PROBLEMS WITH THE CURRENT PROCEDURE FOR DETERMINING THE STANDARD OF NEED IN TENNESSEE'S AFDC PROGRAM

Prepared for

Legal Services of Middle Tennessee

by

Dr. Peter S. Fisher

June 30, 1991

FISHER, SHEEHAN AND COLTON
RR5, Box 27
3722 Hummingbird Lane
Iowa City, IA 52240
(319) 338-1494

Introduction

In determining the standard of need for the AFDC program, the Department of Human Services (DHS) in Tennessee has, since 1983, employed a method that begins with the Bureau of Labor Statistics (BLS) Lower Level Budget for a four-person household, and then makes a number of adjustments to reflect circumstances of an AFDC family in Tennessee. In effect, this method begins with a need figure (the BLS budget) that is in large measure a national market-basket approach, though it relies in part on actual consumer expenditure data. This figure is then adjusted to make the four-person household more like a typical AFDC family, primarily by assuming a single mother with three children instead of a two-parent family, and making appropriate substitutions of a child's costs for a father's costs. The BLS budget is also adjusted to account for the fact that an AFDC family is entitled to Medicaid, and that nearly 90% of AFDC families receive food stamps; these adjustments lower the budgeted amounts for health care and food. Transportation costs were reduced on the assumption that the parent is unemployed. Finally, the BLS housing figure is replaced with an average amount actually spent on rent by AFDC households in Tennessee. All but the last item represent generic adjustments to the national BLS budget to reflect AFDC status; only the last represents an attempt to make the BLS budget reflect actual Tennessee prices. Finally, the four-person standard of need is modified to establish a standard of need for other household sizes.

This report will focus on four specific components of the Tennessee standard of need: (1) housing, (2) utilities, (3) transportation, and (4) other items. We will critique the way in which the Tennessee DHS currently implements the state statute that defines standard of need. The assumption made is that a market basket approach is the ideal--that is, one should determine the market basket of goods and services needed by a Tennessee AFDC household, and the cost of purchasing that market basket in Tennessee. While the current method begins with a national standard, the BLS budget, DHS does make a number of adjustments to that budget. In making these adjustments, DHS should, wherever possible, employ the market basket approach. For example, if the BLS housing cost component is rejected, then the substitute should be calculated as the actual cost of purchasing adequate, safe and decent housing in Tennessee, just as the housing cost component of a full-blown Tennessee market basket standard would be.

Housing Costs

Ideally, the housing cost component of the AFDC standard of need would be determined according to the market basket approach. That is, the characteristics of adequate housing would be determined first, by household size. This is a normative determination based on the physical characteristics of the housing (number of bedrooms, bathroom facilities, structural soundness, etc.). The second step would be to determine the price of such adequate housing in Tennessee. Since the price will vary from one housing market to another, it may be important to determine separately the average price in metropolitan areas and the average price in rural areas.[1]

Such an approach contrasts sharply with the method presently in use to determine the standard of need in Tennessee. The present standard is based on actual expenditures for housing by low-income households in Tennessee. The resulting standard is an average of

[1] Whether or not a separate need standard for urban and rural areas is justified, however, depends on whether or not there is a significant difference in the *total* cost of the market basket. Lower housing costs in rural areas may be offset by higher costs for transportation and heating fuel, for example. If geographic differentials are to be incorporated, they should be based on cost differentials for all components of the standard of need.

expenditures by households who spend a very large share of income renting adequate housing in the market, households who rent substandard housing on the market, households who have no housing at all (and hence no expenditure), households who live rent-free in substandard or perhaps adequate housing of friends or relatives, and households who live in subsidized (but presumably adequate) housing. The resulting average clearly bears no relation to the concept of the cost of adequate housing.

In considering the variety of housing situations that an AFDC family may confront, it is useful to draw two fundamental distinctions: (1) those who, if they were to reside in adequate housing, would have to find such housing on the open market and pay market prices; and (2) those who have *adequate* housing available to them at below market prices.

(1) Households at the mercy of the market

(a) Those who are now renting adequate housing

(b) Those who are now renting sub-standard housing

(c) Those who are living in sub-standard housing with friends or relatives

(d) The homeless

(2) Households with below-market rent options for adequate housing

(a) Those residing in government-subsidized housing

(b) Those who are sharing adequate housing with friends or relatives and paying little or no rent.

Clearly the only appropriate housing need standard for those in group one is the market basket standard as defined above. What such households are actually renting is irrelevant; they do not have the option of paying below-market rent for adequate housing, so they should be provided the full amount needed to rent such housing, at the going price. The difficulty arises with group two. If there is only one housing need standard, based on the market price of adequate housing, the group two households will receive more than they require to live in adequate housing. Since housing costs comprise a large share of the standard of need, this is not a trivial matter.

Let us suppose 75% of AFDC households are in group one, and that market rent for adequate housing for the average AFDC household consisting of three persons is $400 per month. The average actual expenditure for housing by households in this group is only $240. The 25% in group two pay nothing at all for housing. Then the average expenditure for housing among all AFDC households will be $160. Applying a uniform housing standard of need of $400 (and setting AFDC payments equal to 100% of need) would mean that 75% of the AFDC population receive just what they need to purchase adequate housing; more than they actually spend, in many instances, but enough to enable them to upgrade their housing to the minimum level. The other 25% receive $400 that they are then free to spend on other items since they have no housing costs.

The current "solution" to this problem in Tennessee is to base the standard of need on average expenditure. Then every AFDC household in our example will receive $160. The result is that the "excess" payment to 25% of the population is reduced from $400 to $160, but for the other 75%, most (save the homeless) receive less than their actual housing expenditure, and all receive far less than what is needed to secure adequate housing.

There are, presumably, two objectives to be served in designing an appropriate standard of need: (1) To ensure that AFDC households receive sufficient income to enable them to obtain adequate housing, and (2) To ensure horizontal equity among AFDC households. The latter objective requires that two households of a given size and need for housing should be treated equally with respect to housing--they should both receive just enough to enable them to obtain adequate housing. The uniform standard based on the market price of adequate housing attains objective one completely but fails on objective two. The Tennessee solution using average expenditure fails miserably on objective one, and performs no better than the other approach with respect to the horizontal equity objective. The disparity among households is still there; instead of giving 75% just what they need and 25% much more than they need, it gives 75% much less than they need and 25% a little more than they need.

The ideal solution to the problem would be to count the value of housing subsidies as income. One could leave the housing need standard at the ideal level: 100% of the market cost of adequate housing. Objective one is attained for all. Objective two, horizontal equity, is then attained by adding to income the difference between the market rent for the housing one is actually living in and the rent actually paid, wherever rent is below market rates. Let us see how this would affect the different groups, with hypothetical costs as above.

(1) Households at the mercy of the market

(a) Those who are now renting adequate housing: No income adjustment required; $400, in our example, presumably just covers rent.

(b) Those who are now renting sub-standard housing: No income adjustment required since they are paying market rent, lets say $300. They may choose to use the $400 housing allowance to upgrade their housing, or continue to live in sub-standard housing and use the $100 difference for other things they value more.

(c) Those who are living in sub-standard housing with friends or relatives: Adjustment to income equal to the imputed market value of the housing they receive, less rent actually paid. Let’s say their housing is cramped and is worth $300 on the market; they actually pay their friend $50. Then they receive the $400 housing allowance, but the $250 value of the housing subsidy ($300 less $50) is added to income, which in turn is deducted from their AFDC payment, leaving them with, in effect a $150 housing supplement. They could choose to purchase adequate housing on the market for $400, in which case the income adjustment would no longer be made and they would spend all $400 on housing. Alternatively, they could continue to live in the sub-standard housing and use the extra $150 on other items. Again, each household decides how to make the trade off between better housing and better food, clothing transportation, or other household needs.

(d) The homeless: No income adjustment, obviously; presumably, few or none would choose to remain homeless if provided with funds enabling them to rent adequate housing.

(2) Households with below-market rent options

(a) Those residing in government-subsidized housing: Income adjustment is equal to the difference between contract rent for the subsidized housing and the amount of rent the household is required to contribute. If contract rent is $400 and the household must pay $100 towards the rent, then housing subsidy value of $300 is added to income. The household receives the $400 housing allowance less the $300 adjustment to income, leaving them with just the $100 needed to pay their share of the rent for adequate housing.

(b) Those who are sharing adequate housing with friends or relatives and paying little or no rent: Adjustment to income just as in (1)(c) above. The household living in adequate housing with an imputed market rent of

$400 will, in effect, receive just the amount of the actual rent contribution they make, as in (2)(a).

The income adjustment would be easy to implement for those in government subsidized housing since market rents are readily determined. For those sharing housing with friends or relatives, it would be difficult to determine the market rent for such shared housing, and difficult to audit claims that the AFDC household is actually paying a given amount to the friend or relative as rent. Nonetheless, whether such income adjustments were not made at all or were made only imperfectly, this system is a clear improvement over the present one. It attains the objective of ensuring adequate housing, and it reduces the horizontal equity problem, at least among those in government subsidized housing. The existing Tennessee "solution," in contrast, fails on both counts.

Some states, according to the 1980 study by Urban Systems Research and Engineering, *AFDC Standards of Need,* take into account the different housing circumstances of recipients by basing the housing allowance in the need standard on each households' actual rent paid. That is, other components of the need standard are established on a uniform statewide basis, but the housing component is simply a reimbursement for each family's actual rent payment. While this successfully takes into account the situation of the family in subsidized housing, it has all the problems of an expenditure-survey based standard: households are reimbursed for the housing they can afford, however deteriorated or congested, not for the cost of safe and adequate housing. Such an approach would appear to violate the Tennessee statute which seems to call for a normative standard--the cost of decent housing.

Other states appear to establish a uniform standard, that may be a normative, market based one, and make no adjustment for differences in housing circumstances in part because the proportion of AFDC recipients in subsidized housing in many states is quite low--below 10%. Thus any adjustment is viewed as a way of lowering payments, rather than raising them. But in Tennessee, the opposite may be the case. The state has failed to incorporate differences in housing circumstances in an equitable fashion, and instead has used existence of subsidized housing to *lower* the need standard for everyone by using average expenditure to determine need. Thus in Tennessee, where a very sizeable portion of AFDC recipients benefit from public or subsidized housing, the perceived overpayment of these recipients via a uniform standard that was set at market rent for decent housing may be what is preventing such a standard from being adopted. When 40%, rather than 8%, of the AFDC recipients also obtain housing benefits, the horizontal equity issue cannot be ignored.

There are two ways of resolving this problem. First, a statewide consolidated standard of need could be established based on the market price of decent housing in Tennessee. But for AFDC recipients in low-rent public housing or section 8 subsidized housing, the standard housing allowance component would be replaced with an "as paid" allowance--that is, families would be allowed the actual rent they must pay. Assuming that public housing is safe and adequate housing, this would solve the horizontal inequity problem and eliminate the overpayment issue for the vast majority of Tennessee AFDC households.

The other solution is to establish two different need standards. The standard of need for those not in subsidized housing would be established using some measure of the cost of safe, decent and adequate housing. For those who are in public housing or subsidized housing, the average value of these housing assistance programs would be deducted from the market rent figure to determine the housing cost component of the standard of need, equal to the average rent actually paid by these recipients for presumably adequate subsidized housing. While administratively simpler, it does not eliminate the horizontal inequity problem to as large a degree since it ignores the sizeable differences in rent payments among those receiving subsidized housing.

Either of these approaches could set the market cost of decent housing equal to, perhaps, the average of HUD's fair market rents for Tennessee. For example, the simple average of FMR for a two-bedroom unit in Tennessee's seven MSA's in 1989 was $408. In non-metropolitan counties, the median for a two-bedroom unit was about $320. Either approach could reasonably be viewed as implementing the state statute, which requires that DHS shall deduct from the true cost of safe, healthful housing, the value of housing assistance programs. The statute does not require that DHS implement this deduction in any particular way; the approaches outlined here make far more sense than the method currently used. They do not deduct housing subsidies from housing costs for those who in fact have no housing subsidies.

Both methods divide the AFDC population into just two groups, based on housing circumstances: those living in government-subsidized housing, and everyone else. They do include the full market price of housing in the need standard for those who are living rent free with friends or relatives. There does not seem to be a simple way around this problem, but neither does it seem to be a major one. At this point it becomes important to identify the relative proportions of AFDC households in different housing circumstances. According to the recent report of the Subcommittee on Standard of Need Methodology, a 1988 Case Characteristic Profile by DHS found that 43% of AFDC households lived in subsidized housing, 13% rent free. These figures are significantly at odds with figures published by the USDHHS in *Characteristics and Financial Circumstances of AFDC Recipients, FY 1989.* The differences are shown in the table below. It should be noted that the 1989 figures are quite similar to those in the 1988 edition of this USDHHS report.

SHELTER ARRANGEMENTS OF AFDC FAMILIES IN TENNESSEE

	U.S.D.H.H.S 1989	Tennessee DHS, 1988
Private rental housing, no subsidy	50.2%	
Owns or is buying	4.5%	
Sub-total: market priced housing	54.7%	43.6%
Public housing	21.0%	
Subsidized housing	14.9%	
Sub-total: subsidized housing	35.9%	43.0%
Lives rent-free	8.8%	13.0%
Shares group quarters	0.7%	
Total	100.0%	

The discrepancies in these figures need to be explained. The U.S. numbers are based on a sample of Tennessee AFDC cases; while some sampling error is expected, it would be very unusual for discrepancies of this magnitude be due simply to sampling error, particularly since they are present the previous year as well.

Whatever the actual numbers, it is clear that establishing a separate need standard for those in subsidized housing, or giving them a housing allowance equal to actual rent paid, would reduce most of the horizontal inequity associated with a uniform need standard regardless of housing situation. The small number of households living rent free, and the even smaller number who are living in safe, adequate housing rent free, may receive a little more than is justified, but this is a trivial matter compared to the substantial underpayment of over half of AFDC recipients under the present system.

Further investigation would be required to determine:

(1) Whether fair market rents or gross contract rent under the Section 8 program should be used to establish housing needs;

(2) The administrative feasibility of identifying recipients of subsidized housing for assignment into the appropriate standard of need category.

(3) Current practices of other states with respect to integration of housing assistance and AFDC programs or adopting differential standards of need.

Utilities and Other Items

There seems to be little or no justification for the low utility allowance currently used in Tennessee. The appropriate amount could be approximated by using the 1988 Case Characteristic Profile, perhaps, to compute an average utility expenditure *among those renting adequate housing.*

This will still understate utility expenditure required under a normative standard of need, to the extent that households keep temperatures below what is healthy to save on fuel costs, for example. Nonetheless, the problem with expenditure data does not seem severe in the case of utilities, provided that we are looking at utility expenditure associated with the consumption of housing that satisfies the normative standard. One could, perhaps, look at utility expenses of those in the section 8 program.

The determination of an appropriate utility allowance is dependent on the basis for the housing component; if the housing component is based on HUD Contract Rents, for example, rent may commonly include at least some utilities. Section 8 housing also provides a utility allowance. If subsidized housing is to be integrated with AFDC in the manner described above, it might make sense to determine a standard shelter allowance, including rent and utilities (perhaps using HUD figures for both) and then to deduct the average rent actually paid by recipients of subsidized housing.

While a normative, market basket approach remains the ideal, it should be the case that actual expenditures of low income households for such items as utilities, adult dental care, home repairs, or household furnishings can be taken as the lower bound on the ideal. The standard should be set at least that high; these items represent essentials, and households with little income can be presumed to be spending less in these items than what would be required to attain a minimum but adequate standard of living. Thus there can be no justification for a utility allowance that is half what AFDC recipients are actually spending.