsimulation model that can be used to calculate the effects of complex, large-scale government tax, transfer, and health programs on individuals, households, and federal and state budgets.

year, fiscal year 2000, which HUD considered to be the first full year of welfare reform's implementation.[3] As the table indicates, income from earnings and child support is expected to rise while income from AFDC and SSI is expected to fall for people with incomes in the two lowest quintiles.

Table I.1: Impact of Welfare Reform on Income for Households With Incomes in the Two Lowest Quintiles, Fiscal Year 2000

1996 dollars in millions

Income source	Change	
	First quintile	Second quintile
Earnings[a]	$2,166	$279
Child support[b]	266	244
AFDC[c]	- 4,115	- 949
SSI (for adults)[d]	- 1,097	- 1,366
SSI (for children)[d]	- 1,358	- 293
Net change in income	**-$4,138**	**-$2,085**

[a]According to the Urban Institute's assumption, under welfare reform, current welfare recipients' earnings will increase by about $2.5 billion across all quintiles. This assumption about earnings is derived from a paper on the prospects of employment for current welfare recipients by Alberto Martini, How Important Is It to Incorporate Labor Supply Response When Simulating the Effects of Transfer Program Reforms?

[b]According to the Urban Institute's assumption, based on estimates from the U.S. Department of Health and Human Services, increases in child support payments will total $913 million across all quintiles, with an increase of $510 million accruing to households in the two lowest income quintiles.

[c]According to the Urban Institute's estimate, AFDC payments will decline by $5.3 billion across all

[3]In preparing its estimates, the Urban Institute assumed that the full impact of welfare reform would occur after many of the current welfare recipients had exhausted their 5-year lifetime allowance of TANF benefits--in 2001 or later. HUD, however, chose fiscal year 2000 as the reference year for its own analysis because (1) the states are free under the new law to set a time limit of less than 5 years, (2) the Congress gave the states indirect financial incentives to adopt shorter time limits, and (3) many states had already announced their intention to adopt shorter time limits.

quintiles in the year that welfare reform's time limits take full effect. This estimate is based on the assumption that all states will reduce their current benefit levels by nearly 5 percent and will exempt 20 percent (the maximum allowable percentage) of their caseload from the act's work requirements, that 25 percent of noncitizens will be ineligible to receive AFDC payments, that 335,000 disabled children will no longer receive SSI payments, that all teens will attend school or work as required to maintain benefits, and that a $50 payment to welfare recipients is eliminated in cases when child support is collected.

[d]The Urban Institute obtained estimates from the CBO for changes in SSI benefits for adults and children due to the impact of policy changes on the SSI program. According to the Urban Institute's estimate, across all quintiles, SSI benefits for adults will decrease by $3.4 billion and SSI benefits for children will decrease by $2.1 billion.

Source: HUD.

To estimate the financial impact of welfare reform on HUD's programs in the reference year, fiscal year 2000, HUD's Office of Policy Development and Research (PD&R) assumed that 25 percent of the households in the lowest income quintile are HUD-assisted renters and that 12.5 percent of the households in the second lowest quintile are HUD-assisted renters.[4] For each of these quintiles, HUD multiplied the net expected loss in income for all households by the percentage of HUD-assisted renters to obtain the lost income that will accrue to households assisted by HUD. These income losses were multiplied by 0.3, the percentage of adjusted monthly income that tenants provide in rent, to generate expected rental losses to public and assisted housing programs. The calculation for this analysis was therefore [($4,138 million x 0.25) + ($2,085 million x 0.125)] x 0.3 = $388 million in 1996 dollars. Using an annual inflation rate of approximately 3 percent, HUD inflated the $388 million estimate in 1996 dollars to $437 million in year 2000 dollars.

HUD USED CBO'S PROJECTIONS TO ESTIMATE THE IMPACT OF WELFARE REFORM FOR YEARS BEFORE AND AFTER THE REFERENCE YEAR

To estimate the impact of welfare reform for the years before and after the reference year–fiscal year 2000–HUD used data from CBO to create a time path of the expected impact of welfare reform on HUD. The time path was based on CBO's estimates of changes in cash transfer outlays for certain welfare-related programs over

[4]PD&R derived the 25-percent figure from general knowledge that about 25 percent of AFDC recipients have housing assistance and that most AFDC recipients have incomes in the lowest quintile. The 12.5-percent figure reflects an assumption about the percentage of households with incomes in the second lowest quintile that would be likely to have housing assistance.

several years.[5] Using fiscal year 2000 as a base, HUD created an index in which each year's index value is the change CBO expects in transfer outlays for that year as a percentage of the change it expects in transfer outlays for fiscal year 2000. Table I.2 shows CBO's estimates of the changes in transfer outlays for title I (AFDC) and title II (SSI) and the time path index that HUD created from these values, from fiscal year 1997 through fiscal year 2002.

Table I.2: Estimated Changes in Transfer Outlays for Title I (AFDC) and Title II (SSI), and Index of Expenditures Based in Fiscal Year 2000

Current-year dollars in millions

	Fiscal year					
	1997	1998	1999	2000	2001	2002
Estimated changes in transfer outlays	-1,104	-2,267	-2,959	-3,652	-3,939	-4,984
Index of expenditures based in fiscal year 2000	0.30	0.62	0.81	1.00	1.08	1.36

Source: HUD.

HUD next applied the index of expenditures derived from CBO's transfer outlay tables to the current dollar figure of $437 million for fiscal year 2000 to generate HUD's expected costs in years before and after the reference year (see table I.3). For example, HUD multiplied the estimated impact of welfare reform on its budget in fiscal year 2000–$437 million–by the index value of 0.81 (81 percent) for fiscal year 1999 to arrive at an estimated impact of $354 million in fiscal year 1999. HUD estimated the total impact of welfare reform on its budget to be nearly $2.3 billion over the 6 years.

[5]Federal Budgetary Implications of H.R. 3734, The Personal Responsibility and Work Opportunity Reconciliation Act of 1996, CBO (Aug. 1996). Transfer outlays include payments made by the government to individuals for which no future goods or services are required, such as Social Security benefits, unemployment insurance benefits, and welfare payments.

Table I.3: Impact of Welfare Reform on HUD's Housing Assistance Costs, Fiscal Years 1997-2002, and Index of Expenditures Based in Fiscal Year 2000

Current-year dollars in millions

	Fiscal year						Total
	1997	1998	1999	2000	2001	2002	
Impact of welfare reform on HUD's budget	$131	$271	$354	$437	$472	$594	$2,260
Index of expenditures based in fiscal year 2000	0.30	0.62	0.81	1.00	1.08	1.36	

Source: HUD.

HUD APPORTIONED ITS ESTIMATE
OF THE IMPACT OF WELFARE REFORM
ACROSS ITS HOUSING ASSISTANCE PROGRAMS

Using April 1996 data from its Multifamily Tenant Characteristics System and December 1995 data from its Tenant Rental Assistance Certification System, HUD estimated the percentage of HUD-assisted households in each of three housing assistance programs: public housing, the tenant-based Section 8 program, and the project-based Section 8 program. On the basis of the percentage of households being assisted by each of these programs, HUD allocated its preliminary $2.26 billion estimate of the impact of welfare reform among its affected housing programs, assigning $700 million to public housing operating subsidies, $1.152 billion to tenant-based Section 8 assistance, and $408 million to project-based Section 8 assistance.[6]

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[6]The Multifamily Tenant Characteristics System is a database that contains information on households occupying HUD's public and Indian housing. The Tenant Rental Assistance Certification System is a database that contains certified data on tenants from the owners and managers of multifamily housing projects, as well as from local and state housing authorities.

COMMENTS FROM THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-6000

OFFICE OF THE ASSISTANT SECRETARY
FOR POLICY DEVELOPMENT AND RESEARCH

January 21, 1998

Ms. Judy A. England-Joseph
Director, Housing and Community
Development Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Ms. England-Joseph:

Thank you for the opportunity to comment on the draft report Welfare Reform: HUD's Preliminary Estimate of the Financial Impact of Welfare Reform on HUD's Programs (GAO/RCED-98-57R).

The report is a fair and accurate summary of the methods used by the Office of Policy Development and Research in attempting to form a preliminary estimate of the impact of welfare reform on expected HUD subsidy requirements. We have nothing in the way of correction to offer, but we would suggest one addition.

The report notes that PD&R treated FY 2000 as the first year of full implementation of the PRWORA for purposes of applying the TRIM2 estimates to the HUD budget. On page 7, footnote 3, the report notes that the Urban Institute, which developed the TRIM2 estimate, might have preferred FY 2001, because the mandated Federal time limit in the new TANF program is 5 years. In using FY 2000 as the first full year, PD&R took into consideration that; (1) States under the new law are free to set a time limit of less than 5 years, (2) Congress gave States indirect financial incentives to adopt a shorter time limit, and (3) many States had already announced their intentions of adopting a shorter time limit.

The report is correct in stating that HUD will not be using this estimate for purposes of future budgets. We appreciate the chance to review the draft.

Sincerely,

Paul A. Leonard
Deputy Assistant Secretary
for Policy Development

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