

GAO

United States General Accounting Office

Report to the Honorable Thomas J.
Downey
House of Representatives

August 1986

RENTAL HOUSING

HUD's Methods of Determining Fair Market Rents



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

Resources, Community, and
Economic Development Division

B-223794

August 22, 1986

The Honorable Thomas J. Downey
House of Representatives

Dear Mr. Downey:

In response to your February 12, 1986, request, we reviewed the Department of Housing and Urban Development's (HUD) method of determining fair market rents for the section 8 rental assistance program.¹ Your letter raises concerns that fair market rents in Suffolk County, New York, are less than what the market demands. Accordingly, you asked that we provide information on (1) how HUD originally sets fair market rents, (2) how HUD calculates annual rent adjustments, and (3) what recourse local housing authorities have should they consider their particular rent levels too low (see app I).

HUD's intent in setting fair market rents is to reflect costs of modest rental housing available in the private market. These rents are the ceiling rents for units new to the section 8 program. HUD uses three data sources to set fair market rents for 2,755 market areas nationwide—the decennial census, the American Housing Survey, and the consumer price index. The decennial census is the baseline for setting fair market rents in 2,711 of the 2,755 market areas. Baseline rents are to reflect the price that renters who have recently moved paid for modest rental housing. In setting fair market rents, HUD also uses the American Housing Survey data to establish the baseline rents for 44 metropolitan areas individually surveyed and to adjust the census data base to better reflect housing suitable for the section 8 program. In addition, to account for annual rent inflation, HUD uses the consumer price index to adjust the fair market rents for new units and to establish annual rent adjustments for units already under the section 8 program.

Because of limitations in the available central data sources that HUD uses, its schedules of fair market rents and its annual rent adjustments are not representative of rents in all market areas. Those limitations are that the information is not current or geographically specific. For example, the decennial census is about 5 years old when HUD first

¹This program, established under Section 8, U.S. Housing Act of 1937 (42 U.S.C. 1437f), aids low-income families in obtaining decent, safe, and sanitary housing in private accommodations. Low-income families in the program generally pay 30 percent of their income for rent, while HUD pays landlords the difference between the 30 percent and the unit's rent (not to exceed the fair market rent).

receives the information and as much as 15 years old when a new census becomes available. Similarly, the American Housing Survey's individual samples for the 44 metropolitan areas provide new baseline information once every 3 to 4 years. In addition, annual adjustments for local rent inflation and housing quality are based on consumer price index and American Housing Survey data that are not geographically specific nationwide

HUD is aware that its rent schedules are not always accurate for all market areas. Accordingly, its procedures provide for appeals of fair market rents and annual adjustments when interested parties believe these rent estimates can be improved. Under the procedures, interested parties are asked in the Federal Register to submit written evidence to HUD showing that actual rents in the community are different from HUD estimates. HUD's procedures, however, differ on the organizational component within HUD responsible for making final determinations on the merits of the appeals and for revising rent schedules. Under the fair market rent appeals process, HUD headquarters makes final determinations on public appeals for changes to new unit rents. Under the annual adjustment appeals process, however, applicable HUD field offices make the final determinations on the changes to rents for existing units

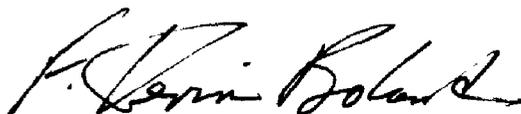
In addressing your request, we obtained information from Suffolk County, New York, on the maximum rents payable to landlords for new section 8 families entering the program and the rents paid for families already in the program. As discussed in appendix II, we found in a small sample of 12 existing rents that in 1986, while HUD headquarters set the maximum rent for new one-bedroom units at \$470 per month, landlords were permitted by the HUD field office to charge as much as \$663 per month for one-bedroom apartments that were already in the program.

HUD officials told us that they could not reconcile these figures but said that a need exists for better coordination between HUD headquarters and its field office to resolve this situation in Suffolk County. HUD officials could not tell us whether this type of situation existed in other parts of the country because HUD does not maintain data needed to make that determination. We are recommending that HUD resolve the situation in Suffolk County and determine whether similar situations exist in other areas and take actions as appropriate to resolve them and to minimize their recurrence (see app III)

Our review was conducted between February and May 1986 at HUD headquarters and HUD's New York Regional Office. We also visited several apartment projects in Suffolk County that were in the section 8 program. We reviewed the procedures HUD uses in developing schedules for fair market rents and the annual adjustment factors. We also examined the disposition of public comments that were received by HUD headquarters and its New York Regional Office on the 1985 proposed fair market rent schedules and the 1985 annual adjustment factors. Our review was performed in accordance with generally accepted government auditing standards.

As agreed with your office, we did not obtain official agency comments on this report. However, we discussed the information contained in the report with HUD officials and incorporated their comments where appropriate. As also arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 14 days from the date of this letter. At that time we will send copies to the Secretary of Housing and Urban Development and other interested parties and make copies available to others upon request.

Sincerely yours,



J Dexter Peach
Assistant Comptroller General

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Abbreviations

GAO	General Accounting Office
HUD	Department of Housing and Urban Development
RCED	Resources, Community, and Economic Development Division

Setting Fair Market Rents and Annual Adjustment Factors

The Department of Housing and Urban Development's (HUD) Economic Market Analysis Division computes fair market rents¹ for 2,755 areas—337 metropolitan areas and 2,418 nonmetropolitan areas across the country. It also computes annual adjustment factors for 77 fair market rent areas and the four census regions (Northeast, South, North/Central, and West). Both the fair market rents and annual adjustment factors were established with the objective of accurately reflecting the costs of modest housing within a particular area. HUD's success in meeting this objective, however, is largely dependent upon the accuracy of its data sources. Because the data sources have limitations, as discussed below, HUD relies on public comments to identify the areas where its estimates can be improved

The Decennial Census Provides the Basis for Fair Market Rent Calculations

The 1980 decennial census was the baseline used by HUD for setting 1986 fair market rents for new section 8 units in 2,711 market areas. The decennial census includes a 15-percent sample of people who had moved in the 2 years prior to the census. These individuals received a questionnaire asking for information on rents and utilities paid and number of rooms. According to HUD, the rents of people who have recently moved most accurately reflect market rents for available rental units. Using this data, HUD sets fair market rents to reflect the cost of 2-bedroom units at the 45th percentile. In other words, 45 out of 100 2-bedroom units rented by recent movers in a particular market area have rents at or below this level. According to HUD, 2-bedroom units are used as a baseline because they are the predominant size of units in the census. The American Housing Survey is used to make adjustments for different bedroom sizes because, according to HUD officials, these data provide better information than the decennial census on standard quality units appropriate for the section 8 program and the information is more up-to-date. Using these data, HUD adjusts rents for other than 2-bedroom units on the basis of the relationship of rents to bedroom size. For example, the 1985 rent for a 2-bedroom unit in Suffolk County was \$550 per month. HUD applied the adjustment factors of 0.855 for a 1-bedroom unit and 1.255 for a 3-bedroom unit that are used nationwide to arrive at fair market rents of \$470 and \$690 per month, respectively.

¹Fair market rents apply to only those units that are new to the section 8 housing program. The units would not necessarily be new in the sense of "just built." Existing unit rents are changed yearly through the annual adjustment factors.

In establishing rents at the 45th percentile, HUD attempts to ensure that rents are high enough to permit a wide selection of units and neighborhoods but still low enough to serve a maximum number of very low-income families. If rent levels are set too low, they reduce the opportunities for low-income families to locate rental housing to meet their needs. On the other hand, if rent levels are set too high, families could rent units that are costlier than units most nonassisted families would rent. This latter situation would reduce the number of families that can be assisted under the program.

Even though the decennial census contains rental cost information for large numbers of households throughout HUD's market areas, it has limitations. The major limitation is its age. The data are about 5 years old when HUD first receives the information and as much as 15 years old when a new census becomes available. A second limitation is that the data provide only limited information on structural characteristics of housing and include rental housing that is not appropriate for the section 8 program. To adjust for these limitations, HUD uses information from two additional sources—the American Housing Survey and the consumer price index.

The American Housing Survey Supplements Census Data

The American Housing Survey provides information on structural characteristics of housing and gross rents. The survey, which is done for HUD by the Bureau of the Census, is composed of a national sample conducted every 2 years and a sample of 44 metropolitan areas taken every 3 to 4 years. According to HUD, the 44 metropolitan areas comprise about 50 percent of the total renter population nationwide.

HUD uses the national sample to adjust the census data base by eliminating housing that is not appropriate for the section 8 program. Specifically, HUD excludes newly constructed units that would tend to have rents higher than the 45th percentile and HUD-defined inadequate housing—such as units lacking adequate heating or plumbing facilities. HUD also excludes public housing units that would tend to have lower-than-market rents. According to HUD, the net effect of these adjustments in 1985 was an increase of 2 percent in the baseline fair market rents nationwide.

HUD uses the metropolitan area samples to set the baseline rents for the 44 areas. For the remaining 2,711 market areas, the 1980 census remains as the baseline for fair market rents.

American Housing Survey data have limitations in that the national survey portion lacks geographic specificity and the metropolitan portion is somewhat dated. More specifically, HUD uses the national sample to make the 2-percent adjustments of census rent levels on a nationwide basis and not for each market area, and the samples for the metropolitan areas are done only every 3 to 4 years.

The Consumer Price Index Is Used to Make Annual Inflation Adjustments

HUD uses the residential rent and the fuel and utilities components of the consumer price index to develop inflation factors that are used to (1) update baseline fair market rents for new units derived from the decennial census and the American Housing Survey and (2) serve as annual adjustment factors for existing section 8 units. The Department of Labor conducts the consumer price index surveys each month in 28 metropolitan areas and the four census regions. HUD applies the inflation factors for the 28 metropolitan areas to 49 additional fair market rent areas in immediate proximity to those metropolitan areas. The remaining 2,678 market areas use the consumer price index measures for either the Northeast, South, North/Central, or West census regions.

The consumer price index provides a standardized source of nationwide price inflation data. However, these data have limitations in that they do not precisely reflect rent changes in every market area primarily because most of the areas are outside the specific 28 metropolitan areas surveyed. These data can also be about one-year old when HUD publishes fair market rents and annual adjustment schedules.

Recourse by Local Housing Authorities

HUD recognizes that because of the limitations of available data, the allowable rents it establishes may not accurately reflect the market conditions in all areas. HUD relies on public comments to rent schedules published in the Federal Register to bring any discrepancies in fair market rents and annual adjustment factors to its attention. While we did not verify the validity of the public comments or the appropriateness of HUD's disposition of them, we noted that public comments generally related to complaints about rent levels set too low. In this regard, HUD's General Deputy Assistant Secretary for Policy Development and Research, testifying before the Subcommittee on Employment and Housing, House Committee on Government Operations, in February 1986, said that HUD had received approximately 1,000 requests for fair market rent increases since 1980 and had approved about two thirds of these requests. Final disposition of the public comments on the 1986

proposed fair market rents was still pending at the completion of our audit work.

Public comments are considered differently by HUD for fair market rents compared to annual adjustment factors. In setting fair market rents for new units in each of the 2,755 areas, HUD headquarters is responsible for making final determinations on public comments before publishing final rent schedules. Conversely, annual adjustment factors for the existing units in the 77 metropolitan areas and 4 regions are published as a final rule making without the opportunity for prior public comment. Subsequent public comments on published annual adjustment factors can be made, however, to HUD field offices that are responsible for determining whether changes are appropriate.

Appeals of Fair Market Rents

HUD requests, in the Federal Register, that public appeals of its fair market rent schedules contain rental market data showing rents at the 45th percentile for standard quality rental housing, including a full description of the data and methodology used. HUD field offices evaluate the appeals, verify that local market surveys are representative, and make recommendations to HUD headquarters as to whether and to what extent the rent schedules should be revised. Suffolk County serves as an illustration of how the appeals process works.

The fair market rent for 1985, published in the July 5, 1984, Federal Register, for a new section 8 two-bedroom unit in the Nassau-Suffolk County, New York, metropolitan area was listed at \$539. By letter dated August 31, 1984, Suffolk County section 8 administrators appealed the published fair market rents and submitted a rental housing survey that estimated the median gross monthly rent for a two-bedroom unit in Suffolk County to be \$626. In their appeal to HUD, the administrators said that Suffolk County is experiencing a rental housing crisis and that families given section 8 certifications are finding it increasingly difficult to find affordable rental housing.

HUD's New York Regional Office reviewed the Suffolk County rental survey and recommended to HUD headquarters that the proposed fair market rents for Suffolk County not be changed. According to HUD's regional economist, this recommendation was made for several reasons. First, the New York Regional Office recomputed the fair market rents for the Nassau-Suffolk County metropolitan area using HUD headquarters methodology and determined that \$539 was adequate for a two-bedroom unit. Second, the Suffolk County complaint represented only one

half of the metropolitan area, and Nassau County, the other half, has never asked for a fair market rent increase, in spite of having higher rents. Third, the Suffolk County rental housing survey did not include a representative sample of all rental units in the county because it covered less than 1 percent of the rental units and excluded existing section 8 units and single-family houses with rental units that are often less expensive

The HUD headquarters economist in charge of establishing fair market rents said that when the New York Regional Office recommendation to not change the Suffolk County fair market rents was received, headquarters was in the process of calculating the 1986 fair market rents. Preliminary calculations by headquarters showed that Nassau-Suffolk County metropolitan area fair market rents for 1986 should be \$576 for a two-bedroom unit. The HUD economist told us that because more current census data showed that the rent level for the Nassau-Suffolk County metropolitan area should be about \$576 in 1986, headquarters decided to increase the area's rent level in 1985 from the published \$539 to \$550.

Aside from the appeals process, local housing agencies also have the opportunity to request an increase in the fair market rent limits on an exception basis. One exception is that housing agencies can increase rents by up to 10 percent, on a unit-by-unit basis, for not more than 20 percent of the authorized units. HUD field offices can approve exceptions to the 20-percent limit if the housing agencies can justify the increase. A second exception is that housing agencies can request a HUD field office to increase the fair market rent ceiling by up to 20 percent. This exception, however, is not to be granted to major portions of a fair market rent area but is to be restricted only to those selected submarket areas where they are needed. HUD defines a major portion of a fair market rent area as including more than 50 percent of the population of the fair market rent area.

The Suffolk County section 8 housing administrators requested twice in 1985 that the HUD New York Regional Office grant a 10-percent increase in the fair market rent levels. The HUD Regional Administrator responded by pointing out that the New York Regional Office is permitted to grant fair market rent increases only to areas where rent levels are substantially above the rent levels for the metropolitan area as a whole. He said that Suffolk County in its entirety does not meet this condition.

Appeals of Annual Adjustment Factors

In appealing annual adjustment factors, local housing agencies are to demonstrate to the responsible HUD field office that the rents of comparable unassisted rental housing have increased at a substantially greater rate than the annual adjustment factors. Housing agencies can demonstrate the increase by submitting detailed operating cost data showing changes over a 12-month period for a representative sample of units in the area, or if such data are not available, HUD field offices can use other data, such as surveys conducted by local rent boards.

On March 27, 1985, HUD published the 1985 annual adjustment factors in the Federal Register. It showed, for example, the published annual adjustment factor applicable to units renting at between \$480 and \$550 per month in Suffolk County was 4.4 percent. In this regard, a landlord renting a two-bedroom unit to a section 8 family for \$500 per month would be allowed a 4.4-percent increase, or \$522 per month.

On May 1, 1985, the Suffolk County section 8 housing administrators requested HUD's New York Regional Office to approve a higher annual adjustment factor for Suffolk County. HUD's Regional Administrator replied, on June 7, 1985, that a higher adjustment factor can be granted only if it is demonstrated that the costs of operating comparable rental housing have increased at a substantially greater rate than the adjustment factor. He said that to date the Suffolk County administrators have provided no evidence of higher operating costs supported by certified financial statements of landlords. On July 5, 1985, the HUD New York regional economist also responded to a letter from a local housing agency requesting a higher annual adjustment factor for rents in Suffolk County. Again, the economist asked for evidence of higher landlord operating costs.

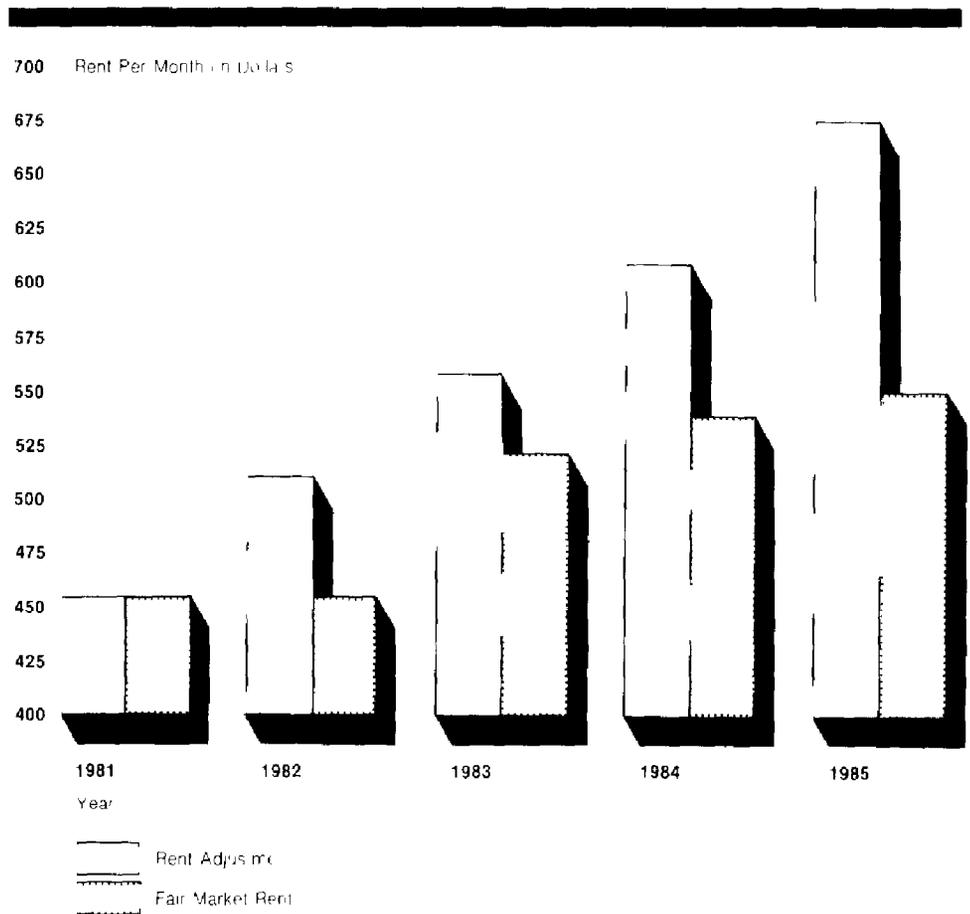
In September 1985 the regional economist recommended to the Regional Administrator that Suffolk County rents be increased by 8 percent. The regional economist told us that the 8 percent was arrived at through negotiations with Suffolk County landlords and that there was no documentation supporting higher operating costs. This increase was approved by the Regional Administrator on September 13, 1985.

Disparity in Suffolk County Section 8 Rent Levels

Fair market rents and the annual rent adjustments both are set to represent rents for modest housing that exists in the local area. However, because HUD's procedures differ on the organizational component responsible for resolving community appeals, wide disparities have arisen in Suffolk County between the rent subsidies HUD allows for units already under the section 8 program and the rent subsidies allowed for units new to the section 8 program.

For the past several years, as shown in figure II 1, HUD's New York Regional Office adjusted rents for existing section 8 units at rates considerably higher than the fair market rents set by HUD headquarters for new units. HUD has not reconciled these differences. As a result, allowable rents for a two-bedroom unit that entered the section 8 program in 1981 had risen from \$455 to \$675 by 1985 while a unit entering the section 8 program in 1985 had the rent capped at \$550.

Figure II.1: Suffolk County Section 8 Rent Levels



Appendix II
Disparity in Suffolk County Section 8
Rent Levels

To further illustrate the rent differential for units in Suffolk County, the Suffolk Community Development Corporation¹ provided us information showing the progressive rent increases for 12 section 8 units surveyed at random. Table II.1 shows the current rents for these units, which entered the section 8 program between 1978 and 1984, compared to the fair market rent ceilings HUD currently allows for new section 8 families.

Table II.1 Suffolk Community Development Corporation Rent Survey

Number of bedrooms	Current fair market rent ceiling	Section 8 1986 rents for existing units	Percent 1986 rents exceed current fair market rents
0	\$385	\$495	29
1	470	663 499 594 540 571	41 06 26 15 21
2	550	679 616 684 691	23 12 24 26
3	690	830 787	20 14

Source: The Suffolk Community Development Corporation

The 1986 section 8 rents for the 12 units exceeded the current fair market rent ceilings by an average of 21 percent. In one case the difference was 41 percent. An additional analysis of 547 section 8 existing units made by the Suffolk Community Development Corporation showed that the rents for 438 units, or 80 percent, exceeded the fair market rents.

¹The Suffolk Community Development Corporation is a non profit corporation authorized by the New York State Division of Housing and Community Renewal to participate in the administration of the Section 8 Rental Assistance Program in Suffolk County.

Conclusions and Recommendations

Conclusions

Our examination of HUD's method for setting rent for section 8 housing showed that HUD headquarters establishes the base level of rent by using three sources of data—the census, the American Housing Survey, and the consumer price index. In addition, because HUD recognizes that limitations exist to the data being used, the fair market rent for new units and the annual adjustments for existing units are allowed to be changed if successfully appealed by community groups

We noted that HUD headquarters and its field offices may take different actions regarding appeals that could result in disparities in the levels of rent allowed for new and existing units. In Suffolk County we found that the rent allowed by the regional office substantially exceeded that allowed by HUD headquarters in establishing the fair market rent for that area. More specifically, we found that in a small sample of 12 existing section 8 units, monthly rents for one-bedroom units were as high as \$663 while HUD's current fair market rent for that area was \$470. The differences in rent are significant since the units being rented are all supposed to provide modest housing. In this regard, the differences suggest that the allowance for rent of new units is either too low or that the rent allowed for existing units has risen too high. HUD officials told us that they could not reconcile these figures but said that there is a need for better coordination between HUD headquarters and its field office to resolve the situation in Suffolk County. HUD officials could not tell us whether this type of situation existed in other parts of the country because HUD does not maintain data needed to make that determination.

Recommendations

We recommend that the Secretary of the Department of Housing and Urban Development

- determine the appropriate levels of rent for new and existing units in Suffolk County which will resolve the rent disparities and
- determine whether similar rent disparities exist in other areas of the country and take actions as appropriate to resolve them and to minimize their recurrence

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