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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION

IN REPLY
REFER TO:

[Ineligible Households in Assisted Housing Projects]

AUG 21 1980

The Honorable Lawrence B. Simons
Assistant Secretary for Housing-
Federal Housing Commissioner
Department of Housing and
Urban Development

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Dear Mr. Simons:

In our current review of the cost-effectiveness of section 8 partially assisted projects we have observed a problem that we believe warrants your attention. This is the practice of some section 8 project owners who are leasing units, for which section 8 assistance is available, to market rate tenants rather then section 8 eligible households. The problem affects both partially and fully assisted projects. Although leasing to such ineligible market rate households is permissible under the section 8 regulations, we believe the current policy and procedures relating to their inclusion in assisted housing could be improved. As you know the Department of Housing and Urban Development recently (1) lowered to 10 percent the percentage of "assisted units" in any project which can be rented to households who are ineligible for section 8, and (2) developed new sanctions for dealing with project owners who fail to comply with the 10 percent limitation. We agree with these changes but feel that some additional measures are needed.

Since HUD is currently making revisions to certain of the regulations applicable to section 8 and rewriting the section 8 contract forms, we believe you should consider,

1) further lowering the percentage limitation on ineligible households to 5 percent, with no exception for partially assisted projects,

2) issuing explicit enforcement guidelines for use by HUD area offices in dealing with project owners who exceed the limitation on ineligible households and

3) making the new percentage limitation on ineligibles applicable to completed projects for which the earlier 20 percent limitation is still in affect.

~~Letter Report~~ Group III

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Our limited data collection indicates a significant number of projects in which ineligible households meet or exceed the current applicable limits on occupancy by ineligibles. But regardless of how widespread or how limited the problem may be at present, we believe our findings warrant your attention because of the potential for greater occupancy by ineligible households in the future, and what may be a growing trend in some areas toward partially assisted projects, to which market rate tenants are much easier to attract.

We are therefore raising this issue now so that HUD can take action as early as possible and so that we can get your reaction before performing additional field work to establish the extent of the problem nationwide. A detailed explanation of our reasoning and further discussion of our views follows.

TWO OBJECTIONS TO THE POLICY OF LEASING TO INELIGIBLE HOUSEHOLDS

Objections to the exception allowing ineligible households to occupy section 8 can be made on at least two grounds. First, occupancy of section 8 contracted units by ineligible tenants probably frustrates the intent of the program by causing the program to fall short of its assistance goals, even though the money to achieve more has been made available by Congress. Second, the cost-effectiveness of the program is degraded since indirect subsidy costs which are incurred regardless of who occupies the housing units, must be counted against a lower number of assisted households.

THE IMPACT OF ALLOWING INELIGIBLE HOUSEHOLDS TO OCCUPY SECTION 8 UNITS

In order to assess the impact of the policy allowing ineligible households we looked at data on occupancy provided by three HUD area offices. In the Los Angeles area office the data was taken from the Management Information System and included a significant number of projects for which no data were recorded. We decided that information from that office was inconclusive. In the other two area offices, Chicago and Detroit, we estimate that at least 1000 units and 400 units, respectively, were occupied by households ineligible for section 8.

In Chicago 86 percent of all uninsured section 8 units were housing eligible section 8 households. Allowing for 3 percent vacancies among contracted units we can conclude that about 11 percent (or 950 units) of the roughly 8900 new or substantially rehabilitated units for which section 8 assistance is available are leased to ineligible households. This overall statistic is made up of projects exhibiting a wide range of variation in the percentage of assisted units occupied by eligible households. (See Table 4.) One small project has had only 1 assisted household during several years of operation and presently houses no eligible tenants. Another project approved for occupancy by 164 assisted households has never exceeded 50 section 8 eligible households. Several partially assisted projects have consistently rented roughly half of the number of units planned for assisted households to market rate households.

One partially assisted project which seemed to be limiting the number of assisted households to about half of those authorized had an extremely high overall vacancy rate of nearly 17 percent. These vacancies could have been eliminated if all units under HAP contract were leased to assisted households. Several of these partially assisted projects, which underuse the available section 8 assistance are in the City of Chicago which has among the longest section 8 and public housing waiting lists in the nation. (See Table 6.) Other uninsured projects housed only eligible section 8 households. The limited number of FHA insured projects in Chicago which are in operation are generally fully assisted and house only eligible tenants.

In the Detroit area office we obtained data on uninsured projects only, since it was more readily available and we were told that the FHA insured projects would generally follow the pattern noted in Chicago. Seven percent of all uninsured units covered by section 8 assistance contracts monitored by the Detroit area office house unassisted households. At the end of June there were 6987 assisted units under lease of which 6563 were leased to eligible households, leaving 424 units leased to market rate households. (See Table 5 for examples of particular projects.)

In both area offices a large number of units which could have served assisted households went to households who were never envisioned as section 8 recipients. Meanwhile the funds to subsidize at least 1400 households went unused.

THE ISSUE OF ECONOMIC INTEGRATION

Our argument that the production goals of the program are frustrated by ineligible occupancy is not inconsistent with another stated program goal--economic integration. This is because economic integration is to be served by developing partially assisted projects and by favoring locations which provide a deconcentration of low income households. Once HAP contracts are signed, the number and location of assisted units have been fixed. Economic integration among the assisted units should be achieved by selecting tenants across the "eligible" income spectrum. The regulations even allow for the inclusion of households whose incomes are initially low enough to qualify, but increase to the point where they would no longer qualify. What we are arguing against is the use of units already ear marked for assisting low income households to house middle income households. For example, if a partially assisted project with 20 percent of its total units designated as assisted, fails to achieve this 20 percent assisted occupancy, the goal of economic integration is damaged since fewer households than planned, are housed in the integrated environment. On the other hand a fully assisted project which has say 15 percent of its units leased to market rate households still has a high concentration of low income families.

Project owners wishing to develop a more viable tenant population by attracting a wide income range among a projects residents, can do so within the eligible section 8 population. Eligiblity currently ranges up to 80 percent of area median income for a family of four, while the average income of section 8 households is much lower, with the bulk of eligible households nationwide being below the poverty threshold.

THE COST OF THE POLICY

The potential cost of allowing ineligible households to occupy section 8 contracted units is quite large. This is because the indirect subsidy costs for the unutilized units, such as HUD administrative costs, the GNMA TANDEM discounts and tax expenditures (where tax exempt bonds are used), are incurred on behalf of ineligible households. These are in effect the hidden costs of providing assisted housing and when they are added to the direct subsidies for assisted units the total subsidy per assisted unit is substantially higher than if all assisted units serve eligible households. This higher cost is illustrated by the calculations in Table 1, which show the possible consequences of leasing 10 and 20 percent of contracted units to ineligible households. The calculations are based upon an FHA financed project where GNMA purchases the mortgage and sells it at a discount. We estimate that allowing 10 percent of such units to be leased to ineligible households increases the subsidy to assisted households by $820 for 20 years of operation. If this additional expense were incurred to subsidize 500,000 units the additional cost occasioned by allowing ineligible households to occupy section 8 units would be $410 million.

Another way of viewing the cost of the new 10 percent allowance for ineligible households is that for every 100,000 units financed under the new regulations with FHA TANDEM loans, 10,000 units (10%) will receive large per unit TANDEM subsidies, yet need never house subsidized tenants. Using the TANDEM subsidy cost figures shown in the footnotes to Table 1, we calculate a potential expenditure of $68,000,000 without any program benefits. This amount of money if applied directly to the purchase of multifamily housing could provide 2,000 dwelling units at $34,000 per unit. Although these illustrations are based on FHA financing, certain indirect costs would be incurred under any section 8 financing mechanism, and in those involving tax exempt mortgage bonds, the potential costs of misutilizing units would be even greater.

Both these cost calculations assume that all units subject to the exemption for ineligible households would actually house market rate tenants. This is very likely unrealistic, yet with a tight rental market throughout major portions of the U.S. and no relief in sight, the pressure for an increase in market rate tenant occupancy is probably quite strong. The cost estimates also show only one of the major subsidies which can be increased when units do not serve the intended beneficiaries and are based upon unit costs which are much lower than those we can expect to experience in the future.

THE PERCENTAGE OF ALLOWABLE INELIGIBLE HOUSEHOLDS COULD BE REDUCED

The exception for ineligible households could be further reduced from 10 percent to 5 percent for fully assisted section 8 projects and eliminated altogether for projects where fewer than half of the total units in the development are under section 8 contracts. This would result in greater availability to needy tenants while reducing the total subsidy cost per household assisted.

Our understanding of the ten percent exception is that it provides leeway to avoid unnecessary administrative problems in granting case-by-case exceptions any time a unit was leased to an ineligible tenant for unavoidable reasons. For example, a tenant might, after a period of time, go over income yet wish to remain, which the program allows.

We believe a 5 percent limit would allow this for even the smallest projects while insuring that if it happens repeatedly, the project owner would have to notify HUD and ask for permission.

For partially assisted projects where the owner already may have significant leeway in choosing market rate versus assisted households each time a vacancy arises, we see no need for the exception. We noted in our limited data collection that for projects with less than half of the units under section 8 assistance contracts, there seemed to be a greater likelihood that market rate tenants would occupy units for which assistance was available.

ENFORCEMENT GUIDELINES ARE NEEDED

With the adoption of the new regulations which were effective in November 1979, HUD now has a number of explicit sanctions for dealing with landlords who lease more than 10 percent of their assisted units to ineligible households. HUD may sue for specific performance of contract terms, suspend or debar the owner from HUD programs or, as in the past, reduce the number of units under section 8 contracts. It would therefore seem to be an opportune time to issue clear guidelines to regional and area office personnel, spelling out acceptable limits within which they should expect project owners to comply, time periods for coming into compliance and a set of procedures which should be followed in enforcing compliance when necessary. To our knowledge no such guidelines exist even though the past HAP contracts probably provided sufficient authority for HUD to take a variety of actions against non-complying project owners, in addition to the reduction in contract units spelled out in the old regulations. Several field office personnel we spoke with felt this reduction in units was their only recourse and were reluctant to use this sanction at any rate. We agree with this view since reducing the contract units has the effect of making permanent the loss of subsidized units.

To make sure that this reluctance to enforce the limitation on ineligible households does not persist in the future, we believe an explicit policy statement and specific guidelines on enforcement would be very effective. Better enforcement would be particularly important if our limited research, which showed that a minority of the projects accounted for most of the ineligible tenants, proves true in other areas of the country.

RETROACTIVITY TO PAST SECTION 8 CONTRACTS SHOULD BE EXPLORED

We believe that HUD should carefully explore the possibility of making the lower limitation on ineligible households retroactive to past section 8 development. This should be done now even if further investigation indicates that it does not appear to be a nationwide problem.

By the end of 1979, more than 5000 section 8 projects, with in excess of 425,000 assisted units, had been started under the new construction and substantial rehabilitation portions of the program. Nearly all these units are covered by the earlier regulations allowing up to 20 percent of all contracted section 8 units to be leased to ineligible tenants. Since all these units included non-recoverable indirect tax and financing related subsidies, the bulk of the program has the potential of being only 80 percent effective but at much higher subsidy costs per unit than anticipated.

We do not have the statistics to make an accurate estimate of the current nationwide situation since the section 8 occupancy data is of uncertain and varying quality and extensive field work would be necessary. Nor can we predict the extent to which section 8 owners will tend to admit ineligible (market rate) households in the future. What is certain is that the incentives to do so, and the market forces which make it possible will increase as the cost of housing grows and the scarcity of quality rental housing becomes more prevalent. If this problem develops to the point where many section 8 owners come to rely on ineligible households as a significant part of their tenancy, then the political difficulty of making a retroactive change will increase proportionately.

Such a change is very likely possible and practical since it passes two sensible tests for a retroactive policy adjustment. First it would buttress the original intent of the program by maximizing the service of the program to the intended beneficiaries. Second, it would not cause any undue hardship on section 8 project owners who, afterall, contracted initially to house section 8 eligible households. The change would merely reinforce the government's consistent position that assisted units should serve eligible households--that is, the change is reasonable given the purpose of the original assistance contract and the favorable financing terms afforded housing developers. Section 8 owners would still have the ability to serve a broad range of income eligible households under current eligibility rules if their motivation in admitting ineligible households has been to provide economic integration.

SUMMARY

Program changes to reduce the impact of the exception for ineligible households in section 8 housing projects could enhance the programs impact, increase its service to needy households, and reduce its per unit subsidy costs while having no apparent adverse affect on the owners and operators of section 8 housing or the programs intended beneficiaries.

We hope that our thoughts on this matter will prove useful and constructive and would appreciate it if you would advise us of actions you intend to take in response to this problem. Should you have any questions on this matter or the contents of this report we would be glad to discuss them with you or your staff. If so you can call me or Mr. William Gainer the team leader on this work at 426-1645.

Sincerely yours,

Richard J. Woods

Richard J. Woods
Associate Director

TABLE 1

Annual Section 8 Subsidy Costs 1/
(per assisted unit)

	100 PERCENT OCCUPANCY BY ELIGIBLE HOUSEHOLDS	90 PERCENT OCCUPANCY BY ELIGIBLE HOUSEHOLDS	80 PERCENT OCCUPANCY BY ELIGIBLE HOUSEHOLDS
Section 8 Assistance 2/	$3,254	$3,254	$3,254
TANDEM Discount 3/	338	375	423
HUD Administrative Costs	40	44	50
Yearly Subsidy	3,632	3,673	3,727
Twenty Year Total	$72,640	$73,460	$74,540

	73,460	74,540
	-72,640	-72,640
Differences	820	1,900

Although these potential cost differences of $820 and $1,900 per unit may not seem significant, they are when we consider the large number of section 8 units covered by the earlier 20 percent exception for ineligible households, and to be developed in the future under the 10 percent exception. Extending those per unit costs to half a million units (or roughly 5 years production) the potential cost of underutilizing assisted units can be calculated at $950 million and $410 million respectively for 20 years of program operation. Since some projects which are already in operation will be sold or converted to private use before 20 years of use the actual cost of assisting households will be even higher. By lowering the percentage of ineligible occupancies allowable to 5 percent, and carefully enforcing this limitation, ineligible occupancy could probably be limited to 3 percent or less, since many projects are currently occupied entirely by eligible households. The cost of having 3 percent ineligible occupancies for an assisted stock of 500,000 units and a 20 year period of operation would be roughly $100 million.

Footnotes to Table 1

1/Based on FHA insured financing. Shown here are the direct section 8 subsidy plus the TANDEM subsidy which GNMA pays when it buys the below market interest rate loan from the original lender and resells it at a loss. There are also subsidy costs such as tax expenditures which are not estimated here for the sake of simplicity. State financed and section 11(b) produced units also incur large indirect subsidies due to the tax exemption for interest paid on lower income housing bonds.

2/The direct subsidy is based on the mortgage amount, interest rate, operating cost and tenant income shown in Tables 2 and 3. The data reflects an average non-elderly unit which went into construction in 1978 and completed construction in January 1980.

3/TANDEM subsidy is based upon the sale by GNMA of 7.5 percent project mortgages when the market interest rate is between 11.5 and 12.5 percent. It is drawn from a prepayment schedule of 40 year term mortgages prepaid at 20 years. Purchasers receive a yield of 11.4 percent on the mortgages and GNMA receives 70.4 percent of the mortgage balance. The loss is figured by subtracting the GNMA fee and discount from the mortgage amount and calculating the difference between GNMA's net price of 95.5 percent and 70.4 percent, times the mortgage amount of $27,000. This results in a one-time subsidy of $6,777 or a per year cost of $339 per year based on 20 years of subsidized operation. This is based upon a GNMA auction which occured in early 1980.

Table 2

Annual Gross Rent
Two Bedroom Apartment
FHA TANDEM

Total Development Cost	30,000
Mortgage Amount	27,000
Interest Rate	7.5%
Mortgage Insurance Premium	.5%

Principal Interest & Insurance Premium (MIP)	2,255
Operating & Maintenance	1,354
Reserve for Replacements	115
Property Taxes	450
Cash Return (6% of stated equity)	180
Gross Rent	4,354

Table 3

Annual Direct Subsidy
Family of Four with Gross Income = $5,000

Gross Rent	4,354
Tenant Contribution	1,100
Direct Subsidy	3,254

Table 4

Sample Of Projects From
The Chicago Area Office
Showing The Range
Of Compliance

	Units Under Effective HAP Contract	Units Under Lease	Units Leased to Eligible Households	Percentage Leased to Eligibles
Project A	5	5	0	0%
Project B	70	70	35	50%
Project C	231	231	69	30%
Project D	212	212	212	100%
Project E	79	79	79	100%
Project F	154	148	77	52%
Project G	210	210	210	100%
Project H	140	140	140	100%

Table 5

Sample Of Projects
From Detroit Area Office
Showing The Range
Of Compliance

	Units Under Effective HAP Contract	Units Under Lease	Units Leased to Eligible Households	Percentage Leased to Eligibles
Project A	170	170	170	100%
Project B	48	48	46	96%
Project C	266	266	252	95%
Project D	86	85	74	86%
Project E	246	245	184	75%
Project F	28	28	12	43%
Project G	132	130	38	29% *

* This project is staged and will eventually include 208 more units (200 elderly and 8 family). As it is anticipated that most of the elderly units will be leased to Section 8 eligible tenants, this percentage will increase to 70%

Table 6

Assisted Housing Waiting Lists
(Number of Households)

City	WAITING LISTS Public Housing	Section 8
Los Angeles	828	16,350
Houston	4,439	2,550
San Diego		8,019
San Francisco	8,000	3,000
Washington, D.C.	7,000	238
San Jose area		747
New Orleans area	8,000	980
Portland, Oregon area	2,306	461
Seattle	2,504	1,453
Denver	936	1,004
Minneapolis St. Paul area	2,048	1,948
Honolulu	2,023	2,201
Philadelphia area	12,933	6,425
Chicago	18,071	44,096
Oklahoma City area	1,097	275
Des Moines area	450	703
North Suburban, Ill	1,557	2,300
Harrisburg area	912	610
Dallas	5,586	1,446
New York, New York	55,500	90,000
Milwaukee area	5,767	5,969
Pensacola	259	504

Source: Congressional Record, June 20, 1980, Volume 126, Number 102, page S7626