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National Affordable Housing Management Association – 400 N. Columbus Street, Suite 203 - Alexandria, VA 22314
Phone 703-683-8630 - Fax 703-683-8634 - www.nahma.org

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Summary of the GAO Report on Project-Based Rental Assistance¹

This GAO Report finds that HUD should update its policies and procedures to keep pace with the changing housing market.

Background

Project-based Section 8 rental assistance is a program operated by the Department of Housing and Urban Development (HUD) that contracts with property owners who receive rental subsidies for units rented to low income tenants. These tenants generally pay 30 percent of their adjusted income as a portion of the rent and HUD subsidizes the remainder. Owners agree to use their units for low-income tenants in exchange for guaranteed rent payments from HUD. In 1988-89, these long-term contracts which typically last 15 to 40 years began to expire with some owners opting not to renew them. To address this issue, HUD has initiated several incentives to retain property owners and preserve the Section 8 program.

HUD's incentives include the Mark-to-Market program, through which owners with above-market rents receive additional assistance from HUD in exchange for reducing rents, and the Mark-up-to-Market program, which adjust rents to prevailing market conditions while maintaining affordability for low-income households. Owners may also obtain funds through non-HUD programs such as the Low-Income Housing Tax Credit (LIHTC) program and tax-exempt bonds, which are administered through the IRS.

¹ The Government Accountability Office Report entitled "Project-Based Rental Assistance-HUD Should Update Its Policies and Procedures to Keep Pace with the Changing Housing Market" and dated April 11, 2007, can be found at:

<http://searching.gao.gov/query.html?dt=&amo=0&ayr=0&bmo=0&byr=0&qt=Project-Based+Rental+Assistance&col=audprod&charset=iso-8859-1>

Despite these programs, there has been a growing concern that HUD is not committed to preserving Section 8 properties. Congress directed HUD and the Government Accountability Office (GAO) to report on the efforts to preserve project-based Section 8 housing, including an analysis of contract activity from 2001 to 2005. Contract renewals declined from 2001 until 2005, resulting in a 5 percent decrease in the number of affordable units (982,701 to 931,570).

The GAO report released on April 11, 2007, examined “(1) patterns in the volume, characteristics, and location of HUD’s project-based Section 8 properties—including those that left the program—from 2001 through 2005; (2) available tools and incentives for encouraging project-based Section 8 owners to keep their properties in the program; and (3) views of property owners, managers, and industry representatives on HUD’s Section 8 housing preservation efforts and the effect of those efforts on owners’ decisions to opt out or keep properties in the program.”

Summary

GAO Findings

GAO found that although a large majority of owners chose to stay in the Section 8 program, there were clear patterns as to the reasons why the remaining owners decided not to continue with the program. Of the 14,373 project-based Section 8 contracts that were up for contract renewal from 2001 until 2005, 13,218 contracts were renewed, or 92 percent of the contracts. The remaining 8 percent (1,155 contracts) covering 51,000 units were terminated—6 percent because owners opted out of the program and 2 percent because HUD foreclosed on the properties.

The discussions with property owners, managers, and industry representatives indicated that market conditions were the main reason owners decided not to renew their contracts in order to seek higher rents or to convert their units into condominiums. GAO also discovered that more properties being rented to families than units being rented to the elderly or persons with disabilities left the program. Additional contracts were not renewed because properties had failed their HUD REAC inspections.

Many owners stated that they remained in the program because they wanted a guaranteed income or because of a desire to meet affordable housing mission objectives. However, some property owners and managers expressed frustration with HUD’s policies and practices, which could eventually lead to fewer contracts being renewed in the future. Specifically, there is a concern about the lack of flexibility in policies such as the one-for-one replacement requirement that prohibits the reductions in the total number of units in a property. This policy has prevented owners from converting efficiency apartments into fewer but more marketable one-bedroom units. Even though this is not a legal mandate, and despite market studies showing a large demand for the conversion, HUD believes that this will undermine efforts to retain the total number of units. However, the opposite occurred in one instance with a Chicago owner who chose to remove an 82-unit property from the program because HUD would not approve of 3 units being lost to the conversion of condominiums.

Another source of frustration with HUD is their management of the Operating Cost Adjustment Factors (OCAF), defined by GAO as “an annual inflation adjustment that

reflects changes in operating expenses such as insurance and utilities.” Industry groups and managers complained that by the time OCAF adjustments were made they were already out of date, and that the adjustments do not reflect regional cost differences, emergency situations such as hurricanes, or market factors.

The administrative burdens leading to contract renewal opt-out can especially be seen by the pattern that exists among properties that have less than 50 percent of units receiving project-based Section 8 funding and those with a majority of units receiving Section 8 funds. For example, some property managers and owners have hired full-time staff to manage project-based Section 8 administrative requirements. These expenses are particularly burdensome for owners that have a small percentage of Section 8 units within their total property units. In fact, properties that were only partially supported by the Section 8 program comprised one-third of the total properties that were eligible for contract renewal from 2001 through 2005. However, 13 percent of those properties in which less than 50 percent of units received Section 8 subsidy opted out of the program, as compared to only 4 percent of the properties with subsidy levels between 50 and 100 percent. In other words, those with a small percentage of Section 8 units more frequently opted out of contracts because they did not want the hassle of dealing with the administrative burdens placed upon them.

The GAO report also discussed how REAC scores affect the probability that a property will opt out of a contract or be foreclosed. HUD officials noted that “in many cases these owners wish to be relieved of HUD oversight and may believe they can do so by failing to meet HUD requirements.” GAO states that “HUD reviews each such case and may take punitive enforcement action against the owner.” REAC inspection scores reflect the properties’ condition with a score of 90-100 signifying a superior condition, satisfactory scores are between 60-89, unsatisfactory between 30-59, and severe being scored at or below 30. Of those scores in the first two groups, 94 percent saw a contract renewal, while unsatisfactory scores had a 37 opt out rate and severe REAC scores showed a 59 percent drop out rate.

Some representatives of multifamily housing industry groups GAO interviewed, including NAHMA, had concerns about the “reliability, consistency, and fairness of REAC’s inspections.” Examples of concerns included REAC inspectors citing minor violations that often were outside of the managers’ control, being cited for minor violations rather than for cumulative violations, and those having inspections that tended to be arbitrary. At the other extreme, HUD’s Chicago field office reported that “REAC inspectors ignored the deteriorating overall condition of a property because the inspectors were either inexperienced or afraid to enter some of the buildings.” One Chicago property containing 1,105 units in 104 buildings received a passing REAC score despite the complex remaining in disrepair; eventually this property was split up, resulting in a loss of 700 Section 8 units.

GAO Conclusions and Recommendations

GAO found that the rigid one-for-one replacement requirement, difficulties with the OCAF adjustments and other administrative burdens have the potential to increase opt-outs. HUD’s one-for-one replacement policy makes properties and managers vulnerable to market changes, particularly by not allowing owners to replace unwanted efficiency apartments into fewer one-bedroom apartments. Ironically, the one-for-one replacement policy itself may force owners to opt out of contracts.

The OCAF adjustment process may also threaten HUD's preservation efforts due to estimates of utilities and insurance costs either not representing the current market conditions, or because they lag behind real-term cost amounts by an average of 15-18 months. This results in property owners struggling to pay their expenses, cash flow problems (as with late HAPs) and often results in owners using capital resources to pay for energy costs instead of using the same money to pay for building upgrades. This problem is doubly evident in emergency situations such as the 2005 hurricane season where no mechanism was or is currently present to "address rapidly changing prices such as spikes in energy costs or rapidly increasing insurance rates in coastal areas."

Ultimately, property owners must ensure that the business is running smoothly, i.e. economically sound. Many owners cite the guaranteed rental income as a primary reason for staying in the program. However, they may leave unless HUD addresses costs associated with insurance and utilities, as well as other unfunded regulatory requirements. If this is not done, managers could choose not to renew contracts with HUD.

Finally, GAO identified other key issues that contribute to "HUD fatigue" and could lead to fewer contracts being renewed. According to the report, these issues included: "policies and procedures that were described as unclear, inconsistently applied, or administratively burdensome; late subsidy payments; higher administrative costs for owners with fewer Section 8 units; and confusion about requirements for persons with limited English proficiency."

GAO has recommended three main executive actions that HUD should make to help preserve affordable housing. These are as follows:

- Modify the one-for-one replacement requirement to allow for a case-by-case assessment of the merits of permitting owners to reduce the number of project-based Section 8 units or reconfigure the units to better meet market demand and to expand its reconsideration of this policy beyond elderly properties;
- Expeditiously reevaluate its OCAF adjustment process to make sure that the adjustments reflect local variations, are implemented in a more timely manner, and are responsive to emergency situations; and
- Determine if any of the additional issues raised by owners such as policies and procedures that are unclear, inconsistently applied, or administratively burdensome could contribute to owners' opting out of the Section 8 program and take steps to address these issues."

Positive Aspects of the Report

NAHMA is extremely pleased that our members were frequently quoted throughout the report. NAHMA staff and members were major contributors to the report. Many top priorities such as inadequate OCAF adjustments, the need for the Rent Increase Cost proposal to be adopted, addressing late HAPs and HUD's LEP Guidance were addressed.

Most important, however, is that GAO has substantiated the concerns that NAHMA has raised over the years. Now, the affordable housing industry may use this report in conjunction with other evidence pointing to changes in HUD's policies and procedures necessary to preserve affordable housing. NAHMA believes this report has already helped make possible ongoing efforts to achieve a legislative compromise to improve implementation of the LEP Guidance.

The GAO report showed NAHMA and other industry groups in a positive light that reflected the general desire to provide affordable housing for those individuals and families needing assistance. The report described in a non-biased manner, how managers and property owners have become exhausted in dealing with inconsistencies and lack of flexibility in the implementation of some key HUD policies. These findings give additional concerns NAHMA has raised with those elected officials for whom this report was prepared.

Issues of Concern to NAHMA

Despite quotes from HUD officials throughout the report and particularly in the Department's response to GAO's findings suggest immediate changes to HUD policies are unlikely to occur. This is in part due HUD's stated desire to continue studying issues.

In an agency response provided by Brian Montgomery, HUD's Assistant Secretary for Housing-Federal Housing Commissioner, the Department generally agreed with the report findings. However, NAHMA is surprised and disappointed by the areas of disagreement. For example, the Commissioner states "the report contains several positive suggestions... (but) none of the recommendations would deter owners who seek to maximize their economic gain in a "hot" real estate market." He also stated that because the report did not analyze how the recommendations could have avoided the opt outs, that it is difficult for his department to "evaluate the expected benefits from implementing these suggestions."

The Assistant Secretary also addressed GAO's three recommendations. First, despite Congress waiving the mandate for the one-for-one replacement procedures nearly 10 years ago, market analysis showing the ineffectiveness of the policy, housing industry groups opposed to the policy, and now a GAO report recommending a change in action, HUD states,

"the Department is aware of the need for property owners to create larger units by reducing overall units to accommodate the market demand,...Therefore, the Department is evaluating that policy to determine what criteria should be established to approve of such a request...the Department is very sensitive to the need for affordable housing units in this country and will be very careful in developing a policy that would reduce affordable units."

NAHMA hopes that a timely decision to reverse this policy will be quickly implemented.

Second, Assistant Secretary Montgomery said the Department has already been looking into a solution for meeting GAO's second recommendation for timelier and better targeted OCAF adjustments. Having already met with a number of industry groups,

HUD anticipates that the review and the results will be announced at the end of FY 2007. While NAHMA certainly welcomes improvements to the OCAF we still believe there is a need for the RIC proposal, which would address mid-cycle operating increases.

Finally, regarding GAO's recommendation that HUD should "determine if other unclear and burdensome policies are contributing to owner opt outs." HUD responded by stating that they are aware of concerns related to late HAPS, administrative costs, outdated procedures, LEP issues and "alleged inconsistencies" with REAC inspections. HUD believes that the delays in the appropriation process are the main factors related to late HAP payments. Additionally, HUD told GAO concerns about the LEP Guidance were sufficiently addressed. Regarding the REAC inspections, HUD's response mentions that "the implementation of this process has resulted in having less than 300 properties in a portfolio of over 33,000 projects with unsatisfactory physical scores...We also note that the Department solicits feedback from owners and managers on inspection inconsistencies and inspector misconduct, and that a formal appeal process exists to address instances where the owner disagrees with the results of the inspection." NAHMA is disappointed by HUD's response to this lost finding, and we continue to seek legislation on these matters.

NAHMA's Position

NAHMA remains committed to working with HUD to implement the recommendations made in the GAO report. The goal of addressing late HAPs, improving OCAFs, and altering the one-for-one policy will help preserve affordable housing.

Preserving affordable housing remains a top priority for NAHMA. The GAO report was very helpful in identifying key issues of concern, and NAHMA fully supports the three recommendations for executive action.

NAHMA will continue to mitigate the effects of the LEP Guidance. With the Chairman of the House Financial Services Committee engaged in these efforts, NAHMA feels confident that real progress is being made to reduce the language service burdens placed upon managers. NAHMA has also drafted language for legislative fixes to the late HAPs issue and the RIC proposal. Likewise, we continue to seek changes discussed in the GAO report to address greater transparency in HUD's processes and procedures. Through aggressive grassroots action campaigns, NAHMA's ongoing efforts to preserve and provide quality affordable housing will be realized.

Additionally, NAHMA believes this report has been helpful in substantiating our concerns about the unfunded costs of HUD's LEP Guidance, late HAPs, and lack of clarity in HUD's policies and/or procedures. We believe this report has helped facilitate ongoing efforts to achieve a legislative compromise on LEP implementation that can be supported by both industry and civil rights groups.