

Impact

A regulatory impact analysis must accompany every economically significant federal rule or regulation. The Office of Policy Development and Research performs this analysis for all U.S. Department of Housing and Urban Development rules. An impact analysis is a forecast of the annual benefits and costs accruing to all parties, including the taxpayers, from a given regulation. Modeling these benefits and costs involves use of past research findings, application of economic principles, empirical investigation, and professional judgment.

Proposed Rule on Section 3

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Abstract

The mission of Section 3 of the Housing and Urban Development Act of 1968 is to use existing federal funding streams for low-income housing and community development to maximize economic opportunities to low-income individuals. This article assesses the benefits and costs of a proposed rule to update the Act's Section 3 regulations.

The proposed regulation would result in a more rigorous targeting of economic opportunity emanating from U.S. Department of Housing and Urban Development funds to those individuals and firms eligible under Section 3. A reasonable estimate of the incremental impact of the proposed rule would be an additional 1,400 jobs targeted to Section 3 concerns annually. The regulatory changes would not create additional jobs; the regulatory action is expected to affect the allocation of resources.

A secondary impact is possible, however, when assisted tenant incomes rise as a result of employment from Section 3. Federal rental subsidy for those tenants would decline. It is estimated that the subsidy impact may be as large as \$28.5 million annually. The total reporting and recordkeeping burden is estimated at \$8.7 million, including \$6.5 million the first year the rule would go into effect and \$2.2 million annually.

Background and Context

Section 3 of the Housing and Urban Development Act of 1968¹ gives the U.S. Department of Housing and Urban Development (HUD) a legislative directive for providing preference to low- and very low-income residents of the local community (regardless of race or gender) and to the businesses that substantially employ these people for new employment, training, and contracting opportunities resulting from HUD-funded projects. As a condition of receiving HUD financial assistance, recipients certify that they will comply with the requirements of Section 3 annually. HUD accordingly has the legal responsibility to monitor recipients for compliance and can impose penalties on those that fail to meet these obligations.

In practice, Section 3 requires certain projects funded by HUD to meet, “to the greatest extent feasible,” specific goals for hiring and training local low-income people and awarding contracts to businesses that substantially employ those people to work on these projects. Priority consideration is to be given to “Section 3 residents” and “Section 3 Business Concerns” when making hiring and procurement decisions. A Section 3 resident is either a resident of public housing or a low-income individual residing in the metropolitan area or nonmetropolitan county where the Section 3 covered assistance is spent. A Section 3 Business Concern is a business that satisfies either ownership or employment criteria regarding Section 3 residents or that can provide evidence of a firm commitment to award 25 percent of subcontracts to other Section 3 Business Concerns.

Public housing agencies (PHAs) that administer Public and Indian Housing operating or capital fund program assistance are the primary subjects of Section 3. Recipients of HUD housing and community development grants are also subject to Section 3 but only if the grantees’ annual expenditure on construction-related activity exceeds a specific threshold.²

Impact Analysis

Section 3 requirements and reporting are not a new phenomenon. Section 3 requirements have been in effect since the enactment of the Section 3 of the Housing and Urban Development Act of 1968. The proposed rule would clarify and strengthen existing regulations. The key provisions of the rule that may have an effect are clearer compliance requirements related to new hires under Section 3, refinement of program thresholds, and requirements that increase reporting costs.

Costs Impact of the Proposed Rule

Program participants are already required to report on Section 3 activities. It is therefore anticipated that the implementation of this proposed rule would have only a marginal negative effect on the administration of the program and on program participants.

¹ 12 U.S.C. 1701u and 24 CFR Part 135.

² Approximately 7,500 people (that is, PHAs, local and state governments, multifamily property owners, and nonprofit organizations) are direct recipients of HUD funding. Approximately 86,000 subrecipients and contractors that receive HUD-funded contracts would also be required to comply with the proposed rule.

Administrative Burden

The proposed rule would impose additional recordkeeping, verification, procurement, monitoring, and complaint processing requirements on covered recipients. Additional administrative work would be one of the outcomes of an invigorated effort to provide economic opportunities to the greatest extent feasible.

HUD estimates that compliance with the requirements of this proposed rule would necessitate approximately 70,000 hours of additional effort annually, plus 202,400 hours in the first year (various adjustment costs).³ Assuming an average hourly wage of \$32,⁴ the total reporting and record-keeping burden would be \$8.7 million, including \$6.5 million the first year the rule would go into effect and \$2.2 million in recurring costs.⁵ These expenses represent additional administrative costs that would need to be financed either by a reduction of services or by additional appropriations.

Reducing Flexibility of Contractors

The proposed rule would require covered recipients to monitor contractors more closely for compliance and impose sanctions as appropriate. Some contractors may have to alter their business practices to meet these more precise Section 3 regulations. These are likely to be short-run adjustment costs and possibly may be offset by the greater transparency provided by the proposed rule.

Benefits Impact of the Proposed Rule

If effectively structured and implemented, Section 3 can reduce poverty, overcome spatial barriers to employment, and reduce federal costs. Section 3 could leverage a substantial portion of more than \$20 billion in annual federal housing investments into economic opportunities for low-income people.

Greater Employment: Increased Income for Eligible Workers

HUD assumes that, on net, participation will be greater in Section 3 as a result of the proposed rule.⁶ The effect of the rule would be to increase the income for eligible participants in the labor force. For example, suppose that the proposed rule has the desired impact of increasing employment among eligible workers. Using HUD's office of Fair Housing and Economic Opportunity estimates, the Section 3 program reported 28,407 new jobs and \$885 million in contracts in 2012⁷ provided to program participants who otherwise would not have had these economic opportunities. If we assume that, as a result of the rule, the number of jobs held by Section 3 residents

³ Computations were made by HUD's Office of Fair Housing and Economic Opportunity, which is responsible for the administration and compliance with the Section 3 requirements.

⁴ Average total compensation of all workers (BLS, 2014).

⁵ A "loaded wage," often used in benefit-cost analysis to reflect the opportunity cost of time, is often greater than the wage rate to include benefits, taxes, and overhead. The loaded wage rate can be as high as twice the wage received by the employee, in which case the periodic cost of the rule would be \$4.4 million.

⁶ To facilitate the success of the regulatory reform, the proposed rule would require recipients to coordinate with U.S. Department of Labor workforce investment boards, and other local resources, to target Section 3 residents for training programs as appropriate.

⁷ HUD (2012).

would increase 5 percent above the current number reported, an additional 1,420 jobs would be available for Section 3 residents annually. Assuming 2,087 work hours per year⁸ at \$32 an hour,⁹ an additional \$95 million in income would be generated locally for Section 3 participants (1,420 x 2,087 x \$32). In addition in the proposed rule, economic activity and local tax revenue may be transferred to Section 3 areas.

Reduced Federal Subsidies: Transfer From Tenants to Federal Government

Section 3 might indirectly reduce the federal costs of providing affordable housing. Public housing residents generally pay 30 percent of their income in rent, with federal subsidies paying the rest. When residents' incomes rise, the rent payments they make rise as well, so the federal housing subsidy declines. The same pattern holds for Section 8-assisted households. Section 3 can reduce the cost of federal housing assistance by increasing the incomes of assisted households. Each \$1,000 in extra income the households earn will reduce federal costs by roughly \$300.

Applying the 30-percent figure to the increased earnings estimate of \$95.0 million yields a reduction of approximately \$28.5 million. This figure is almost certainly an overestimate of the reduction in housing subsidies because not all Section 3 residents receive housing assistance; a Section 3 resident only has to be a local resident that is eligible to receive housing assistance. Furthermore, the earned income disregard provision may negate some of the transfer to the Treasury.

Raising Thresholds: Excluding Some Entities From Section 3 Responsibilities

Although HUD expects that, on net, the implementation of Section 3 will be more rigorous and lead to greater employment of Section 3 residents, one aspect of the proposed rule may not lead to greater participation—increasing the threshold for which Section 3 requirements apply to grantees. The proposed rule would raise the threshold for non-PHA recipients from the receipt of \$200,000 of covered HUD assistance to the expenditure of \$400,000 of such funds. This change acknowledges that it is the expenditure of covered funds that produces economic opportunities—not the receipt of it. Recipients of housing and community development assistance that are above the current threshold but under the proposed threshold will benefit from reduced administrative burden. Section 3 residents who live in areas that are covered by the current rule, however, but who would not be covered under the thresholds in the proposed rule, would not receive a job preference under the proposed rule.

In addition to setting the threshold level, the proposed rule would clarify how the threshold level should be measured—as the aggregate expenditures of covered HUD funds. Depending on current practices of grantees, this clarification may increase Section 3 activity by some community development grantees that previously applied a “per project” threshold in error. The joint effect of formalizing the definition of a threshold and raising its level is not immediately evident.

⁸ <http://www.opm.gov/policy-data-oversight/pay-leave/pay-administration/fact-sheets/computing-hourly-rates-of-pay-using-the-2087-hour-divisor/>.

⁹ BLS (2013).

Reducing Poverty

Section 3's most obvious potential benefit is to increase the incomes of low-income people by making more jobs available to them. Public housing residents, who receive first preference for Section 3 opportunities on HUD-funded public housing projects, experience high levels of unemployment. HUD reports that 42 percent of families living in public housing that are headed by an individual who was not elderly or disabled had no earnings in 2008. Section 3 can also enhance the long-term employment prospects of other low- and very low-income people within the metropolitan area or nonmetropolitan county. Possessing basic job skills has a positive impact on an individual's short- and long-term earnings. Many low-income people unfortunately lack access to the job training programs that teach those skills. Section 3 is intended to provide that access, because grantees would be required to make training or apprenticeships available on covered projects and would be required to coordinate with local U.S. Department of Labor training providers, as appropriate.

Conclusion

The mission of Section 3 is to use existing federal funding streams for housing and community development to enhance economic opportunities to low-income individuals. By directing economic opportunities to Section 3 residents and businesses in the service area, the expenditure of HUD funds would have secondary effects, such as reducing poverty, lowering federal housing subsidies, and overcoming spatial barriers in labor markets. Federal expenditures on housing and urban development are made via annual appropriation and, as such, the only uncertainty is with the size of the funding and its associated impact on Section 3. The increased oversight and compliance requirements that engender these beneficial effects may come at a cost to grantees in the form of an increased administrative burden. Such a cost would have to be met either by a reduction in services or by additional appropriations.

Notwithstanding the gains accruing to the Section 3 program participants, particularly in hiring and contracting, it can be argued that the success of the program could be at the expense of those non-Section 3 participants who would have received jobs or contracts without the change in regulation. Whether this transfer is significant can be measured only retrospectively. If the change has its intended impact, then the economic transfer would be significant. Many good reasons for redistributing economic opportunity may exist; however, any gain in economic well-being for the community would carry with it the costs of displacing some of the current recipients of Section 3 funds.

In summary, the proposed regulatory changes better realize the goals of Section 3, which originate from the Housing and Urban Development Act of 1968.

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