



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D C 20548

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COMMUNITY AND ECONOMIC  
DEVELOPMENT DIVISION

JUN 27 1978

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

Dear Mr Simons.

In connection with our on-going work in the housing and community development areas, we have noted that one of the procedures followed in relation to the new construction and substantial rehabilitation portions of the section 8 lower-income rental program may result in higher assistance payments than are necessary. Specifically, we are referring to the practice of allowing contract rents to be adjusted downward in those instances where a project sponsor benefits from tax-exempt financing, but not doing so in those instances in which the sponsor secures a below market interest rate loan or a real property tax abatement. The effects of the two situations on sponsor costs are identical, yet their treatment in establishing contract rents is quite different. We believe that the two situations should be handled consistently and that, in fact, there are savings to the Federal Government which would result if contract rents were adjusted downward for favorable financing and real property tax abatements as well as for tax-exempt financing.

BACKGROUND

Under the new construction and substantial rehabilitation portions of the section 8 program, rents must be approved individually for each proposed unit based on rents for comparable units in the area. The contract rent (the total rent payable to the owner including the portion payable by the family) must be determined by the Department of Housing and Urban Development to be reasonable in relation to the quality, location, amenities, and management and maintenance services of the project. In most cases, the contract rents plus any allowance for utilities and other services may not exceed the fair market rents established by the Department for each market area in the country.

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- According to the new construction and substantial rehabilitation processing handbooks, the Department assesses the reasonableness of the unit rents at the time the proposals are placed in a stage known as technical processing. Rent comparables by unit may be obtained from recently constructed rental housing for units to be constructed and from existing rental housing for units to be rehabilitated. Each estimate of rental value made for a particular unit size and type should preferably be based on five market rent comparables, but in no event should an estimate be based on fewer than three rent comparables. Adjustments must be made for all significant differences between each comparable unit, taking into consideration such things as location, age, condition, size of units, amenities, utilities, etc. The handbooks also provide for special adjustments to be made for such items as providing amenities and design features required in units planned for elderly/handicapped occupancy, and the additional management costs associated with projects in which 100 percent of the units are assisted.

As of March 31, 1978, there were 381,316 new construction and substantial rehabilitation unit reservations under the section 8 program. On that date, there were 38,819 newly constructed and 6,011 substantially rehabilitated units that were occupied. The fiscal year 1979 budget justification estimates that the average annual subsidy costs for these units range from \$3,200 to \$4,500 for newly constructed and substantially rehabilitated units depending on the type of unit and project (e.g., private developer, State agency, elderly, etc.).

#### ADJUSTMENT FOR FINANCING

Federal Regulations applicable to each portion of the section 8 program, in addition to processing handbooks, provide that appropriate reductions in contract rents may be made where a project proposal is expected to benefit from tax-exempt financing. This downward adjustment of rentals is made so that any of the savings in finance charges is reflected in lower assistance payments. However, the handbooks specifically disallow adjustments for other favorable financing or for real property tax abatement. This appears to us to be an inconsistency.

There are a number of sources from which a project sponsor might obtain favorable financing. Those we are most familiar with are Department supported and include (1) below market interest rate rehabilitation loans from local governments

under the community development block grant program, (2) section 8 tandem assistance which makes mortgages available at interest rates as low as 7-1/2 percent, and (3) section 312 rehabilitation loans which bear interest rates of 3 percent.

We recently asked several officials in the Section 8 and Leased Housing Division, Office of Assisted Housing Development, why adjustments were disallowed for favorable financing and tax abatements, while they were allowed for tax-exempt financing. These officials were unable to provide us with an answer. One official stated that the Department was more concerned with the reasonableness of proposed rents in relation to the rents of comparable units in the area, than it was with the "cost side of the picture." He also added that rents are adjusted downward for tax-exempt financing to prevent sponsors from realizing a "windfall profit," although he could not explain why such profits are allowed for sponsors using other forms of favorable financing.

Another official told us that favorable financing and real property tax abatements are not considered in setting contract rents because the thinking of the Department, at the time the regulations were developed, favored the comparability approach. He said that the Department's experience with this approach in establishing rents in other programs had been favorable. He said, however, that top-level management is becoming more cost-conscious regarding the section 8 program and is considering the downward adjustment of rents for favorable financing and tax abatements as a means to help minimize program costs.

We recognize that some project sponsors may participate in the section 8 program because contract rents are not adjusted downward for favorable financing or for tax abatements. The procedure certainly provides financial incentive for participation. We question, however, the need for the full amount of such financial advantages going to project sponsors. Why not eliminate these advantages in their entirety with the resulting savings (through reduced contract rents) going to the Federal Government, or at least developing some kind of arrangement in which both the Federal Government and project sponsors share in the savings?

#### CONCLUSIONS AND RECOMMENDATION

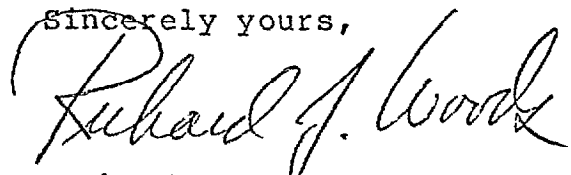
While we have not determined the extent to which project sponsors currently participating in the program are benefiting from below market interest rate loan financing, or from

real property tax abatements, it appears to us that savings in rental assistance payments could result to the Federal Government by treating such favorable financing or tax abatements in the same manner as is done for tax-exempt financing. We believe that the Department is missing an opportunity to reduce the amount of assistance payments under the program by ignoring favorable financing methods other than for tax-exempt financing and by ignoring real property tax abatements. Given the high cost of providing housing to lower income families--as much as \$4,500 annually under the new construction and substantial rehabilitation portions of the program--downward adjustments to contract rents in those instances where project sponsors are benefiting from direct or federally assisted low-interest loans or from tax abatements would allow HUD to achieve economies not now being realized.

We trust you will consider our thoughts during your deliberations on the matter and recommend that you direct the changing of applicable regulations to allow the downward adjustment of contract rents on the basis of favorable financing or real property tax abatements to a level which optimizes dollar savings to the Federal Government while at the same time encouraging program participation by project sponsors.

We shall be pleased to discuss this matter with you or members of your staff if you desire

Sincerely yours,

A handwritten signature in cursive script that reads "Richard J. Woods". The signature is written in dark ink and is positioned above the typed name and title.

Richard J. Woods  
Associate Director

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