November 5, 2009

Regulations Division
Office of the General Counsel
U.S. Department of Housing and Urban Development
451 7th Street, S.W.
Room 10276
Washington, DC 20410-0500

Subject: Docket No. FR-5323-N-01
Request for Comments on Ending "Hold Harmless" Policy in Calculating Income Limits Under Section 8 of the United States Housing Act of 1937; and
Docket No. FR-5323-N-02 – same title as N-01, Correction

Dear Sir or Madam:

On behalf of the undersigned organizations, please accept comments on the above-referenced notice, published in the *Federal Register* on September 14, 2009. Our organizations represent members involved in all aspects of residential construction, including the building, operation, and management of affordable rental properties. Our organizations are also affiliated with local associations that work with HUD field offices, public housing authorities (PHAs) and state housing finance agencies (HFAs). Collectively, we have a strong interest in the HUD median income limits, as these limits set income eligibility for almost all federal housing programs.

Background

The Notice explains that for FY 2009, HUD has continued its policy of maintaining Section 8 income limits at the previously published level in cases where HUD's estimate of area median income or housing cost adjustment data, or changes in calculation methodology, would lead to a lower income limit than was previously published. The hold harmless policy was instituted to ensure continued financial feasibility in Low Income Housing Tax Credit and tax-exempt bond-financed rental properties because their rents are tied to Section 8 income limits. (HUD refers to these projects as Multifamily Tax Subsidy Projects or MTSPs.) The Notice further explains that the Housing and Economic Recovery Act of 2008 (HERA) statutorily implements a project-level hold harmless provision for existing MTSPs, which eliminates the need for HUD to continue its policy for the benefit of these projects.

HUD is requesting comment on whether HUD should discontinue the hold harmless policy with respect to Section 8 income limits such that income limits generally would be allowed to decrease. HUD says that maintaining artificially high income limits has had an adverse effect on other housing programs because higher income limits increase the number of eligible participants, thereby making it harder to target limited resources to those most in need.

HUD cites a number of housing programs, including those administered by the U.S. Department of Agriculture (USDA) and Treasury (e.g., tax-exempt mortgage revenue bonds for homeownership financing) that would be affected by discontinuing the hold harmless policy.

HUD also invites comments on whether the hold harmless policy should be maintained with respect to Section 8 income limits used for calculating rents in the HOME Investment Partnerships Program, while discontinuing the hold harmless policy with respect to eligibility requirements under the HOME program and other programs. HUD indicates in the Notice that it could implement such a policy, which would prevent rents from falling while ensuring that HOME funds are targeted to those most in need.

Comments: Overview

First, our organizations greatly appreciate the opportunity to comment on the hold harmless policy and the question of whether it should be retained with respect to Section 8 income limits. Although HUD publishes new median income estimates and income limits each year as required by law, stakeholders generally do not have a chance to review and comment on them before they go into effect.

We commend HUD for recognizing that removing the hold harmless policy would constitute a significant change and that this change has the potential to impact a large number of housing programs beyond Section 8. We further commend HUD for providing an opportunity for the public to review and comment on this important issue.

Second, we believe that neither the intent nor the effect of the hold harmless policy has been to maintain artificially high income limits. Rather, the hold harmless policy smoothes a generally upward trend of successive median family income estimates, preventing a pattern of temporary declines followed by large increases. In turn, for some programs, this ensures that rent levels do not fluctuate significantly, either up or down, on a year-to-year basis.

In the absence of a shift to a new data source or other changes in underlying methodology, the result of the hold harmless policy is a smoothing of anomalies that occur occasionally in areas like the Johnson City Tennessee Metropolitan Statistical Area (MSA). In this particular MSA, the Census Bureau’s one-year American Community Survey (ACS) estimates show median family income declining by 13.6 percent in 2006 before increasing by 6.6 percent in 2007 and 11.9 percent in 2008. After this series of relatively large changes in both directions, the ACS median family income in the Johnson City MSA was 3.0 percent higher in 2008 than in 2005. Applied to this example, the effect of a hold harmless policy would be the same 3.0 percent increase from 2005 to 2008, but without the double-digit decline in between. We believe that this kind of smoothing of program limits over time is convenient and desirable for many housing programs.

A hold harmless policy would maintain artificially high income limits only in cases where median family income declines, in nominal terms, year after year. We are unaware of an example of such a persistently declining trend in recent times. In contrast, evidence of general upward trends is widespread. The attachments to the *FY2009 HUD Income Limits Briefing Material* indicate that median family income increased by more than 19 percent in every state between 1999 and 2009, and one-year ACS estimates show median family income increasing every year even in an area like the Detroit-Livonia-Dearborn Metropolitan Division, where the unemployment rate has risen to over 18 percent.

As mentioned in the Federal Register notice, the reach of Section 8 income limits is broad, stretching across a number of housing programs and impacting a variety of government agencies and other stakeholders at the federal, state, and local level.

Because the impact of income limits is so broad, our organizations oppose the removal of the hold harmless policy until potential problems for specific programs have been resolved. These programs include HOME, the Treasury Department's Tax-exempt Mortgage Revenue Bond (MRB) program, the MTSP programs outside the scope of the hold-harmless provisions in HERA, and the Neighborhood Stabilization Program (NSP) established under both HERA and the American Recovery and Reinvestment Act of 2009 (ARRA).

Removal of the hold harmless policy also may adversely impact the Department of Agriculture's rental and homeownership assistance programs, and the Federal Home Loan Banks' rental and homeownership programs. In these cases, however, the Department of Agriculture and Federal Home Loan Banks have sufficient flexibility to deal with income limits through their own internal regulatory procedures.

We have further concerns about removing hold harmless at this particular time due to the unusual macroeconomic conditions that prevail, which are likely to exacerbate problems for any of the housing programs listed above, especially in the year 2011.

These issues are discussed in more detail in the following sections of this comment letter.

<u>HOME Investment Partnerships Program</u>

HOME is a flexible program created by Congress in 1990 and administered at the federal level by HUD's Office of Community Planning and Development (CPD). Under HOME, CPD allocates funds to state and local jurisdictions for use in any of a number of eligible activities, including financing assistance to home buyers and building or rehabilitating rental housing.

Income eligibility requirements that are allowed to decline temporarily from one year to the next create complications and confusions for households on waiting lists who lose eligibility to receive assistance without an increase in their incomes, and for the state and local jurisdictions that operate the homeownership and rental housing programs and must ensure compliance with rent and income eligibility. For property owners, compliance would become significantly more complicated because different income limits and rents could vary widely in one property and among multiple properties. For these reasons a hold harmless policy should be maintained for income limits in the HOME rental and homeownership programs.

Moreover, in the HOME program, rents are tied to income limits much as they are in the Low Income Housing Tax Credit (LIHTC) program. Hence, declining income limits can adversely impact HOME rental properties the same way they can adversely impact certain LIHTC rental properties. For this reason, a hold-harmless policy should be maintained for rents in the HOME program.

On the issue of whether the hold harmless policy should be maintained for HOME rents but discontinued for HOME eligibility requirements, we note that HOME is very often combined with MTSPs. Conflicting eligibility requirements between HOME and MTSPs thus have a strong tendency to create confusion. It is therefore especially important that HOME income limits be held harmless in order to maintain compatibility with MTSP income limits.

This raises the question of how quickly and easily CPD would be able to change its policy and impose a hold harmless policy for income limits in the HOME program independent of the policies HUD applies to Section 8 income limits.

The Federal Register notice states that the legislative language defining income limits for the HOME program does not refer specifically to a section of a particular law with reference to income limits. Therefore, HUD has concluded that it may establish separate HOME income limits with variations like a hold-harmless policy.

Assuming that the law does in fact provide sufficient flexibility, the logical subsequent question is whether similar flexibility is provided by the regulations that govern income limits in the HOME Program: 24 CFR Part 92.

24 CFR Part 92.217 deals with income targeting requirements for homeownership assistance under HOME, stating simply that 100 percent of these funds must be invested in dwelling units occupied by households that qualify as low-income families.

24 CFR Part 92.216 deals with income targeting under HOME rental programs, generally limiting eligibility to households with no more than 60 percent of area median family income, except that HUD may establish income ceilings higher or lower than 60 percent of the median if such variations are necessary because of prevailing levels of construction cost or fair market rent, or unusually high or low family income.

24 CFR Part 92.252 deals with rent limitations in HOME-assisted rental units. Under this section of the regulation, HOME rents must not exceed 30 percent of the annual income of a

family whose income equals 50 percent of the median income for the area, as determined by HUD, with adjustments for smaller and larger families.

The regulation for income targeting in homeownership assistance programs seems quite flexible, containing no specific language on how low income is to be defined. In contrast, the regulations governing income targeting and maximum rent in rental programs provide both specific formulae, and specific conditions under which the formulae may be altered—and a hold harmless policy is not listed as a legitimate grounds for alteration.

It therefore seems unlikely that HUD can impose independent hold harmless policies on renter income limitations or maximum rents in the HOME program without proposing a change in the regulation that must go through the official rule making process, allowing a reasonable period for public comment, before it can be implemented.

Treasury Department Tax-Exempt Mortgage Revenue Bond Program

MRBs refer to tax-exempt bonds used to finance mortgage loans targeted to moderate-income first-time homebuyers. Due to their tax-exempt status, MRBs allow states to borrow at lower interest rates. The savings can be passed on to homebuyers in the form of below market rate mortgages.

To qualify for a mortgage financed by an MRB, the household's income cannot exceed 115 percent of area median family income. The price of a home purchased with an MRB-financed mortgage may not be greater than 90 percent of the average price of homes in that area. The participant must not have owned a home in the previous three years.

In some states, the house price limits tend to be more binding and restrictive than the income limits, but in other states, the reverse is true. Members of our organizations have reported that allowing income limits to decline from one year to the next would cause problems in particular states. These problems include confusion and resentment among potential buyers who qualify for an MRB-financed loan in one year, but then become ineligible the next even though their incomes have not increased; administrative burdens for the state agencies that operate the program and have no experience dealing with this situation; and problems it would create for the agencies trying to target the program to particular areas in their state during the year when the income limits decline.

Moreover, section 143(f) of the Internal Revenue Code specifies that the 115 percent limitation on incomes of mortgagors under the MRB program be based on area median gross income, taking into account the regulations prescribed under Section 8 of the United States Housing Act of 1937. Therefore a hold harmless policy that is independent of the Section 8 income limits cannot be applied to the MRB program without a legislative change.

MTSP Programs Outside the Scope of the HERA Hold-Harmless Provisions

HERA codifies the hold harmless provision for MTSPs at the project level. In other words, it specifies that income limits will not decline from one year to the next for individual projects once their rent levels are determined. A consequence of this it that different projects located in the same Fair Market Rent areas will in some cases have different rent and income limits, depending on when the rents are initially determined.

If median family income estimates temporarily decline from one year to the next in a particular area, projects placed in service in the latter year will be at a financial disadvantage to projects that were placed in service in earlier years in both the amount of rent they can charge and in the number of tenants that can qualify to live in the project. Moreover, this would create an administrative burden on agencies such as the Internal Revenue Service, the state agencies, developers, investors, and property management companies that are responsible for tracking the rent and income limits. As would be the case for the MRB program, income limits without a hold harmless policy can make it difficult for state agencies trying to target the program to particular areas during the year when the income limits decline and new projects are at an economic disadvantage compared to existing projects in the same area.

Neighborhood Stabilization Program

HERA established a system of NSP grants to provide emergency assistance for redeveloping abandoned and foreclosed residential property. These are called NSP1 grants. Subsequently, ARRA created a system of NSP2 grants. The NSP2 grants are similar to NSP1 in terms of objectives and eligible uses of the funds, although the rules for allocating the grants are somewhat different.

As of this writing, all NSP1 grants have been awarded, and grantees have 18 months and four years from the date of the award, respectively, to obligate and spend the funds. NSP2 grants have not yet been awarded, but the deadline to apply for the grants has passed.

The NSP is similar to the Community Development Block Grant (CDBG) program in that funds are awarded by CPD. Due to these similarities, Section 8 income limits as applied in the CDBG program are likely to apply to the NSP as well. After foreclosed properties have been purchased and, if necessary, repaired using NSP grants, these properties must be used to assist households with incomes at or below 120 percent of area median income. There is an additional requirement that 25 percent of the funds be used for households with incomes at or below 50 percent of area median income.

There are materials on the HUD website that provide examples of how to satisfy these requirements assuming that the 120 percent and 50 percent criteria can be documented. If income limits decline after the criteria have been properly documented, as could happen in the absence of a hold-harmless policy, NSP grantees in these areas would be in violation of the NSP requirements.

Even prior to identifying and documenting the incomes of eligible households, NSP grantees must make plans to distribute grants based on a perception of the pool of eligible households and what they can afford to pay for housing. If either of these parameters were to shrink as the result of declining income limits, plans for the use of NSP grants may be disrupted.

As far as we have been able to determine, none of the issues that a temporary decline in income limits would cause in the NSP have been addressed in Federal Register notices or materials posted on the HUD website. Until this has been done, or the NSP has run its course, it would be premature to remove a general hold harmless policy from the income limits.

Timing Issue: Income Limits in 2011

The disruptions that a temporary decline in income limits may cause in the various housing programs discussed above will be exacerbated if the hold harmless policy is eliminated prior to a year of generally declining median income estimates.

In conjunction with the Federal Register notice on the elimination of the hold harmless policy, HUD published a table of areas where income limits would have been different in 2009 had the hold harmless policy not been in effect. However, neither this table nor an estimate of the likely impact of the hold harmless policy on 2010 income limits addresses the timing issue of greatest concern; that is, the likely impact of the removal of the hold harmless policy on 2011 income limits.

This timing issue results from the conjunction of the method HUD uses to compute income limits, the way the Census Bureau constructs the underlying data, and the peculiar macroeconomic circumstances that prevail at present.

At present, HUD bases income limits primarily on three-year American Community Survey (ACS) estimates. The ACS is the replacement for the data previously collected in the decennial Census long-form questionnaire, which has been discontinued. However, it takes several years for the ACS to cover as large a sample as the decennial Census long form, which has led the U.S. Census Bureau to produce multi-year ACS estimates based on data accumulated over more than one year. To adjust income for inflation across years, the Census Bureau applies the annual changes in the overall Consumer Price Index (CPI), so that the changes in three-year ACS estimates are based two-thirds on the change in the CPI and one-third on new income data.

If HUD continues to apply its current methodology, 2010 income limits will be based on the 2006-2008 ACS estimates, and the 2011 estimates will be based on the 2007-2009 ACS estimates. Largely because of the relatively high rate of overall inflation in 2008 (the annual CPI increased by 3.8 percent, the largest one-year change in this measure since 1991), removal of the hold harmless policy at this time would likely have only a minimal effect on 2010 income limits.

However, 2009 has been an atypical year, combining what may be the most severe recession since the 1930s with a general deflationary trend. Although the annual 2009 CPI measure is not yet available, the year-over-year changes in the monthly CPI have been persistently negative (for the first time since 1955), and seven of the nine seasonally adjusted monthly CPI numbers posted so have been below the annual CPI for 2008. A weak or even negative CPI adjustment combined with new income data from a recession year have a strong potential to produce widespread declines in the next release of three-year ACS estimates, and therefore in 2011 income limits.

In other words, removing the hold harmless policy at this time is likely to have little effect on 2010 income limits but produce large declines in 2011 that many industry stakeholders may not anticipate and therefore be ill-prepared for.

Conclusion

For all the reasons noted above, we believe that a decision to discontinue the hold harmless policy on Section 8 income limits at this time would be premature and we urge HUD to address the issues our organizations have outlined before taking further action.

Again, we greatly appreciate the opportunity to comment on the value of the hold harmless policy with respect to Section 8 income limits. We look forward to further collaborating with HUD in the future toward the goal of providing safe, decent, and affordable housing for all Americans. If you have any questions about our organizations' comments, please contact Paul Emrath (202-266-8449, pemrath@nahb.com) or Claudia Kedda (202-266-8352, ckedda@nahb.com

Sincerely,

American Association of Homes and Services for the Aging (AAHSA)
Council for Affordable Rural Housing (CARH)
Institute for Real Estate Management (IREM)
National Affordable Housing Management Association (NAHMA)
National Association of Affordable Housing Lenders (NAAHL)
National Association of Home Builders (NAHB)
National Leased Housing Association (NLHA)
National Multi Housing Council (NMHC) and National Apartment Association (NAA)