



*Good Neighbors*

# San Diego Housing Commission

**DATE ISSUED:** April 16, 2004

**ITEM 104**

**REPORT NO.:** HCR04-17

**SUBJECT:** Fiscal Year 2004 Section 8 Program Funding

## **SUMMARY**

**Issue:** What steps should the Housing Commission take in preparation for a potential shortfall of funding for the FY04 Section 8 Rental Assistance Program?

**Recommendation:** That current Section 8 contract obligations continue to be met for the duration of the fiscal year, and that staff be directed to continue to seek HUD contract amendment approval, engage advocacy groups and prepare a specific contingency funding plan.

**Fiscal Impact:** As described herein, the fiscal impact is up to \$7 million. Impact on Section 8 revenues may not be known until August, and potential impacts on non Section 8 revenues are not yet identified nor authorized.

**Affordable Housing Impact:** Section 8 participants earn less than 60 percent of area median income. This recommendation would not have an impact on voucher holders, however, other alternatives might have an affordable housing impact, as described below. Future funding levels may require program changes that could reduce either the amount of assistance or the number of households that can be assisted.

**Previous Related Actions:** The Housing Commission approved the current Section 8 funding level in the original and amended FY04 budgets, but has not taken actions specific to a potential shortfall. The Chief Executive Officer has orally apprised the Board of this situation at past Housing Commission meetings.

**Future Related Actions:** Depending on HUD actions, budget amendments to add federal funds or redirect currently budgeted monies may be required. In addition, future consideration will be given to changes in the Housing Commission's Section 8 Housing Choice Voucher program that could result in greater control over program costs. These could have far reaching implications for program structure including number of participants or cost per family.



## **BACKGROUND**

Congress authorized the Section 8 Rental Assistance Program (RAP) in 1974. It utilizes the private market to provide affordable housing for low-income households through a direct subsidy paid to landlords. Assisted households lease privately owned dwelling units and pay a portion of the rent. The remainder of the agreed upon rent is paid by the housing agency and is referred to as the HAP payment (Housing Assistance Payment). From its inception in 1974, the program experienced little modification until the 1996 Conforming Rule and the 1998 Quality Housing and Work Responsibility Act.

The original Section 8 Certificate program “capped” rents that could be paid to landlords by HUD-determined Fair Market Rents (FMR). A housing agency received budget authority to lease a specific number of units. The total budget authority was calculated by multiplying the total number of units of various bedroom sizes by the appropriate FMR for the term of the Annual Contributions Contract (ACC).

In 1987 Congress authorized the Housing Voucher program, which operated very similarly to the Certificate program. The primary difference between the programs was that a payment standard was used for voucher recipients that capped the amount of subsidy the housing authority would pay rather than capping the amount of rent a landlord could charge for a unit. Under the Voucher program, the assisted household was allowed to make up the difference (up to 40% of the household’s income) between the requested rent and the payment standard.

Typically, the HUD FMR has been adjusted once a year to keep pace with rental rates in the community. Two factors have accelerated the FMRs, and hence the cost of the program to the federal government. First, Section 8 is supposed to provide modest housing, so FMRs were set at 40% of the rents in a given market area. In more expensive markets with low vacancy rates, holding the FMR so low made leasing up voucher families difficult. A few years ago, Congress allowed such communities to set FMR at 50% of local rents. Further fueling the rise in HAP costs is the rate of rent increases in certain markets, including San Diego and most of coastal California. Taken together, these factors have caused Section 8 program costs to grow faster than other areas of the HUD budget. Concern over Section 8 budget growth is, in part, responsible for a series of recent program changes.

Original annual contributions contracts were executed for twenty-year periods. This term changed over the years – from the longest term of twenty years to the current term of three months. Any unused budget authority was maintained in a Section 8 Project Account, rolling over from year to year, to cover program cost should the annual budget authority be insufficient to meet program costs. Prior to 1998, there was no limit to the amount that a housing authority could accumulate in the Project Account.

Since the 1996 Confirming Rule, the Section 8 Rental Assistance Program has been in a state of constant change, both from operational and financial/budgeting aspects.

Today, the RAP is very different than in the past. All certificates and vouchers were converted to "Housing Choice Vouchers" and the program now focuses on becoming more "private market" to make it more appealing to landlords who may have been reticent to participate because of the rules and red tape associated with government subsidies. Housing authorities are permitted more flexibility in establishing the payment standard for the jurisdiction. Given the rent levels and extremely low vacancy rate in the San Diego rental market over the past several years, the Housing Commission adopted a payment standard that is 110% of the HUD published Fair Market Rent. Prior to adopting this level of payment standard, assisted households had a much more difficult time finding and leasing a housing unit in San Diego.

It is virtually impossible to control Section 8 program expenditures by adjusting operations. Statutes dictate whom to house (at least 75% of new voucher holders must have extremely low incomes), how much of their incomes they should pay for rent, and type of housing (number of bedrooms and stringent physical condition are mandated, and other criteria about location are advised). Yet changes from the 1996 law, and more recent legislative amendments affecting program budgeting include:

- (1) The Project Account (ACC reserve fund), which is used to fund program costs beyond the budget authority, is now limited to one month of current distributions (1/12 of the annual expenses);
- (2) Since budget authority renewals are now done on a quarterly basis, housing agencies must manage multi million dollar programs without any assurance that the next quarter funding will be forthcoming;
- (3) HUD has frequently revised the method by which future funds are allocated to Housing Authorities. Currently, budget authority is based on the lease up rate and actual cost data reported in the year-end settlement plus an adjustment factor. Thus, it is imperative that housing agencies maintain a 100% lease up rate in order to maximize future year funding and earn administrative fees. Note that there is another recent change basing renewals on August unit count and HAP amounts, not on the prior quarter's more current data.
- (4) Finally, Congress recently authorized a Central Fund, to be maintained by HUD. The Central Fund was created to fund budget amendments needed for leasing more units than in the prior year, up to the baseline unit number approved in the ACC, and for significant increases in actual per unit cost of baseline vouchers, when compared to the cost used in the renewal calculations. Federal FY04 budget language may limit use of the Central Fund only to the former purpose, and not for the latter.

The Housing Commission has implemented all rule changes appropriately. During FY03, common practice was used to compensate for lower leased months with leasing over 100% in other months trying to ensure a high average lease up rate at fiscal year end. On March 8, 2002, HUD issued a notice stating that housing agencies could no longer over lease. Staff immediately responded by slowing leasing activities; through attrition, the average FY03 lease up rate fell to essentially 100% at fiscal year end, and

has remained between 98% and 100% in FY04. A one-time HAP contract amendment authorized last year by HUD, coupled with about \$850,000 from the Commission's Project Account were used to pay for any FY03 over leasing costs. To date, HUD has not replenished our Project Account to 1/12 of annual expenses as regulations suggest should be done.

Given these changes in HUD procedures for calculating initial budget amounts and budget amendments, funds available to the Housing Commission from Federal Fiscal Year 2004 (applicable to the Housing Commission's FY04 and FY05 budget years) will be calculated using different and untested methods. It is likely that the Housing Commission will see a significant drop in rental assistance funding relative to need. There continues to be disagreement among housing industry professionals, HUD staff and members of Congress on the correct way to administer funding for the program.

## **DISCUSSION**

The Housing Commission's FY2004 Section 8 Housing Choice Voucher budget was submitted to HUD in March 2003 and HUD approved an annual requisition for \$104 million on June 23, 2003. This requisition was based on an average housing assistance payment (HAP) for each unit under lease of \$662 and an average continuing lease up of 11,971 units. Each month since July 2003, HUD has deposited in the Housing Commission's bank account 1/12 of the original annual approved HAP amount, regardless of actual monthly HAP expenditures.

As in past years, the financial staff completed a midyear analysis of anticipated needs in January 2004, and determined that the average HAP had increased to \$711, bringing our anticipated annual funding need to about \$111,480,000. A budget revision was submitted to HUD on February 2, 2004, detailing the need for additional budget authority. According to its published notice, HUD is supposed to respond to a budget revision request within 30 days of receipt. To date, this revision has not been approved.

Further complicating the situation, Congress approved the Federal FY04 budget in late January. This appropriations law allows the Central Fund to be used for increased units to baseline, but does not mention use of the Central Fund for rental cost increases. However, new appropriations and their attendant rules generally lag behind adoption (HUD Notice implementing the FFY03 law, adopted by Congress in February of 2003, was issued in October of 2003) and there is sufficient budget authority remaining in the prior year HUD HAP budgets to pay for larger contracts with local agencies.

HUD staff has not responded to repeated attempts to determine if the budget revision will be officially approved. This, along with the short funding experiences of other housing authorities, both in California and across the country, has raised the possibility that the Housing Commission may be short funded in this fiscal year's final payment, due on June 3, 2004. If this occurs, it would mean that the total of monthly payments to be received by the Housing Commission for the fiscal year may not be sufficient to pay

all subsidy costs for Section 8 units leased during FY04. Inexplicably, in March and April the Housing Commission did receive monthly payments from HUD at the higher level reflected in our requested budget amendment. Three potential outcomes are possible:

- If HUD executes a budget amendment consistent with annualizing these higher payments, there would be no shortfall. However, even if sufficient funds are received, without an executed budget revision there is still an opportunity for HUD to recapture the overage during the year-end closeout process.
- If HUD does authorize a budget amendment but uses its current methodology with costs from August 2003, it is anticipated that the Housing Commission's Section 8 shortfall would be about \$3 million.
- If, however, HUD stands by the original approved contract amount, the shortfall would be closer to \$7 million.

## **ALTERNATIVES**

There are several alternatives available to the Housing Commission to reduce the program's financial obligations. Stopping the lease up of additional families is not suggested as an alternative. The savings if additional units are not placed under lease are minimal (\$300,000 to 400,000) compared to the size of the potential problem, and ending the fiscal year below the authorized number of units leased could permanently reduce the baseline program size for FY05 by 400 to 500 households. Alternative courses of action that the Housing Commission might take include:

1. Direct the staff to inform Section 8 assisted households and landlords that the June rent subsidy may be reduced proportionately to ensure every household receives some level of assistance.
2. Direct staff to not issue any rent subsidy checks in June if full funding is not received; households and landlords would be notified of this possibility as soon as possible.

*Analysis:* Both of these alternatives will result in hardship to landlords and, potentially, to assisted households. However, the housing assistance contract and related documents prohibit a landlord from soliciting payment of the HAP from the assisted tenant, and a landlord may not evict a tenant for failure of the housing agency to pay the HAP subsidy. The Commission's contract with owners is binding so long as sufficient appropriations are available, so these options have some legal grounds, although important business relationships are likely to be irreparably damaged, with longer-term program implications.

3. Direct the staff to use the funds received to provide subsidy on behalf of assisted households based on their income levels, e.g., all households

earning at or below 30% of AMI could be fully subsidized while households earning more would receive a portion of needed subsidy.

*Analysis:* In addition to concerns cited above, this alternative requires a great deal of administrative effort and may be perceived as discriminatory. There is no precedent for treating eligible clients differently based upon income, and would likely require a HUD waiver.

4. Use all available Housing Commission resources to make up any funding shortfall. Potential resources include Section 8 program reserves, local reserves, HOME program funds, proceeds received from past sale of public housing units.

*Analysis:* This alternative is least disruptive to the program and all related parties. However, it would create a financial hardship to the Commission by depleting the amount of reserves currently held and significantly affecting other programs, e.g., housing rental production and replacement of public housing inventory.

Paying owners less than contracts call for would have a chilling affect on trust and good will that the program has cultivated in the past; this would seriously impede operation of any rental assistance program in the future. Use of reserves or other housing funds to cover Section 8 operations, if the Board deems this appropriate for meeting current year obligations, is not sustainable in the long run and would still necessitate program changes next fiscal year. In part, the choice one makes now is influenced by how one anticipates HUD will respond in the next few months.

This report addresses potential local responses to a national problem. The National Association of Housing and Redevelopment Officials (NAHRO) has had several discussions with HUD, as have other public agency groups. A sign on letter to HUD was endorsed by many private sector organizations. In addition, staff has contacted San Diego's members of Congress and brought this matter to the firm of Patton Boggs, under contract with the City to represent its interests in Washington.

Respectfully submitted,

Approved by,

**Signature on File  
With Original Document**

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