United States General Accounting Office

GAO

Report to the Honorable
William S. Cohen,
U.S. Senate

March 1995

MULTIFAMILY HOUSING

Better Direction and Oversight by HUD Needed for Properties Sold With Rent Restrictions

GAO/RCED-95-72

GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-259672

March 22, 1995

The Honorable William S. Cohen
United States Senate

Dear Senator Cohen:

Between 1990 and 1993, the Department of Housing and Urban Development (HUD) began foreclosure on a large number of insured mortgages on multifamily properties that experienced financial, physical, or operating problems. To help carry out the legislative goal of preserving certain units as housing affordable to low-income households when these properties were sold to new owners, HUD had attached long-term rent subsidies directly to the properties. However, HUD was unable to promptly sell many of these properties because of a shortage of funds for the rent subsidies. To compensate for the funding shortages, HUD explored alternatives that would allow property sales without using the subsidies. Under one alternative, used on 62 properties thus far, purchasers agreed to restrict rents charged to low-income households to the same rents that these households would have paid under the HUD rent subsidy program—usually 30 percent of the household income.

As requested, this report focuses on HUD's procedures for implementing this rent-restriction alternative. Specifically, the report discusses (1) HUD's instructions to its field offices and to property purchasers on how the rent-restriction alternative should be implemented, (2) HUD's instructions to field offices on monitoring purchasers' compliance with rent-restriction agreements, and (3) the expected future use of this rent-restriction alternative.

Results in Brief

HUD has not provided clear and consistent instructions to its field offices or to property purchasers on how the rent-restriction alternative should be implemented. A particularly important inconsistency in HUD's instructions has been whether or not property owners must fill vacant units on a first-come, first-served basis. HUD required purchasers of about half of the 32 properties we reviewed to fill vacancies in this manner. Essentially, this practice ensured that the new property owners accepted low-income households regardless of how much rental income the owners received. HUD gave purchasers of other properties greater latitude in filling vacancies—essentially allowing them to exclude a household from their

rent-restricted units if the renter could not pay the full rent, either directly or through a rent subsidy assigned to the household.

HUD did not require its field offices to monitor property owners' compliance with rent-restriction agreements until July 1994, after we had discussed the matter with HUD officials. The officials said that they had placed a low priority on establishing monitoring requirements because relatively few properties had been sold with rent restrictions. In July 1994, HUD provided field offices with interim monitoring instructions and directed them to review compliance at properties containing more than 20 rent-restricted units. The field offices determined that 14 of the 16 properties reviewed were in compliance as of November 1994.

Even though HUD had planned to issue instructions clarifying program requirements, it had not established a time frame for doing so. However, the agency's January 1995 comments on our draft report indicated that revised use agreement riders detailing purchasers' obligations for meeting rent-restriction requirements would be available for use in sales contracts by April 1, 1995, and that revised monitoring instructions would be issued to its field offices by May 1, 1995.

HUD officials believed that changes authorized by new property disposition legislation enacted in April 1994 are likely to diminish the agency's use of the current rent-restriction alternative.[1] A key change authorized in the new legislation is that, in many cases, occupants of rent-restricted units may be required to pay rents computed as a percentage of the area median income rather than as 30 percent of their own adjusted household income. In response to our draft report, HUD said that its new use agreement riders and revised monitoring procedures will reflect rent-restriction alternatives authorized under the new law.

Background

HUD provides mortgage insurance on more than 13,000 privately owned multifamily properties under various programs designed to help low- and moderate-income households obtain affordable rental housing. In recent years, HUD had experienced a significant growth in the number of defaulted multifamily mortgages because of financial, operating, or other problems. As of July 1993, HUD held more than 2,400 mortgages with unpaid principal balances totaling about $7.5 billion, more than 2,000 of which were assigned to HUD as a result of default.

[1]Multifamily Housing Property Disposition Reform Act of 1994 (P.L. 103-233, Apr. 11, 1994).

HUD's Federal Housing Administration (FHA) insures mortgage lenders against financial losses in the event owners default on their mortgages. When a default occurs, a lender may assign the mortgage to HUD and receive an insurance claim payment from the agency. HUD then becomes the new lender for the mortgage. HUD's policy is to attempt to restore the financial soundness of the mortgage through a workout plan. If a workout plan is not feasible, HUD may, as a last resort, initiate foreclosure in order to sell the property and recover all or part of the debt. If HUD is unsuccessful in selling a property at a foreclosure sale, it may acquire ownership of the property. HUD retains these properties in its "HUD-owned inventory" until it can sell or otherwise dispose of them.

The Housing and Community Development Amendments of 1978 (12 U.S.C. 1701z-11), as amended, required that in disposing of properties, HUD preserve a certain number of units as affordable housing for low-income households.[2] To accomplish this requirement and to ensure that units remain affordable to eligible households,[3] HUD normally uses a federal rental subsidy program called section 8 project-based assistance. Under this program, households do not have to pay more than 30 percent of their adjusted income for rent. Through contracts with HUD, owners are then reimbursed the difference between a unit's rent and the portion paid by the renter.

HUD's ability to sell a large number of foreclosed properties while preserving affordable units for low-income households was significantly impeded by a shortage of federal funds needed to support section 8 project-based contracts.[4]

[2]The act established preservation goals based on conditions that exist at the time HUD pays off the mortgage. All units should be preserved in properties receiving a HUD subsidy—such as below market interest rate loans—or receiving housing assistance payments for more than 50 percent of their units. For properties not meeting these criteria, but occupied by some unassisted households who had incomes qualifying them for rental assistance, the number of units preserved can be limited to the number of households qualifying for rental assistance. The Multifamily Housing Property Disposition Reform Act of 1994 authorized new preservation alternatives in order to make it easier for HUD to dispose of properties. As of December 1994, HUD was in the process of issuing implementing regulations.

[3]To be eligible, a household's annual income, adjusted for family size, must be at or below 80 percent of the median income for the area.

[4]In our May 1993 testimony before the Subcommittee on Housing and Community Development, House Committee on Banking, Finance and Urban Affairs, we reported that HUD would need as much as $3 billion in section 8 funding to dispose of the 440 properties in its inventory or foreclosure pipeline at the end of fiscal year 1992 but that it was appropriated only $93 million for this purpose in fiscal year 1993. Multifamily Housing: Impediments to Disposition of Properties Owned by the Department of Housing and Urban Development (GAO/T-RCED-93-37, May 12, 1993).

As a result, in some cases, HUD assumed ownership of the properties rather than sell them to other purchasers at foreclosure sales. HUD then operated these properties until funding for section 8 was available.

To facilitate the sale of some properties, in 1991 HUD started using alternatives to providing section 8 project-based assistance that were allowed by the property disposition legislation. These alternatives included getting the purchaser to agree to keep the required number of units available and affordable to lower-income persons for 15 years and to charge occupant households no more than 30 percent of their income for rent. Under this procedure, HUD required new owners, as well as any subsequent owners, to set aside the same number of units that they would have been required to allocate for the section 8 program. Purchasers agreed to fill these rent-restricted units with tenants meeting the same household income eligibility criteria as used in the section 8 program. Use of the rent-restriction approach was limited to properties that, at the time HUD paid off the mortgage lender, were not receiving any HUD subsidy (such as a below market interest rate loan) or were receiving rental assistance payments for fewer than 50 percent of their units.

HUD generally assumes that because occupants will pay no more than 30 percent of their adjusted household income toward the rent, the owner's rental income would be reduced on the rent-restricted units. Accordingly, HUD adjusts the minimum bid prices it is willing to accept on the properties downward to the point that the properties should have a positive cash flow even if the owner received no rental income on the rent-restricted units.[5] Because rent-restricted units can reduce a property's cash flow, HUD has found that the rent-restriction procedure is usually financially feasible only when a relatively small proportion of a property's total units (usually no more than 10 percent) have rent restrictions.

Through December 1994, HUD had used the rent-restriction alternative in the sale of 62 properties, or about 17 percent of the properties sold. The 62 properties contained 10,595 units, of which 1,344 were rent-restricted units.

[5]The properties are sold to the highest bidder, generally for prices that exceed the minimum acceptable bid. According to HUD property disposition officials, the minimum acceptable prices are used internally and usually are not disclosed to the public.

Lack of Uniform Instructions Led to Different Rent-Restriction Requirements

HUD's instructions for disposing of multifamily properties did not provide HUD field offices or purchasers of HUD properties with clear directions for implementing the rent-restriction alterative. Field offices therefore made different judgments as to what requirements should apply—particularly whether or not properties should be subject to certain rules and practices that had been used in connection with the section 8 project-based rental assistance program. Consequently, field offices incorporated different, sometimes conflicting, requirements into sale documents and accompanying deed restrictions.

Rent-Restriction Instructions Were Not Uniform

HUD first issued instructions for implementing the rent-restriction approach as part of a July 1991 notice prescribing procedures that field offices were to use in selling defaulted mortgages at foreclosure sales. (These instructions did not apply to sales of HUD-owned properties.) The notice described the conditions under which rent restrictions could be used, the length of time the restrictions were to remain in effect at each property, and the limitations on tenants' rents. The notice also included two, slightly different standard-use agreements that HUD used in writing sales contracts for properties sold at foreclosure. One agreement was to be included in sales contracts when HUD was also requiring that the purchaser perform repairs to a property after the sale; the other was to be used when HUD was not requiring the purchaser to perform post-sale repairs.

Both agreements required purchasers to maintain a specified number of units as affordable housing for 15 years and to limit what households pay toward rent to no more than what they would be charged under the section 8 project-based rent subsidy program. Both agreements also required purchasers to follow certain procedures that were required under the section 8 project-based program.

First, purchasers had to maintain waiting lists of eligible applicants and fill vacant restricted units on a first-come, first-served basis but give preference to applicants who were involuntarily displaced, living in substandard housing, or paying more than 50 percent of their household income for rent. Also, both agreements required purchasers to annually verify the income of households occupying restricted units using procedures similar to those used in the section 8 project-based program.[6] While neither of these procedures was specifically required by the

[6]This program requires property owners to use HUD's standardized rent-calculation forms in determining the level of adjusted household incomes and rent payments. In addition, owners are required to recertify household incomes annually to determine if rent payments need to be adjusted.

property disposition legislation, HUD field office officials believed that they were appropriate because they help ensure that proper controls are used in the management of rent-restricted properties. Moreover, several officials believed that the procedure for filling vacancies is beneficial because it can place more of the cost of providing affordable housing on property owners since it essentially requires the owners to accept low-income households on a first-come, first-served basis even if they would not pay the full rental cost.

The primary difference between the two agreements was that the agreement for properties without post-sale repair requirements stated that rent-restricted units could not be occupied by households that continued to possess a section 8 voucher or certificate after occupancy.[7] Several of the field office officials we talked with said that this requirement was appropriate because they believed that rent-restricted units were intended to serve unassisted households.

In September 1992, HUD issued instructions for the sale of HUD-owned properties. These instructions, however, differed from the 1991 instructions in that the use agreements only required that purchasers restrict rents on the specified number of units for 15 years and limit rents paid by the occupants to what would be charged under the section 8 project-based program. The use agreements did not require waiting lists or annual income verification procedures and did not prohibit occupancy by section 8 voucher or certificate holders. Thus the agreements gave purchasers greater latitude in filling vacancies—essentially allowing them to exclude a household from their rent-restricted units if the renter could not pay the full rent, either directly or through a rent subsidy assigned to the household.

In June 1993, HUD replaced the 1991 and 1992 instructions with instructions that applied both to properties sold at foreclosure and to HUD-owned properties. The use agreements included in the 1993 instructions were essentially the same as the 1992 use agreements with respect to requirements for rent-restricted units. The 1993 instructions

[7]The section 8 certificate and voucher programs are similar to the project-based program but attach rental assistance to a specific household rather than to a specific property. A household possessing a section 8 certificate pays 30 percent of its adjusted income for rent while HUD makes up the difference between that amount and the actual rent, which is approved by the local housing agency and which usually cannot exceed a "fair market rent" determined by HUD for a unit with the same number of bedrooms in the market area. The voucher program is slightly different in that an assisted household may elect to pay more or less than 30 percent of its adjusted income toward rent. HUD's subsidy, however, is generally equal to the difference between 30 percent of the household's adjusted income and a subsidy benchmark set by local or state housing agencies.

thus eliminated any specific requirements for (1) filling vacancies from waiting lists on a first-come, first-served basis; (2) verifying household incomes; and (3) prohibiting section 8 voucher and certificate holders from occupying rent-restricted units. Property disposition officials told us that these changes were made to reduce government regulation and to delegate more authority to field offices.

In September 1993, HUD's Office of General Counsel (OGC) specifically directed field offices to discontinue use of the 1991 use agreement that prohibited section 8 voucher or certificate holders from occupying rent-restricted units. Although field offices had approved sales contracts containing the 1991 use agreement, the OGC subsequently concluded that excluding voucher and certificate holders violated section 204 of the Housing and Community Development Amendments of 1978. (Section 204 prohibits property owners from unreasonably refusing to lease units to anyone simply because he or she held a section 8 voucher or certificate.)

HUD headquarters officials told us in November 1994 that the difference in use agreements for rent-restricted units since 1991 occurred unintentionally. The officials said that because of the relatively few properties sold with rent restrictions, they considered the instructions to be a low priority and thus had given them little attention. The officials said that there is no reason why requirements for rent-restricted units should differ because of the type of sale or because post-sale repairs are required.

The officials also told us that after discussing the lack of guidance with us in June 1994, HUD issued interim instructions to field offices in July 1994, advising them to direct owners to use waiting lists, annually certify household incomes, and not exclude section 8 voucher and certificate holders. Also, according to the officials, HUD will incorporate these specific requirements into new use agreements that the agency will develop to reflect the rent-restriction provisions of the Multifamily Housing Property Disposition Reform Act of 1994. The officials said that the revised use agreements should be completed after the regulations implementing the 1994 act are finalized. In its comments on our draft report, HUD said that new use agreement riders would be ready for field offices' use in sales contracts by April 1, 1995.

Different Requirements for Purchasers of Properties

HUD's inconsistent guidance has led to different requirements being used for owners of properties with rent-restricted units. In a review of 32 properties sold with rent restrictions from February 1993 through June 30,

1994, we found an equal split between properties with the more specific use agreements issued in 1991 and properties with the more general use agreements issued in 1992 and 1993. In six instances, however, the responsible field office had used the more specific 1991 use agreements during 1994, well after they had been replaced by the more general agreements in June 1993. We also found that several field offices were continuing to actively discourage purchasers from counting certificate and voucher holders toward satisfying rent-restriction requirements even after the OGC, in September 1993, advised them of section 204 and its applicability. HUD property disposition officials told us that they intended to give field offices flexibility to modify the 1993 use agreements on the basis of local preferences, but that field offices should not be discouraging voucher and certificate holders from occupying rent-restricted units.

The three properties we visited illustrate how HUD's waiting list requirements can influence the extent to which a property owner actually experiences reduced rental income because of rent-restricted units. Two of these properties were formerly HUD-owned and, therefore, were sold under the more general use agreements, without requirements for filling vacancies from waiting lists on a first-come, first-served basis. The third property was sold with a 1991 use agreement that specifically required use of a waiting list.

On-site managers at the two properties sold with the 1992 use agreement told us that they did not accept tenants in rent-restricted units unless the households also had a section 8 voucher or certificate or unless 30 percent of their adjusted income (i.e., what the tenant would have to pay) equalled the full rent. Households that did not have certificates or vouchers or that did not have the necessary income to pay the full rent were turned away.

In contrast, the third property was using a waiting list to fill unoccupied units. This particular 280-unit property had 55 rent-restricted units. Because the waiting list provided a systematic selection process, applicants were selected on a first-come, first-served basis. None of the 55 households residing in the rent-restricted units had vouchers or certificates or sufficiently high incomes; therefore, the owner was receiving less than the full rent on each of the units. According to data provided by the on-site management company, the property was receiving an average of $357 less than the full monthly rental income for each of the rent-restricted units.

HUD's Initiatives to Improve Oversight

Until recently, HUD headquarters' and field offices' actions to oversee compliance with the rent-restriction agreements were limited. However, in July 1994, HUD directed its field offices to review compliance at a number of selected properties. The field offices found that 2 of the 16 properties they reviewed had not fully complied with their rent-restriction agreements. The property owners disagreed, and HUD was reviewing the cases as of November 1994.

HUD did not issue instructions to its field offices for monitoring compliance with rent-restriction agreements until we discussed the matter with its property disposition officials in June 1994. The officials told us that they had not required field offices to monitor purchasers' compliance with rent-restriction agreements because they considered this to be a low priority, given the relatively small number of properties that had been sold with rent restrictions. However, the officials agreed that some form of oversight was needed.

HUD issued a memorandum in July 1994 that required field offices to perform a one-time on-site compliance review at each property having more than 20 rent-restricted units. The agency also provided general guidelines for monitoring compliance and a checklist to use during the review. The memorandum also stated that HUD was considering various alternatives and would later provide instructions for the long-term monitoring of projects to ensure that they remain in compliance with the terms and conditions of the use agreements under which they were sold. According to HUD officials, these instructions were to be prepared after the field offices completed the initial compliance reviews.

Field offices were directed to complete their compliance reviews by August 15, 1994. However, because the July 1994 memorandum did not require the field offices to formally report the results of the reviews to HUD headquarters, a second memorandum was issued in September 1994 that extended the time for completing and reporting on the reviews until October 1994.

The results of the compliance reviews were reported to HUD headquarters in October 1994. In all, 25 properties containing a total of 949 rent-restricted units met the criteria to be reviewed (i.e., they contained 20 or more rent-restricted units). However, reviews at 9 of the 25 properties were postponed for several months because the properties had only been recently sold and had not yet had time to fully implement their rent-restriction procedures. The field offices determined that 14 of the

remaining 16 properties complied with the provisions of their use agreements and that 2 properties were not in compliance. As of November 1994, HUD was reviewing these two cases to determine what actions, if any, should be taken. HUD property disposition officials said that they were satisfied with the overall compliance found to date.

HUD property disposition officials told us that the agency had planned to develop instructions to field offices for the long-term monitoring of owners' compliance with rent-restriction agreements, but as of December 1994, they did not have a specific target date for issuing them. In commenting on our draft report, HUD said that it would issue revised monitoring procedures to its field offices by May 1, 1995.

Future Use of Existing Rent-Restriction Requirements

In April 1994, the Congress enacted the Multifamily Housing Property Disposition Reform Act (P.L. 103-233), which revised the procedures HUD may use to dispose of multifamily properties. Although rent-restriction agreements are likely to continue as an important aspect of HUD's multifamily property disposition activities, future use of the current rent-restriction alternative is likely to decrease.

The act authorizes HUD to use rent restrictions as a means of complying with a number of its requirements (such as ensuring that units in certain properties that do not receive project-based section 8 assistance remain available and affordable to low-income families). The act gives HUD broad discretionary authority to use rent restrictions and to discount sales prices in order to meet the act's property disposition goals. The act also established an additional way to determine the maximum amount that occupants of rent-restricted units have to pay toward rent. Occupants can be required to pay a percentage of the median income in the local area, instead of a percentage of their household income. This could increase the amount that some households with low incomes pay toward rent.

HUD officials told us that while the previously used rent-restriction agreements may still be used under the 1994 act, they believe that the need to use them in future sales may be limited. Instead, HUD is likely to use rent-restriction agreements that base tenants' rent payments on a percentage of the area's median income. The officials also noted that the need for the previous agreements will be diminished at least through fiscal year 1995 because larger amounts of section 8 funding have been appropriated (approximately $550 million in fiscal year 1995 compared with $93 million in fiscal year 1993).

As proposed in our draft report, HUD recently established a firm schedule for prompt issuance of instructions implementing the new rent-restriction options that it plans to use in carrying out the 1994 legislation. In its comments on our draft report, HUD said that new use agreement riders reflecting the 1994 legislation would be available for use in sales contracts by April 1, 1995, and that its revised monitoring instructions, scheduled for issuance by May 1, 1995, would include revisions to reflect the 1994 legislation.

Conclusions

HUD has not (1) provided its field offices nor purchasers of HUD multifamily properties with clear instructions on the procedures owners must follow in managing properties subject to rent restrictions or (2) established long-term requirements specifying how field offices should oversee owners' compliance with agreed-upon use restrictions. As a result, HUD has placed inconsistent requirements on property owners and, until recently, had not required field offices to oversee owners' compliance.

HUD has acknowledged that it did not provide field offices and property owners adequate instructions when the rent-restriction approach was implemented. Although HUD had planned to clarify property management requirements and issue instructions to field offices for the long-term monitoring of properties with rent-restriction agreements, it did not have a definite time frame for completing these actions. However, in response to our draft report, HUD said that it would have revised use agreement riders, which detail purchasers' obligations for meeting rent-restriction requirements, ready for field offices to use in sales contracts by April 1, 1995. HUD also said that it would issue revised monitoring procedures to its field offices by May 1, 1995.

According to HUD officials, the agency will require owners to maintain waiting lists and to fill vacancies from the lists on a first-come, first-served basis. This requirement should increase the availability of future rent-restricted units to households that are not already receiving federal rent assistance by preventing owners from purposely filling vacancies exclusively with holders of section 8 vouchers and certificates.

While it is unclear to what extent the previously used rent-restriction agreements will be used in the future, rent restrictions will be a key tool for HUD to use in meeting the requirements of new property disposition legislation enacted in April 1994. HUD plans to soon have available new use agreement riders and monitoring instructions that reflect the additional

rent-restriction options it will use in implementing the 1994 act. As was the case with previous rent restrictions, the effectiveness of future restrictions will depend, in part, on how effectively the new riders communicate the procedures owners must follow in managing rent-restricted properties and on the adequacy of the new monitoring instructions.

Agency Comments and Our Evaluation

In its comments, HUD said that we correctly pointed out the problems it had experienced in developing procedures to implement the rent-restriction approach but noted that there have been relatively few properties and units sold with rent restrictions. Through its comments, HUD implemented the recommendations that we proposed by establishing a firm schedule for (1) clarifying procedures that owners must follow in managing rent-restricted units, (2) clarifying procedures field offices are to use in monitoring owners' compliance, and (3) establishing similar procedures for new rent-restriction options that the agency will use to carry out requirements of the Multifamily Housing Property Disposition Reform Act of 1994. Accordingly, this report makes no recommendations, and it has been revised to reflect HUD's additional actions. We plan to monitor HUD's issuance of the revised procedures and ensure that the revisions adequately address the problems that we found. (See app. I for the complete text of HUD's comments.)

Scope and Methodology

To evaluate HUD's instructions and compliance monitoring, we reviewed applicable laws, regulations, and procedures concerning the rent-restriction approach and analyzed information and data provided by HUD on properties sold with rent restrictions through December 31, 1994. We discussed the implementation of the rent-restriction approach with officials from the Office of Preservation and Disposition and the Office of General Counsel at HUD headquarters in Washington, D.C., and with corresponding officials at field offices in Denver, Colorado; Jacksonville, Florida; Atlanta, Georgia; Kansas City, Kansas; St. Louis, Missouri; Greensboro, North Carolina; and Fort Worth and Houston, Texas. Through June 30, 1994, these eight field offices were responsible for selling about 60 percent of the rent-restricted properties. We also visited three properties that were sold with rent restrictions, obtained and analyzed information on their rent-restriction procedures, and interviewed property owners and on-site staff.

To determine the expected future use of rent restrictions, we (1) reviewed the provisions of the Multifamily Housing Property Disposition Reform Act

of 1994, (2) determined what changes the act makes in HUD's authority for establishing rent restrictions, and (3) discussed with property disposition officials HUD's plans for implementing the act.

We conducted our review from May through December 1994 in accordance with generally accepted government auditing standards.

As arranged with your office, unless you publicly announce it contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies to the Secretary of Housing and Urban Development. We will also make copies available to others on request.

Please contact me at (202) 512-7631 if you or your staff have any questions. Major contributors to this report are listed in appendix II.

Sincerely yours,

Judy A. England-Joseph
Director, Housing and Community
Development Issues

Comments From the Department of Housing and Urban Development

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

JAN 31 1995

Ms. Judy A. England-Joseph
Director
Housing and Community Development Issues
General Accounting Office
Washington, DC 20548

Dear Ms. England-Joseph:

I am writing in response to your Draft Report, "MULTIFAMILY HOUSING: Better Direction and Oversight Needed for Properties Sold with Rent Restrictions."

Prior to enactment of the Multifamily Housing Property Disposition Reform Act of 1994 (the MHPDR Act of 1994), Section 203 of the Housing and Community Development Amendments of 1978, as amended (the Act), required that, upon foreclosure of a multifamily project with a HUD-held mortgage or sale of a HUD-owned multifamily project, the maximum rent for preexisting lower-income families could not exceed that which would be paid if the family were to be provided Section 8.

As you know, for several years prior to FY94, HUD did not receive a sufficient allocation of Section 8 to assist all families who were eligible for such assistance. Absent this resource, in an effort to reduce HUD costs and return projects to the private sector, HUD implemented Section 203(d)(3) of the Act. Under that Section, HUD sold projects without Section 8 but with use restrictions which required units occupied by such families to be preserved for low- and moderate-income families. HUD determined that the market price HUD received at foreclosure or HUD-owned sale would reflect these affordability restrictions and that preservation would continue in accordance with statute.

As you correctly point out in the Draft Report, there were problems in the procedures HUD developed while implementing this sales effort. HUD had been addressing these problems as they became known and subsequently issued a memorandum to the field on July 15, 1994 that comprehensively addressed the problems.

Before I address your specific recommendations, I want to place the problems in their proper context. As of October 1994, the number of units preserved using this procedure totaled only 1344 units in 62 projects. The projects contain a total of 10,595 units. The units in question represent less than 13 percent of the units in the projects sold with affordability restrictions. Moreover, even in the 1344 units that are the focus of your Draft Report, all of the families living in the units sold with affordability restrictions are families that are Section 8 income eligible.

I would also like to note that had HUD held the units in inventory waiting for Section 8 appropriations rather than sell them with affordability restrictions, the holding cost to the government would have averaged anywhere from $7 to $10 a unit per day. Assuming HUD would have held the 62 projects off market for two years (a conservative estimate of holding time in inventory during this period due to the lack of Section 8) the cost to the government would have been over $65 million at a holding cost of $8.50 a day. In short, not only were the units preserved as affordable, the program was cost-effective.

RECOMMENDATION 1

HUD should clearly specify the procedures that owners must follow in managing rent-restricted units, particularly in filling vacant units and verifying the incomes of households occupying these units.

RESPONSE

On July 15, 1994, the Deputy Assistant Secretary for Multifamily Housing Programs issued a memorandum to our field staff providing these procedures. In addition, since selling units that are not assisted but are affordable is a component of the MHPDR Act of 1994, HUD is revising Sales Contract and Use Agreement Riders to comply with and implement the MHPDR Act of 1994. The obligations of purchasers in managing rent-restricted units will be part of these revisions. We expect to have these revisions available for the field to use by April 1, 1995.

RECOMMENDATION 2

Provide language for field offices to include in future sales agreements that sets forth the specific rent-restriction requirements.

RESPONSE

See our response to Recommendation 1.

RECOMMENDATION 3

Establish procedures for field offices to follow in monitoring owner compliance with rent-restriction requirements.

RESPONSE

On July 15, 1994, the Deputy Assistant Secretary for Multifamily Housing Programs issued a memorandum to our field staff providing these procedures. We plan to revise that memorandum, to reflect the MHPDR Act of 1994, and issue the revision to the field by May 1, 1995.

RECOMMENDATION 4

The Secretary should direct the Deputy Assistant Secretary to establish a firm schedule for prompt issuance of similar instructions for implementing any new rent-restriction options that HUD will use to carry out requirements of the MHPDR Act of 1994.

RESPONSE

See responses to Recommendations 1, 3 and 4.

In closing, I want to thank you for the constructive tone of your Draft Report. The Report has been helpful in focusing our attention on the need to clarify our existing procedures and to issue revised instructions as we implement the MHPDR Act of 1994.

Sincerely,

Nicolas P. Retsinas
Assistant Secretary for Housing-
Federal Housing Commissioner

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