

**AFFORDABLE HOUSING AND SECTION 8 UTILITY ALLOWANCES:**

**An Evaluation and a Proposal for Action**

**(Part I: Adequacy of Annual Allowances)**

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Public utilities should become involved with the establishment of Section 8 utility allowances as a mean of generating public funds to help pay low-income utility bills. Under federal law, a low-income household who lives in Section 8 housing and who purchases her own utility service is entitled to a "utility allowance" that reduces the household's total shelter costs to no more than 30 percent of income.<sup>11</sup> The U.S. Department of Housing and Urban Development (HUD) has defined shelter costs to include both contract rental payments<sup>12</sup> and charges for home utilities, including heating, electricity and water/sewer service.<sup>13</sup>

Section 8 tenants can represent a significant portion of a utility's low-income population. According to a 1991 GAO study, there were 1.3 million Section 8 tenants in the United States in Fiscal Year 1991 (FY 91), 80 percent (1.04 million households) of whom paid their own utility bills.<sup>14</sup> In FY 91, the federal government provided \$800 million in utility allowances nationwide.<sup>15</sup>

### SECTION 8 AND UTILITY ALLOWANCES

The purpose of providing affordable housing is served through the provision of rental subsidies and a "subsidized utility allowance." Under Section 8, a property owner is permitted to set a rent not to exceed a HUD-determined "fair market rent."<sup>16</sup> A Section 8 utility allowance is provided that varies depending on fuel source, type of housing and the like. The utility allowance, when summed with the rental subsidy, is intended to reduce the total shelter costs of program participants to 30 percent of income.

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<sup>11</sup> 24 *C.F.R.* §813.107 (1992).

<sup>12</sup> "Contract rent" is defined to include "the total amount of rent specified in the Housing Assistance Program (HAP) contract as payable to the owner by the Family, and by HUD or the PHA on the Family behalf." 24 *C.F.R.* § 813.102 (1992).

<sup>13</sup> 24 *C.F.R.* § 813.102 (1992) ("utility allowance" includes the "cost of utilities (other than telephone).").

<sup>14</sup> U.S. General Accounting Office, *Assisted Housing: Utility Allowances Often Fall Short of Actual Utility Expenses (Vol. I)* (March 1991); *Assisted Housing: Utility Allowances Often Fall Short of Actual Utility Expenses (Vol. II)* (March 1991).

<sup>15</sup> Average monthly utility allowances for 1.04 million households receiving such allowances were \$64, according to GAO.

<sup>16</sup> "Section 8 of the United States Housing Act of 1937 (42 *U.S.C.* 1437f) authorizes a housing assistance program to aid lower income families in renting decent, safe, and sanitary housing. Assistance payments are limited by fair market rents (FMRs) (or payment standards based on FMRs in the Housing Voucher Program) established by HUD for different areas. In general, the FMR for an area is the amount that would be needed to rent privately owned, decent, safe, and sanitary rental housing of a modest (non-luxury) nature with suitable amenities." Section 8(c) of the Act requires the Secretary of HUD to publish FMRs "periodically, but not less frequently than annually, to be effective on October 1 of each year." 56 *Federal Register* 49024-01 (Sept. 26, 1991).

The operation of this 30 percent limit can be shown by example. If a Section 8 household has an annual income of \$4,000, the household will be required to pay no more than 30 percent of that income (\$1200 a year or \$100 a month) toward her shelter costs. The 30 percent limit is "enforced" in two ways. First, limits are set on the contract rent<sup>17)</sup> that a landlord may charge for a Section 8 dwelling. The contract rent plus the subsidized utility allowance may not exceed the Fair Market Rent for the region in question. If the shelter costs *do* exceed the fair market rent, the property is not eligible to be certified as a Section 8 unit. Given a Fair Market Rent of \$500, and an \$85 subsidized utility allowance, in other words, if the landlord seeks a rent of \$430 (thus making total shelter costs \$515), the landlord may not participate in Section 8.<sup>18)</sup>

Second, the household is, at least presumably, held harmless against all utility bills (except telephones). Each local Public Housing Authority (PHA) is directed to develop a subsidized utility allowance such that the sum of the Section 8 tenant's uncovered utility bill and contract rent will be no more than the 30 percent limit. In fact, however, under Section 8, the rental subsidy *plus* the subsidized utility allowance are paid entirely to the landlord. According to the U.S. General Accounting Office:

Utilities are individually metered when utility consumption is measured for each housing unit and the assisted household pays its bill directly to the utility company. Here, a utility allowance is provided as a reduction in the amount that the household would pay to equal 30 percent of adjusted income. For example, if 30 percent of a household's income is \$250 per month and the allowance for reasonable utility costs is \$100 per month, then the household pays the PHA or the Section 8 landlord \$150 per month for shelter cost and retains the \$100 to pay utility costs.<sup>19)</sup>

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<sup>17)</sup> "Contract rent" is defined by federal regulation to include "the total amount of rent specified in the Housing Assistance Payments (HAP) contract as payable to the owner by the Family, and by HUD or the PHA on the Family's behalf." 24 *C.F.R.* §813.102 (1992).

<sup>18)</sup> HUD regulations regarding its "existing housing" program define "fair market rent" as: "The rent, including utilities (except telephone), ranges and refrigerators, and all maintenance, management, and other services, which would be required to be paid in order to obtain privately owned, existing, decent, safe, and sanitary rental housing of modest (non-luxury) nature with suitable amenities." 24 *C.F.R.* §882.102 (1992). HUD regulations for "new construction" provide, pursuant to a definition of fair market rent, that "the contract rent plus any utility allowance for the unit must not exceed the Fair Market Rent in effect at the time of processing." 24 *C.F.R.* §880.204 (1992).

<sup>19)</sup> U.S. General Accounting Office, *Assisted Housing: Utility Allowances Often Fall Short of Actual Utility Expenses (Vol. I)* (March 1991); *Assisted Housing: Utility Allowances Often Fall Short of Actual Utility Expenses (Vol. II)* (March 1991).

As can thus be seen, notwithstanding the subsidized utility allowance, the tenant is then merely *assumed* to devote her \$100 payment in this case to her utility payment. Moreover, the actual utility bills are merely assumed to be no more than the \$100 subsidized utility allowance.

### INADEQUACY OF SECTION 8 UTILITY ALLOWANCES

Nationwide, the subsidized utility allowances provided to Section 8 households fall seriously short of covering actual Section 8 utility bills, according to a recent study by the U.S. General Accounting Office (GAO).<sup>10\</sup> The households hardest hit, GAO found, involve those "households with the lowest incomes and the largest disparity between the allowance and their utility expenses\* \* \*."<sup>11\</sup> The GAO has documented the prevalent nature of the mismatch between subsidized utility allowances and actual utility costs. According to GAO:

For Section 8 households, rent burdens averaged about 36 percent of adjusted monthly income--notably different than the statutory amount. \* \* \*[A]bout 70 percent of the Section 8 households paid more than 30 percent of their adjusted income for rent and utilities. Even more striking, 32 percent of the Section 8 households had rent burdens exceeding 40 percent of adjusted income.

On average, those Section 8 households that exceeded 30 percent of adjusted income paid about \$43 more in utility expenses than they received in allowances. The total monthly income of the Section 8 households in our review averaged \$544 (plus/minus \$24). After paying \$165 per month (36 percent of adjusted income for rent and utility expenses--the average result we obtained), Section 8 households in our review, on average, had about \$379 in disposable income remaining each month to cover other living expenses. Thus, \$43 each month for additional utility expenses represents a sizable portion of the households' disposable income.<sup>12\</sup>

GAO noted that "invariably, households with very low incomes and high utility allowances risk incurring greater rent burdens than households

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<sup>10\</sup> U.S. General Accounting Office, *Assisted Housing: Utility Allowances Often Fall Short of Actual Utility Expenses (Vol. I)* (March 1991); *Assisted Housing: Utility Allowances Often Fall Short of Actual Utility Expenses (Vol. II)* (March 1991).

<sup>11\</sup> *Id.*, at 22 - 23.

<sup>12\</sup> *Id.*, at 24 - 25.

with high incomes and low allowances when expenses exceed allowances. Therefore, a household's allowance takes on a greater or lesser importance in achieving the 30-percent rent burden amount depending on its income and utility expenses."<sup>13\</sup> As GAO explained:

For example, a hypothetical household has an adjusted monthly income of \$250, a \$10 utility allowance, and a resulting monthly rent (including the utility allowance) of \$75 ( $\$250 \times 0.3 = \$75$ ). If the household's utility expenses were 50 percent more than the allowance, the rent burden would be 32 percent. However, if this same household received a \$75 allowance and again consumed 50 percent more than the allowance, the rent burden would rise to 45 percent. On the other hand, if the hypothetical household's adjusted monthly income were \$750, with the same allowance and consumption factors as cited above, the rent burden would be 31 percent with a \$10 allowance and 35 percent with a \$75 allowance.<sup>14\</sup>

Section 8 households tend to be amongst the lowest income households on a utility's system. These households, nationwide, have an average annual income of less than \$5,400. For a household size of three, this income places them at roughly 50 percent of the Federal Poverty Level.<sup>15\</sup>

### **REASONS FOR THE INADEQUACY OF UTILITY ALLOWANCES**

Under the Section 8 structure, "utility allowances" are set by the local Public Housing Authority (PHA). A variety of reasons exist regarding why Section 8 utility allowances so often do not cover actual utility costs. First, establishing utility allowances is a difficult and expensive task. While federal regulations "require" the PHA to redetermine utility allowances on an annual basis,<sup>16\</sup> few PHAs devote either the time or the

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<sup>13\</sup> *Id.*, at 27.

<sup>14\</sup> *Id.*, at 27 - 28.

<sup>15\</sup> 100 percent of Poverty for a family of three in 1991 was \$11,140.

<sup>16\</sup> 24 *C.F.R.* §965.478(a) (1992) ("The PHA shall review at least annually the basis on which Utility Allowances have been established and, if reasonably required in order to continue adherence to the standards stated in §965.476, shall establish revised Allowances. The review shall include all changes in circumstances\* \* \*indicating probability of a significant change in reasonable consumption requirements and changes in utility rates.")

money to doing so.<sup>\17\</sup>

Second, setting public utility allowances is an inherently imprecise task. The legal standard is to set an allowance, differentiated by "each dwelling unit category and unit size" which amount "*shall* (emphasis added)\* \* \* approximate a reasonable consumption of utilities by an energy conservative household of modest circumstances consistent with the requirements of a safe, sanitary and healthful living environment."<sup>\18\</sup> Moreover, the federal regulations state, to the extent that a tenant's actual utility consumption exceeds her utility allowance, the amount of excess consumption should be "reasonably within the control of a tenant household."<sup>\19\</sup> Unfortunately, this legal standard is inherently imprecise. It is difficult to measure what constitutes "reasonable consumption." Nor is it easy to articulate what consumption is "reasonably within the control of a tenant household."

Third, utility allowances compete with "Fair Market Rents" in Section 8 housing. Each year, HUD publishes a determination of "Fair Market Rents" in each urban area and non-urban county. The combination of contract rent plus utility allowances (not actual utility costs) may not exceed this Fair Market Rent. To the extent that utility allowances are kept artificially low, therefore, the portion of the "Fair Market Rent" that can be committed to area landlords is increased.

Of course, to the extent that *actual* utility costs exceed utility allowances, this process of keeping utility allowances low so as to keep contract rents high transfers the risk of utility bills to the low-income tenant who is charged with paying them, adequate allowance or not. Ultimately, therefore, the risk is transferred to the utility who must carry the resulting arrears, write-off the resulting bad debt, and pay the resulting expenses associated with credit and collection activities.

### A PROPOSED UTILITY RESPONSE

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<sup>\17\</sup> HUD regulations state further: "The PHA may revise its Allowances for Tenant-Purchased Utilities between annual reviews if there is a rate change (including fuel adjustments) and *shall be required to do so* if such change, by itself or together with prior rate changes not adjusted for, results in a *change of 10 percent of more* from the rates on which such Allowances were based. Adjustments to Tenant Rent as a result of such changes shall be retroactive to the first day of the month following the month in which the last rate change taken into account in such revision became effective." 24 *C.F.R.* §965.478(b) (1992). (emphasis added).

<sup>\18\</sup> 24 *C.F.R.* §965.476(a) (1992).

<sup>\19\</sup> 24 *C.F.R.* §965.476(a) (1992).

One might legitimately ask what utilities might do to help rectify this situation. After all, the utility allowance is provided to the *tenant*, not to the utility. The utility may well have no legal "standing" to challenge even the most grossly inadequate Section 8 utility allowance.<sup>120\</sup> There are, however, avenues of redress.

Many --perhaps even most-- PHAs lack both the time and the expertise to establish reasonable utility allowances. Moreover, they do not gather the relevant information because no one is "making" them do so. However, while PHAs may arguably have the discretion to *not collect* the data necessary to establish adequate utility allowances, federal regulations do not allow PHAs to *ignore* relevant data that is *presented* to them in usable form. Accordingly, as much relevant data as possible should be presented to the PHA each year regarding actual usage and other relevant factors that go into adequately matching utility allowances to utility bills.

The regulation to consider provides a PHA with discretion only on the "methods" used to arrive at the local utility allowance:

(c) The complexity and elaborateness of the *methods chosen* by the PHA, in its discretion, to achieve the foregoing objective will be dependent upon the data available to the PHA and the extent of the administrative resources reasonably available to the PHA to be devoted to the collection of such data\* \* \*.<sup>121\</sup> (emphasis added).

The regulations further state:

(d) In establishing allowances, the PHA *shall take into account* relevant factors affecting consumption requirement[s]\* \* \*.<sup>122\</sup> (emphasis added).

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<sup>120\</sup> For example, HUD regulations provide that a PHA "shall provide all *tenants* an opportunity to submit written comments" prior to the establishment or revision of a utility allowance. 24 *C.F.R.* §976.473(c) (1992). Moreover, the regulations provide that "the PHA shall give notice to all *tenants* of proposed allowances\* \* \*and revisions thereof." *Id.* The absence of language to the effect of "interested parties" may indicate that utilities were not intended to have a right either to receive notice or to provide comment.

<sup>121\</sup> 24 *C.F.R.* §965.476(c) (1992).

<sup>122\</sup> 24 *C.F.R.* §965.476(d) (1992).

The "relevant factors" explicitly listed by the federal regulations include: the climatic location of the housing projects; the size of the dwelling units and the number of occupants per dwelling unit; the type of construction and design of the housing project; the energy efficiency of the PHA-supplied appliances and equipment; the utility consumption requirements of appliances and equipment "whose reasonable consumption is intended to be covered by the Total Tenant Payment"; the physical condition (including insulation and weatherization) of the housing project; the temperature levels intended to be maintained in the unit during the day and at night, and in cold and warm weather; and the temperature of domestic hot water.<sup>123\</sup>

A PHA, for example, would be hard-pressed to *not* use information provided by local utilities. The federal regulations recommend --they do not require-- that certain sources of data for determining "reasonable consumption levels" be used.<sup>124\</sup> Those sources include:

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<sup>123\</sup> 24 *C.F.R.* §976.476(d)(1) - (d)(9) (1992).

<sup>124\</sup> 24 *C.F.R.* §965.476(c) (1992).

1. Consumption data on residential use of utilities obtained from utility suppliers or other sources;<sup>125\</sup>
2. Engineering calculations based on technical data concerning energy requirements of appliances and equipment and of project and units having particular characteristics;<sup>126\</sup>
3. Data concerning energy requirements available from governmental and other sources;<sup>127\</sup> and
4. Data obtained from energy audits.<sup>128\</sup>

If utilities took the initiative to develop and present data, whether or not the PHAs took the initiative to *solicit* such data, the PHA would be hard-pressed to ignore such presentations.<sup>129\</sup> While a utility might legitimately complain that the legal responsibility for establishing a rational utility allowance lies with the PHA, it is uncontrovertible that each dollar of underpayment in utility allowances to Section 8 tenants is likely to be a dollar of underpayment ultimately to the utility, compounded by the additional working capital and credit and collection expenses associated with carrying the resulting arrears of the Section 8 tenants.

#### **UTILITY DEVELOPED DATA**

Utilities seem uniquely well-suited to develop and present relevant and reliable information to local Public Housing Authorities, upon which to base Section 8 utility allowances. Such assistance can be helpful on several levels. First, a utility seems uniquely qualified to be able to develop

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<sup>125\</sup> 24 *C.F.R.* § 965.476(c)(2) (1992).

<sup>126\</sup> 24 *C.F.R.* §965.476(c)(3) (1992).

<sup>127\</sup> 24 *C.F.R.* §965.476(c)(4) (1992).

<sup>128\</sup> 24 *C.F.R.* §965.476(c)(5) (1992).

<sup>129\</sup> Nonetheless, HUD regulations state: "Except where a different standard of review is applicable in review procedures governed by applicable State law, the PHA's determinations of Allowances\* \* \*and revisions thereof shall be final and valid as to tenants unless found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 24 *C.F.R.* §965.473(e) (1992).

and document an objective standard by which to measure Section 8 utility allowances against the statutory test that allowances "\* \* \* approximate a reasonable consumption of utilities by an energy conservative household of modest circumstances consistent with the requirements of a safe, sanitary and healthful living environment." A utility should further be able to develop and document an objective standard by which to measure that consumption which, given the range of factors affecting consumption by low-income households, is "reasonably within the control of a tenant household."

In addition, among the information that utilities would seem uniquely well-suited to develop and present to a PHA with regard to utility allowances are:

1. The type, quality and age of housing served by the PHA, along with the energy consumption inherent in this housing;
2. The weatherization and other energy efficiency characteristics of PHA and Section 8 housing, along with the energy consumption inherent with those characteristics;
3. The type, quality and age of appliances, along with the energy consumption inherent in those appliances;
4. The use of supplemental heat sources (such as portable electric heaters), along with the consumption inherent with such use;
5. Engineering estimates of energy usage based on the type and size of dwelling unit, the number of household members, and the like; and
6. Estimations of energy use based on local heating and cooling degree days.

Most importantly, the utilities would seem uniquely qualified to develop estimates regarding the costs and utility bills associated with the different Section 8 dwelling units in their service territory. Finally, utilities are uniquely well-suited to monitor cumulative rate changes that will affect bills charged to Section 8 households. In such a fashion, utilities can help enforce the mandatory obligation of PHAs to update utility allowances when cumulative rate increases have reached 10 percent or more.<sup>301</sup>

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<sup>301</sup> See, note **Error! Bookmark not defined.**, *supra*.

## SUMMARY

In sum, Section 8 utility allowances provide public assistance that is on the same level of magnitude nationwide as the LIHEAP program. Utilities would best serve their own interests, as well as the interests of their low-income customers, by seeking to ensure that these allowances are (1) established at adequate levels, and (2) distributed in a rational fashion.

While a utility might rightfully complain that it should be neither its responsibility nor its obligation to be the driving force behind the development of reasonable and adequate Section 8 utility allowances for a Public Housing Authority, it may well be cost-effective for a company to devote resources to just such a task. Research has demonstrated that Section 8 utility allowances are not only "often times" inadequate to cover actual utility bills, but that they are *most often* inadequate. As a result, low-income households for whom the allowances are designed to reduce utility bills to reasonable levels of affordability are denied that benefit. Ultimately, the costs of such failures are passed on to utilities and their customers in the form of uncollected revenue, credit and collection expenses, working capital expenses associated with carrying arrears, and the like.

While a Public Housing Authority has no obligation to seek out or develop information from utilities to use in establishing adequate Section 8 utility allowances, it does indeed have an obligation to consider and use information that is provided to it by others. Public utilities should devote resources to establishing and documenting what level of utility allowance is necessary to cover actual utility bills. Whether or not it "should" be responsibility of the utility, such an effort will have an immediate and potentially substantial, financial payback.

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**(Part II: Adequacy of Monthly Allowances)**

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Public utilities have a discreet self-interest in ensuring that Section 8 utility allowances are accurately set. Section 8 is one of the major public housing programs serving low-income Americans. Part and parcel of this program involves a federally-funded effort to bring "shelter" costs under control for program participants. "Shelter costs" have been defined to include not only rent payments, but to include utility payments as well.<sup>131\</sup>

Section 8 serves 1.3 million households nationwide. These households tend to be the very poor. They have average income nationwide of less than \$5,400. According to the 1991 review of federal entitlement programs, most rental housing assistance is now targeted to "very low-income households."<sup>132\</sup> "Very low-income" is a term of art, referring to households who live at or below 50 percent of a state's median income.

Moreover, the trend is toward serving increasingly low-income populations. According to the 1991 *Green Book*, "housing aid is being targeted toward a poorer segment of the population, requiring larger subsidies per assisted household. \* \* \*rents in assisted housing have probably risen faster than the income of assisted households, causing subsidies to rise faster than the inflation index used here --the gross national product (GNP) implicit price deflator."<sup>133\</sup>

### **THE SECTION 8 UTILITY ALLOWANCE CONCEPT**

The crux of the Section 8 program is the provision of a housing subsidy that reduces the shelter costs of such households to 30 percent of the household's income. The shelter subsidy is paid directly to landlords. Nonetheless, the subsidy includes a "utility allowance" that is at least purportedly designed to pay the household's actual utility expenses. Despite the federal subsidy, however, the household purchases utility service directly from the energy vendor and remains personally responsible to the utility for bill payment. Direct vendor payments are not usually made.

If Section 8 utility allowances are *inaccurate*, the utilities serving Section 8 households will likely experience a shortfall in payments for the affected households. Accordingly, just as public utilities have an interest in ensuring that LIHEAP payments are sufficient (and accurate), public utilities have an interest, also, in ensuring that Section 8 utility allowances are accurate (and sufficient). Indeed, in FY 91, the federal

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<sup>131\</sup> In turn, "utility" payments include payments for heat, electricity and water/sewer service. Only telephone costs are excluded. 24 *C.F.R.* §813.102 (1992).

<sup>132\</sup> *1991 Green Book: Overview of Entitlement Programs*, at 1439 (May 7, 1991).

<sup>133\</sup> *Id.*, at 1445 - 46.

government paid out roughly \$800 million in Section 8 utility allowances to serve 1.04 million households.<sup>134)</sup> In contrast, during that same Fiscal Year, the federal government paid \$1.610 billion through LIHEAP to provide home energy assistance to roughly five million households.<sup>135)</sup>

### INADEQUATE SECTION 8 UTILITY ALLOWANCES

A recent report by the U.S. General Accounting Office (GAO) should give rise for concern to individuals who might serve Section 8 households on their system. The GAO report examined how accurately public utility allowances reflected actual utility costs for Section 8 households. According to the GAO report, approximately 70 percent of Section 8 households "had utility expenses that were higher than their allowances\* \* \*Because the deviations were so great for some households, paying utility bills can pose financial hardships\* \* \*."<sup>136)</sup>

Moreover, GAO found that even when *annual* utility allowances adequately covered *annual* utility expenses, "because allowances are typically the same each month while utility expenses vary, *month-to-month* rent burden fluctuations can create cash flow problems for lower-income households despite an overall 30 percent rent burden."<sup>137)</sup> GAO found that within the population of Section 8 households with annual rent burdens equal to 30 percent of income, *monthly* rent burdens varied from 18 percent to 48 percent because of the uneven nature of utility usage throughout the year.

Finally, GAO noted that "month-to-month fluctuations in utility bills can also create payment problems for assisted households, particularly

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<sup>134)</sup> According to the U.S. General Accounting Office, the average Section 8 utility allowance is \$64 a month. There were 1.3 million Section 8 households, 80 percent of whom paid their own utility bills and thus received a utility allowance.

<sup>135)</sup> Just as importantly, while LIHEAP is a shrinking program, having gone from \$2.077 billion in 1985 to \$1.607 billion in 1991, housing assistance -- particularly rental assistance-- is a growing program.

<sup>136)</sup> *Id.*, at 3.

<sup>137)</sup> *Id.*, at 18. (emphasis added). Reaching a 30 percent rent burden is the measure of whether utility allowances accurately cover utility bills. Contract rents (paid to landlords) are, by law, set equal to 30 percent of household income. Hence, if a utility allowance is accurately set, and thus covers the entire utility bill, the utility bill should add no further burden to the household. However, if the household bears a "rent burden" of 35 percent, that means that the excess utility bill over the utility allowance equals five percent of the household's income.

when utilities are individually metered."<sup>38\</sup> According to GAO:

The difficulty arises because allowances remain the same each month, while utility bills vary. As a result, households have to budget so that they will have sufficient funds to pay utility bills in high consumption months when utility expenses exceed allowance amounts. This budgeting may be difficult for lower-income households because, by definition, they have less income to pay for living expenses than higher-income households.<sup>39\</sup>

GAO reported that notwithstanding the federal law which limits Section 8 shelter costs --including utility bills-- to 30 percent of household income, "approximately 60 percent of these [Section 8] households *never* met the 30-percent amount for any 1 month during our 12-month review period, and fully 93 percent of the households had 3 or fewer months in which the burden equaled 30 percent."<sup>40\</sup> Less than one percent of the Section 8 households had rent burdens of 30 percent for 10 or more months of the year.

The analysis set forth below considers the implications for public utilities of these GAO findings regarding the seasonality of bills. The analysis considers the situation where, even when annual allowances are adequate to cover annual bills, the mismatch between monthly utility allowances and monthly utility expenses results in unaffordable monthly utility bills to these Section 8 households. This evaluation considers how utilities might help to redress the situation in a cost-effective manner.

### **THE COST TO UTILITIES OF INADEQUATE MONTHLY SECTION 8 UTILITY ALLOWANCES**

Inadequate monthly utility allowances can impose significant costs on public utilities. These costs arise because of lost revenues, working capital expenses, credit and collection expenses and the like. These costs may arise for Section 8 households even in those situations where annual utility bills are no more than annual Section 8 utility allowances. Consider a scenario where the *annual* allowance equals the *annual* bill, but an arrearage develops nonetheless because of the mismatch between monthly bills and monthly allowances.

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<sup>38\</sup> *Id.*, at 28.

<sup>39\</sup> *Id.*

<sup>40\</sup> *Id.*, at 30.

In the example set forth below, the household is assumed to devote its entire utility allowance to its utility bill each month, including payment of arrears. The household, however, is assumed to pay *no more* than its utility allowance toward its bill.<sup>\41\</sup> Finally, the household is assumed to divert the excess allowance to non-utility uses in those months where: (1) there are no arrears; and (2) the monthly allowance exceeds the currently monthly bill. Hence, if there is a current bill of \$75 and no arrears, the household is assumed to pay the current bill and to use the "extra" \$25 for other household necessities such as food and clothing. This scenario would seem to be the "best case" from the perspective of the utility. The scenario assumes that the household diverts no more of its utility allowance to non-utility uses than the excess of the monthly allowance over the monthly bill.<sup>\42\</sup>

The costs of the mismatch between monthly Section 8 utility allowances and monthly Section 8 utility bills are two-fold: (1) an absolute revenue loss to the utility that is unlikely ever to be made up; and (2) the costs of carrying the Section 8 household arrears. Table 1 illustrates the costs to a typical utility.

- o First, in the Table, the utility experiences an absolute revenue loss of \$50, as that part of the Section 8 allowance is diverted to other uses in months when the allowance exceeds the amount owing to the utility.
- o Second, the utility experiences a working capital return of nearly \$12 on the arrears appearing in Table 1, assuming an annual weighted cost of capital of 12 percent (one percent per month). If funded through a 50/40/10 equity/debt/preferred equity capital structure, and assuming a combined federal/state tax effect of 42 percent for equity returns, this requirement represents a \$16.78 revenue requirement.

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<sup>\41\</sup> Hence, for example, in a month where the current month utility bill is \$75 without arrears, and the utility allowance is \$100, the household is assumed to pay only the \$75 rather than to make a \$100 payment thus creating a bill credit.

<sup>\42\</sup> Clearly this limitation need not be the case. There may well be many months when a household chooses to not pay its utility bill in order to have money to pay for other household necessities, despite the fact that a utility allowance was received that equalled or exceeded the utility bill.

In Table 1, the total revenue requirement impact of the monthly mismatch between utility allowances and utility bills, not including credit and collection expenses, thus reaches roughly \$65, calculated as follows:

\$50.00	Revenue lost to diversion
\$ 4.68	Return on working capital financed by debt ( $\$11.70 \times .40$ )
\$ 7.02	Return on working capital financed by equity ( $\$11.70 \times .60$ )
<u>\$ 5.08</u>	Tax on equity portion of working capital return
\$66.78	Total

When viewed in a modest Section 8 housing situation, with perhaps 10,000 Section 8 households and 70 percent meeting the criteria of this scenario,<sup>43)</sup> this mismatch between monthly Section 8 allowances and monthly utility expenses costs the utility roughly \$470,000 a year ( $\$67/\text{participant} \times 7000$  participants). And, this arises from a government program that provides annual benefits that *equal* annual utility costs.

The scenario discussed above, however, imposes fewer costs on a utility system than is likely to be experienced under reasonably expected conditions. Consider a more typical scenario: rather than allowing the bill to continue, the utility enters into an April payment plan (after the close of the winter shutoff moratorium) under which the costs of the arrears are spread in equal payments over the six months remaining before the next winter heating season. This scenario would result as follows in Table 2 below.

In this situation, the company ends up *even worse off* than it would be without the payment plan. There is an absolute revenue loss of \$75. There is a working capital cost of \$14.30, which yields a revenue requirement impact of \$20.51 ( $\$5.72$  debt return plus  $\$8.58$  equity return plus  $\$6.21$  tax on equity return). When one adds a \$15 cost for negotiating a payment plan, the total per household cost to the utility is roughly \$108 ( $\$75 + \$20.51 + \$15 = \$110.51$ ). Again, assuming 10,000 Section 8 households and a 70 percent mismatch, there is a total cost of nearly three-quarter million dollars ( $\$110.51 \times 7000 = \$773,600$ ).

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<sup>43)</sup> See, note **Error! Bookmark not defined.**, *supra*, and accompanying text.

Table 1						
	Monthly Bill	YTD Bill	\$8 Utility Allowance	Monthly Arrears	Cumulative Arrears	Wkg Capital Return (1%/month)
Jan	\$200	\$200	\$100	\$100	\$100	\$1.00
Feb	\$200	\$400	\$100	\$100	\$200	\$2.00
Mar	\$140	\$540	\$100	\$40	\$240	\$2.40
Apr	\$80	\$620	\$100	(\$20)	\$220	\$2.20
May	\$60	\$680	\$100	(\$40)	\$180	\$1.80
June	\$40	\$720	\$100	(\$60)	\$120	\$1.20
July	\$40	\$760	\$100	(\$60)	\$60	\$0.60
Aug	\$40	\$800	\$100	(\$60)	\$0	\$0
Sept	\$60	\$860	\$100	\$0	\$0	\$0
Oct	\$90	\$950	\$100	\$0	\$0	\$0
Nov	\$100	\$1050	\$100	\$0	\$0	\$0
Dec	\$150	\$1200	\$100	\$50	\$50	\$0.50
Totals		\$1200	\$100		\$50	\$11.70

Table 1							
	Pay Plan Amount	Current Mo. Bill	Total Mo. Bill	\$8 Utility Allowance	Monthly Arrears	Cumulative Arrears	Wkg Capital Return (1%/month)
Jan		\$200	\$200	\$100	\$100	\$100	\$1.00
Feb		\$200	\$200	\$100	\$100	\$200	\$2.00
Mar		\$140	\$140	\$100	\$40	\$240	\$2.40
Apr		\$80	\$80	\$100	(\$20)	\$220	\$2.20
May	\$37	\$60	\$97	\$100	\$0	\$183	\$1.83
June	\$37	\$40	\$77	\$100	\$0	\$146	\$1.46
July	\$37	\$40	\$77	\$100	\$0	\$109	\$1.09
Aug	\$37	\$40	\$77	\$100	\$0	\$72	\$0.72
Sept	\$37	\$60	\$97	\$100	\$0	\$35	\$0.35
Oct	\$35	\$90	\$125	\$100	\$25	\$25	\$0.25
Nov		\$100	\$100	\$100	\$0	\$25	\$0.25
Dec		\$150	\$150	\$100	\$50	\$75	\$0.75
Totals			\$1200			\$75	\$14.30

## A PROPOSED UTILITY RESPONSE

Public utilities should extend significant efforts to identify the Section 8 households on their system. Once identified, a utility can offer these households one of two different programs to maximize the collection of revenue. The first program is designed to encourage Section 8 households to enter into 12-month levelized Budget Billing plans. The second program is designed to elicit direct vendor payments of Section 8 utility allowances.

### Budget Billing Plans

Each Section 8 household should be encouraged to enter into a levelized 12-month Budget billing program.<sup>44\</sup> In such a fashion, the actual monthly bills will more closely match the monthly utility allowances, thus ensuring the allowance will be used to pay the utility bill it was intended to pay. This single effort can make a tremendous contribution to helping utility bills for Section 8 households remain paid.

The impact of placing Section 8 households on a 12-month levelized Budget Billing plan would be to save the dollars lost to the utility through diversion as discussed above. So long as the annual bill is no less than the Section 8 utility allowance, no diversion of funds will occur as a result of seasonal variation in bills. Even in those instances where the utility bill *is* less than the utility allowance, the Budget Billing plan would more likely result in the entire bill being paid than if no Budget billing plan existed.

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<sup>44\</sup> It appears that reform must occur in the behavior of the tenants, rather than in the distribution of the Section 8 utility allowance. Federal regulations provide: "Monthly Allowances *shall be established at a uniform monthly amount* (emphasis added) based on an average monthly utility requirement for a year." 24 *C.F.R.* §976.475(b) (1992). Allowances "may provide for seasonal variation" only in those instances where "the utility supplier does not offer tenants a uniform payment plan." *Id.*

## Direct Vendoring of Section 8 Utility Allowances

A second mechanism utilities should pursue is the direct vendoring of Section 8 utility allowances. Through such agreements, Section 8 utility allowances would be paid directly to the utility by the local Public Housing Authority (PHA).<sup>145\</sup> As a result of such payment, the utility will capture the full annual utility allowance to be credited against the annual utility bill.

### An Appropriate Incentive

A utility should offer the incentives necessary to gain the participation of Section 8 households in a Budget Billing or direct vendor payment program. Incentives would be necessary since a refusal to enter into either a Budget Billing or a direct vendor program would retain for the household the greatest discretion and control over its entire month-to-month allocation of household resources. Without such participation, in other words, the household retains the discretion to divert the excess utility allowance to uses such as food and clothing in low-bill months. The question, therefore, should not be whether an incentive can be created for these households that is "cost-based."<sup>146\</sup> Instead, the question should be whether the utility is better off with or without an incentive to encourage Section 8 households to enter into levelized Budget Billing plans or direct vendor payment.<sup>147\</sup>

The incentive to be paid by the utility to gain participation in either a levelized Budget Billing program or a direct vendoring program should be a commitment to forgive the "excess" bill over the utility allowance. For the Budget Billing participant, the forgiveness would occur for each month where the full Budget billing payment is made. For the direct vendor payment program, the forgiveness would occur for the entire excess. The different treatment is justified. In the direct vendor payment program, the household cedes all discretion over the use of the utility

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<sup>145\</sup> Federal regulations provide that: "if the Family and the utility company consent, a PHA or Owner may pay the Utility reimbursement jointly to the Family and the utility company, or directly to the utility company." 24 *C.F.R.* §813.108 (1992).

<sup>146\</sup> A "cost-based incentive" seems to be contradictory. If the price break is cost-based, it is not an "incentive," it is merely cost-of-service ratemaking.

<sup>147\</sup> Simply "requiring" Section 8 households to enter into levelized Budget Billing plans would likely be a violation of the federal Equal Credit Opportunity Act (ECOA). 15 *U.S.C.* §1691 - 1691f (1989 and 1991 supp.). Such a requirement would constitute discrimination, as defined by that statute, based upon the receipt of public assistance. 15 *U.S.C.* §1691(a) (1989 and 1991 supp.). *See generally*, National Consumer Law Center, *Equal Credit Opportunity Act*, §5.12 (defining discrimination) and §6.8 (discussing discrimination based upon the receipt of public assistance) (2d ed. 1991 and supp.).

payment. The forgiveness should be as automatic as the payment. In the Budget Billing program, the household still retains the discretion to use its utility allowance for other than its Budget Billing payment amount. Accordingly, the forgiveness of the excess should be made contingent upon actually meeting the Budget Billing obligation.

In general, several reasons support a utility's decision to forgive the amount of the annual bill which exceeds the annual Section 8 household's utility payment as an incentive to gain participation:

1. The excess bill over the utility allowance will push the household's shelter costs over the statutory 30 percent limit and will, therefore, be "unaffordable" by definition.
2. To the extent that unaffordable bills are charged to Section 8 households, the utility will likely incur credit and collection costs to collect the excess. To simply "forgive" this excess bill will avoid those credit and collection expenses.
3. The direct vendoring of payments will eliminate all other credit and collection expenses for Section 8 households during the course of the year as well. The "affordable" portion of the bill --i.e., that portion covered by the utility allowance-- will *automatically* be paid each month to the utility, while the remainder is written off.
4. The amount of the excess will provide one measure of the need for utility-financed energy conservation programs directed to these Section 8 households. To the extent that such conservation programs can be targeted to participating Section 8 households, the utility has the same ability to eliminate the excess over time. The bills will be reduced while the allowance remains the same.
5. The amount of the excess will provide an incentive for the utility to work with the Public Housing Authority to set more realistic utility allowances in the first instance. If the allowances are accurately set, the excess should be reduced, if not outright eliminated.

## SUMMARY

In sum, it makes economic sense for a utility to convert as many Section 8 households as possible to direct vendor payment agreements. Recent GAO research finds that more than 93 percent of all Section 8 households have annual utility allowances that *inadequately* account for *monthly* differences in utility bills in nine or more months a year. A utility would be cost-justified in converting all Section 8 households to

levelized monthly billing plans and in offering a financial incentive to encourage such households to take advantage of such a plan. Moreover, a utility would be justified in offering incentives for Section 8 households to enter into agreements through which Section 8 utility allowances are directly vendored to the company. For a variety of reasons, an appropriate incentive for either of these programs involves a forgiveness of the difference between the annual utility allowance and the annual actual utility bill.