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September 11, 2012

NAHMAanalysis 2012 – 0911

Updates to the Section 8 Renewal Policy Guidebook

Effective Date or Deadline

Changes were effective upon release of the Guidebook (May 18, 2012) unless otherwise noted. Most of the policies which are of interest to NAHMA—including using current debt service for budget-based rent increases for Option 4 properties and limiting budget-based rents for Option 4 contracts—take effect on October 15, 2012.

Background

The Section 8 Renewal Policy Guidebook is a comprehensive overview of options and procedures for renewing Section 8 project-based contracts. The six options available to owners when their Section 8 contracts expire are:

- Option One (Mark-Up-To-Market) is available for certain projects with below market rents located in strong rental markets;
- Option Two (Other Contract Renewals with Current Rents at or Below Comparable Market Rents) allows renewal with existing rents adjusted by the operating cost adjustment factor (OCAF) or budget-based rents when rents under the expiring contract are at or below market;
- Option Three (Referral to the Office of Affordable Housing Preservation [OAHP]) refers projects to OAHP for processing because the contract has rents greater than market and is subject to an FHA-insured or HUD-held mortgage. Rents for these properties will be reduced to market levels, and the property may undergo mortgage restructuring to remain viable with reduced rents;
- Option Four (Renewal of Projects Exempted From OAHP) permits renewal of Section 8 contracts for “exception” projects, which may continue operating with above market rents under the Multifamily Assisted Housing Reform and Affordability Act (MAHRA) and for properties exempt from debt-restructuring under MAHRA;
- Option Five (Renewal of Portfolio Reengineering Demonstration or Preservation Projects) is available to projects that completed the “Demo” program as evidenced by a recorded Demo Program Use Agreement and Preservation Projects (primarily Section 236 and 221d3

BMIRs) whose owners entered into long-term use agreements with HUD under the Preservation Program; and

- Option Six (Opt-Outs) describes procedures owners must follow when they choose not to renew the Section 8 contract.

In Chapter 9, the renewal guide also provides guidance to owners, appraisers, HUD staff and contract administrators on the required elements for rent comparability studies (RCS). This chapter is critical because the RCSs have been used to determine the comparable market rents since the passage of MAHRA.

The May 18 page changes to the Section 8 Renewal Policy Guidebook included several measures to limit rent increases in the project-based Section 8 program. NAHMA has been on record in opposition to such proposals as early as 2010, when HUD initially released a proposal to cap budget-based rent increases for exception projects. On October 6, 2010, NAHMA submitted comments on HUD's draft Section 8 Renewal Policy Guidebook¹ which opposed this policy:

“Section 6-3.B. (Budget-Based Rent Adjustments for Multi-Year Contracts).

Revisions to this section permit budget-based rent adjustments in a multiyear contract only if the owner submits an RCS and the proposed rents do not exceed comparable market rents.

NAHMA members are concerned about how this provision will be applied to the Section 202, Section 81 and Section 515 projects, which fall under Option 4. For example, the rents at renewal for a Section 202 property will be based on the lower of OCAF or BBA. If two years later, there is a significant increase in insurance or utility costs, the owner must have an RCS done, and any rent increase will be limited to comparable rents. This scenario will be a problem if the reason the property initially used Option 4 was because it needed “exception rents” to operate.”

HUD confirmed its plan to limit budget-based rent increases (BBRIs) in its November 22, 2011 memo to multifamily project owners, “Impact of HUD's Fiscal Year 2012 Budget on Section 8 Project Based Rental Assistance.”² The memo stated, “... all Option 4 renewals and annual rent adjustments will be limited to OCAF increases if proposed rents exceed market.” The memo also announced HUD's intention to “benchmark” rents. It read,

“...all rent comparability studies will be required to justify proposed rents that exceed 110% of Small Area Fair Market Rents (SAFMR). Forthcoming guidance will contain instructions on the additional analysis required to justify proposed market rents in excess of this SAFMR benchmark.”

¹ National Affordable Housing Management Association, Letter to HUD Multifamily Director of Housing Assistance Policy Gail Williamson Commenting on the Draft Changes to the Section 8 Renewal Guide July 2010 (As Revised), October 6, 2012.

<http://www.nahma.org/Leg%20area/Draft%20Sec%20%208%20Renewal%20Guide%20comments%20Oct%202010.pdf>

² Department of Housing and Urban Development Multifamily Acting Deputy Assistant Secretary Janet Golrick, “Impact of HUD's Fiscal Year 2012 Budget on Section 8 Project Based Rental Assistance,” Memorandum to All Multifamily Project Owners, November 22, 2011.

<http://www.nahma.org/member/New%20HUD%20Docs/Golrick%20Memo%20112211%20FY2012%20Budget's%20Impact%20on%20HUD.pdf>. It is also worth noting that this memo also announced HUD's intention to offset Section 8 HAP payments for new regulation Section 8 properties with residual receipts.

These ideas, along with using residual receipts to offset project-based Section 8 HAP payments, were subsequently included in HUD's 2013 budget request.

In addition, the Senate Appropriations Committee directed HUD to undertake many of the "cost-saving" measures from its FY 2013 budget in its report on S. 2322, the FY 2013 Transportation-HUD Appropriations bill, including:

- Applying residual receipts to offset assistance payments for new and old regulations contracts;
- Limiting exception rent levels to the operating cost adjustment factor (OCAF);
- Applying Small Area Fair Market Rents (SAFMR) as a benchmark for rents subject to comparability; and
- Shortening vacancy payments.³

Unfortunately, a number of these ill-advised "cost-saving" measures were included in the May 18 page changes to the Section 8 Renewal Policy Guidebook.

Summary

The May 18 page changes to the Section 8 Renewal Policy Guidebook made a number of significant revisions to HUD's Section 8 contract renewal policies. Almost all of these revisions are controversial. Unless otherwise noted, the policy changes were effective as of May 18, 2012.

First, HUD discontinued the use of Attachment 20, which ended HUD's policy of allowing properties to extend multi-year contracts. Now, the Department will only allow the early termination and renewal of a Section 8 contract upon approval by the Hub Director or designee. Properties must renew their contract with a mandatory 20-year term, plus the remaining years left on the original contract. If the use agreement is for a shorter term than the new contract, the use agreement must be extended for the life of the contract. The Agency informed NAHMA that this policy decision was driven by refinancing. This policy change also applies to Mark-to-Market properties under Option 3.

Second, the page changes eliminated Note 1 following Section 3-2 D, which required rents for an Option One B⁴ renewal to be limited to use-restricted levels.

Next, the Agency made a number of revisions to Option 4 contracts. HUD will now require the use of current debt service in an owner's BBRI request for Option 4. The Department also removed the language in Chapter 16, "Other Issues," that required the original debt service to be used in BBRI requests in Option 4 to make it consistent with this policy change. In addition, it will only permit rent adjustments in multi-year Option 4 contracts using a budget basis if the proposed rents do not exceed comparable market rents. The debt service and rent adjustments changes are effective on October 15, 2012.

³ Senate Appropriations Committee, Report 112-157 "Transportation and Housing and Urban Development, and Related Agencies Appropriations Bill, 2013," Washington, DC: Government Printing Office, April 28, 2012.

⁴ The discretionary authority for properties that do not meet the eligibility criteria under Option One A but are still important affordable housing resources to participate in Mark Up to Market.

Finally, the policy guidebook included a requirement for appraisers to follow new procedures when market rents in a RCS were above 110 percent of SAFMRs for metropolitan areas or Fair Market Rents (FMR) in non-metropolitan areas. The RCS report would have included a statement describing the percentage of properties in the market area whose rents exceed 110 percent of the SAFMR in metropolitan areas or 110 percent of the FMR in non-metropolitan areas. Furthermore, the RCS would have required appraisers to support this conclusion by documenting through paired rents the conditions that differentiate the properties below the 110 percent threshold from those above it (e.g., variances in condition, age, neighborhood support facilities, etc.). Fortunately, HUD has suspended the implementation of this requirement, effective immediately. HUD is considering further revisions to the RCS guidance.

Issues of Concern to NAHMA

NAHMA is extremely concerned about the changes to the Section 8 Renewal Policy Guidebook. Fundamentally, we believe the changes may harm project-based Section 8 property operations and preservation efforts, thereby creating a disincentive for property owners to remain in the program.

Ending the Use of Attachment 20

Discontinuing multi-year contract extensions in favor of mandatory contracts covering 20 years plus the length of the remaining term of the terminated contract (and the longer extended use agreements) may create a financial disincentive for property owners to refinance their loans and/or renew their contracts. NAHMA has long argued that owners should have an option for 20 year contracts. However, the use of mandatory contracts is a major policy change that should have been properly vetted before implementation.

With the threat of sequestration looming, the timing of this policy change is also a problem. We question whether or not HUD will be able to honor the long-term contracts if short-funding and partial-year funding contracts become the norm again. In addition, NAHMA asks if sequestration will impact HUD's ability to honor its long-term obligations.

Current Debt Service for BBRI Requests

HUD's requirement to use current debt service in an owner's BBRI request for Option 4 is also problematic. First, it is not entirely clear what HUD means by "current debt service." It could be the original debt if an owner has not refinanced the current mortgage, has put in place interim financing, or obtained a restructured loan that includes the 1.15-1.2 debt coverage ratios typically required by their lender. Under this new policy, HUD could potentially wipe out the revenue necessary for owners to meet their obligations to the lenders.

NAHMA is also concerned that the requirement to use current debt service in an owner's BBRI request for Option 4 renewals may reduce rents, which would substantially limit the amount of rehabilitation that can be accomplished through refinancing a property. This policy has the potential to wipe out the owners' savings from refinancing because rents could be adjusted downward to reflect lower mortgage payments. As a result of the constant changing HUD requirements, lenders are requiring significant re-tenanting (lease up) reserves, which further limits an owner's ability to adequately rehabilitate a project. While HUD strives to make its

programs compatible with the Low-Income Housing Tax Credit program, its changing Section 8 Renewal Policy guidelines are destabilizing to such financing.

Taken together with other changes in the renewal guide to benchmark rents and cap BBRI, this policy has many NAHMA members extremely worried. They are concerned that refinanced properties might not be able to generate sufficient cash flow to satisfy the 15 to 20 percent after-debt financial cushion lenders require borrowers to maintain for emergency or other expenses.

Limiting Option 4 Renewals

One of the most controversial changes in the revisions to the Section 8 Renewal Policy Guidebook is limiting Option 4 renewals. Originally, MAHRA envisioned that some properties would require exception rents in order to make the projects financially viable. NAHMA fears that holding BBRI on Option 4 renewals to comparable market rents may cause hardships for some properties, particularly rural and senior properties. Rural properties have difficulty determining comparable rents because there are few, if any, market-rate rental properties in the same location. Senior properties offer a number of services to their residents, the costs of which are incorporated into the rents. Comparable market-rate rental properties typically do not provide similar types of services to their tenants.

Furthermore, properties refinanced under Option 4 may not take on second and third mortgages, which are common to the Mark-to-Market projects of Option Three. These additional mortgages provide immediate cash flow to properties in exchange for longer-term debt. The refinancing limitations coupled with BBRI limits to Option 4 properties significantly limit a project's ability to undertake rehabilitation or address unforeseen operational costs in the future. Therefore, NAHMA continues to urge HUD to allow flexibility in the policy for properties that cannot operate under this limitation.

NAHMA is also concerned that there may be some confusion regarding the contract renewal process for Section 202 properties, considering:

- The Section 8 Renewal Policy Guidebook's changes to:
 - The contract and use agreement terms; and
 - The limits of Option 4 rent increases;
- The rules of Section 202 payments under Notice H 2012-08, "Updated Requirements for Prepayment and Refinance of Section 202 Direct Loans;" and
- Notice H 2012-08's subsequent frequently asked questions (FAQ) document.

Each Section 202 prepayment transaction coupled with a contract renewal under Option 4 is unique, due to the types of financing used at the properties, and has many moving parts. We worry that these significant changes may be confusing for HUD field offices, developers, and owners trying to complete these transactions. The confusion could result in unintended consequences during the underwriting and contract renewal processes for these properties. NAHMA will request HUD to be mindful of the complexity of these situations and the difficulty of balancing multiple regulatory changes as it moves forward with processing Section 202 prepayment transactions.

Benchmarking Rents

Another controversial change is requiring the use of SAFMRs and FMRs as rent benchmarks for the RCSs. NAHMA strongly opposes this change because the market already acts as the benchmark for comparable rents.

It is important to note that HUD's recent *Federal Register* notice, "Notice of Proposed Information Collection: Comment Request; Section 8 Renewal Policy Guide," stated:

"The Multifamily Housing Reform and Affordability Act of 1997 (MAHRA) for fiscal year 1998 (Pub. L. 105-65, enacted on October 27, 1997), required that expiring Section 8 project-based assistance contracts be renewed under MAHRA. Established in the MAHRA policies renewal of ***Section 8 project-based contracts rent are based on market rents instead of the Fair Market Rent (FMR) standard*** [Emphasis NAHMA's].

MAHRA renews submission should include a Rent Comparability Study (RCS). If the RCS indicated rents were at or below comparable market rents, the contract was renewed at current rents adjusted by Operating Cost Adjustment Factor (OCAF), unless the Owner submitted documentation justifying a budget-based rent increase or participation in Mark-Up-To-Market. The case is that no renewal rents could exceed comparable market rents. If the RCS indicated rents were above comparable market rents, the contract was referred to the Office of Affordable Housing Preservation (OAFP) for debt restructuring and/or rent reduction."⁵

Here, HUD specifically acknowledges that comparable market rents, rather than FMRs, are the standard for renewals. SAFMRs and FMRs are also not related to comparable market rents; they are set at the 40th percentile of rents paid by recent movers. By requiring the use of these arbitrary data points in the RCSs, HUD is effectively inserting an artificially low rent benchmark to influence the appraiser's estimate of the comparable market rent. Not only is this policy revision inconsistent with MAHRA—which requires the determination of comparable market rents when renewing most Section 8 contracts—it also results in rent comparisons that are not an accurate reflection of actual market rents.

Furthermore, HUD's SAFMR demonstration programs are still underway and have yet to be evaluated. NAHMA questions the wisdom of implementing a new evaluation tool without understanding how it will affect the financial viability of the portfolio.

⁵ Department of Housing and Urban Development, Docket No. FR-5607-N-25 "Notice of Proposed Information Collection: Comment Request; Section 8 Renewal Policy Guide," *Federal Register*, Washington, DC: Government Printing Office, August 8, 2012. <http://www.gpo.gov/fdsys/pkg/FR-2012-08-08/html/2012-19326.htm>

Positive Developments

RCS Appraisal Requirements

NAHMA is extremely pleased to see that HUD recently suspended the Section 8 Renewal Policy Guidebook changes to the RCSs' appraisal requirements. The additional data required for the RCSs under these changes were flawed and could not have been successfully obtained.

A number of appraisers and NAHMA members told us that the information HUD wanted to include in the RCSs regarding the percentage of properties in the market area that exceed SAFMRs and FMRs did not exist. In a June 22, 2012 industry stakeholder letter to Secretary Shaun Donovan, which NAHMA signed on to, our organizations explained:

“This revised standard would require the appraiser to obtain all rental information in a particular market, regardless of the fact that most of it is proprietary. Assuming that the information could be obtained there would be no certain way for a reviewer to verify it. It is not reasonable to require appraisers to opine mathematical certainty about the market based on largely inaccessible property data.”⁶

In addition, the paired rent analysis requirements in the RCS were flawed. The SAFMR and property characteristics are two different types of data that have no discernible relation to or impact on each other.

NAHMA was also pleased to learn that HUD will take industry feedback into consideration as it revises the RCS guidance. Likewise, HUD has announced that it will put any revisions to the RCS policy out for public comment before implementation. We will provide members with additional information, including the revised guidance, as it becomes available.

Public Comments

HUD has informed the industry that it is working on a reissue of the Section 8 Renewal Policy Guidebook, which the Agency will put out for public comment. The Department is also soliciting public comments via a *Federal Register* notice on a number of forms affiliated with the Section 8 Renewal Policy Guidebook.⁷ The documents have been updated to reflect the recent Guidebook changes. Overall, we are pleased to see that HUD is soliciting comments on the guidebook and its affiliated materials. It is an indication that the Department is taking NAHMA and industry

⁶ Appraisal Institute, Council for Affordable and Rural Housing, Institute for Responsible Housing Preservation, Institute of Real Estate Management, Leading Age, National Apartment Association, National Association of Affordable Housing Lenders, National Association of Homebuilders, National Association of Housing Cooperatives, National Affordable Housing Management Association, National Leased Housing Association, and National Multi Housing Council, Letter to HUD Secretary Shaun Donovan Stating Industry Stakeholder Opposition to the Rent Comparability Study Changes in the Section 8 Renewal Policy Guide (Revised May 18, 2012), June 22, 2012.

<http://www.nahma.org/member/New%20HUD%20Docs/Industry%20Letter%20on%20Section%208%20Renewal%20Guide%20RCS%20Changes%20062212.pdf>

⁷ Department of Housing and Urban Development, “Notice of Proposed Information Collection: Comment Request; Section 8 Renewal Policy Guide,” Docket No. FR-5607-N-25, *Federal Register*, Government Printing Office: Washington, DC, August 8, 2012. <http://www.gpo.gov/fdsys/pkg/FR-2012-08-08/pdf/2012-19326.pdf>

stakeholder concerns seriously. NAHMA will be submitting comments on the revisions to the guidebook and its affiliated materials to the Agency.

NAHMA's position

NAHMA understands that many of the policy changes in the Section 8 Renewal Policy Guidebook were driven by the difficult federal budget environment. Congress is pressuring HUD to hold the line on spending for the project-based Section 8 program as part of its efforts to control non-security, discretionary government expenditures.

However, NAHMA believe the revisions to the Guidebook, as well as the changes to HUD's residual receipts policies, are inappropriate methods for achieving this goal. These policies work against HUD's goals of providing quality affordable housing to low-income tenants. The revisions increase financial burdens on the properties, which reduces projects' abilities to operate effectively and hurts portfolio preservation efforts. They also create disincentives for owners and lenders to continue participating in the project-based Section 8 program. As a result, NAHMA continues to strongly urge HUD to reexamine the proposals and revise the recent changes to the Section 8 Renewal Policy Guidebook.

Further, NAHMA encourages HUD to pursue a number of other Department-supported proposals that will strengthen the operation and preservation of federally subsidized affordable housing, including the project-based Section 8 program. Not only do these proposals improve the efficiency of federal rental programs, but they create additional cost-savings to the government.

For example, the Department recommended that Congress pass a number of reforms to the Section 8 housing choice voucher (HCV) program in the FY 2013 budget request, which include streamlining physical inspections and reforming rent calculations and income reviews. These provisions are expected to reduce the administrative burdens to HUD, PHAs, and private owners, thereby leading to additional savings. These proposals were incorporated into the House Financial Services Committee's draft of the Affordable Housing and Self Sufficiency Improvement Act. NAHMA strongly supports Congressional passage of these provisions.

Likewise, HUD is working with the Rental Housing Working Group—made up of officials from the White House, other Federal agencies, and industry stakeholders—on a number of proposals to harmonize federal housing rental programs. In fact, two pilot programs are already underway to reduce the number of physical inspections on rental properties receiving federal assistance and the number of subsidy layering reviews. The physical inspections pilot has already saved the federal government \$250,000 in 2012. The initial feedback from the subsidy layering review pilot suggests that it could generate cost savings for developers. The Obama Administration is examining expanding both of these pilot programs in 2013.