



Good Neighbors

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REPORT

DATE ISSUED: May 10, 2004 **ITEM 105**

REPORT NO.: HCR04-38
For the Agenda of May 14, 2004

SUBJECT: Section 8 Rental Assistance Program Funding

SUMMARY

Issue 1: Should the Housing Commission use funds budgeted for other purposes to pay full Housing Assistance Payments (HAP) subsidies for the last month of the Commission's FY04 (June) to private rental owners on behalf of currently assisted Section 8 clients?

Recommendation 1: Make full HAP payments in June and seek replenishment of the Section 8 project reserve to cover costs, or, failing HUD funding of the reserve, use Section 8 program reserves and proceeds from the sale of public housing units to the San Diego Unified School District, subject to HUD approval.

Fiscal Impact 1: It appears that HUD Section 8 funding for June will be \$6.5 million resulting in a shortfall of about \$3.9 million. Use of the Section 8 reserves (about \$2 million) will result in depletion of all Section 8 program reserves; use of about \$2 million from the public housing sale proceeds will result in less funds available to replace the acquired units which would ultimately result in fewer public housing units in the Housing Commission's inventory. The FY05 Budget, also on today's agenda, has been prepared using the method of funding used by HUD until April 22, 2004. The FY05 budget will be revised based on the decisions made by the Board of Commissioners.

Issue 2: Should the Housing Commission approve immediate cost containment and reduction recommendations to the Section 8 program to ensure the Housing Commission is able to operate the rental assistance program within the FY05 funding available from the Department of Housing & Urban Development (HUD)?



Recommendation: Approve the proposed program revisions that will result in cost containment and cost reduction in the Section 8 Rental Assistance Program. These revisions include changes to the payment standards, the subsidy standards, approval of a rent “cap” procedure, and requests to HUD for waiver of several program regulations.

Fiscal Impact: Early analysis of the new funding allocation method being used by HUD indicates that the Housing Commission will receive about \$104 million for HAP in FY05. The Commission’s Proposed FY05 Budget projects costs of \$109 million in HAP under current program procedures. Program revisions recommended in this report are estimated to reduce the HAP cost of the program by about \$4.1 - \$5 million. In addition, there is uncertainty about funding already received and expended for the months of July – December 2003. It is possible that additional “collect back” will occur from the funds expected in the FY05 year.

Affordable Housing Impact: All 12,000 Section 8 participating households in San Diego earn less than 80 percent of area median income (AMI) (\$54,800 for a family of four); average household income is about \$15,300. Currently, about 20 percent of households assisted pay more than 30 percent of their income for housing. If implemented, program changes described in this report may result in assisted households paying significantly higher portions of their income for housing costs.

Previous Related Actions: At the April 23, 2004 meeting the Housing Commission directed that the current Section 8 contract obligations be met through FY04 (June 30). Should sufficient funds not be provided by HUD to meet those obligations, the Board directed staff to provide information on available resources to make up the immediate shortfall and the consequences of using those resources so that the Board may direct action to be taken.

Future Related Actions: Depending on Board decisions, budget amendments to redirect currently budgeted monies will be completed. In addition, program changes approved by the Board will be implemented; some changes will require notice to program clients and owners participating in the program.

BACKGROUND

On April 22, 2004, the Department of Housing and Urban Development (HUD) issued a notice making significant changes in the method of funding for the Section 8 Housing Choice Voucher program. Analysis of the new method indicates that about 900 housing agencies across the country (including the Housing Commission), will not receive sufficient funding to continue the same level of subsidy to all currently assisted households.

The HUD notice, which is retroactive to January 2004, provides little guidance regarding the implementation of the new method. Recent discussions with HUD staff, in the Financial Services Center in Kansas City and at HUD-Central in Washington, D.C., provided contradictory explanation of the new method. Under the new method of funding, housing

agencies, including the Housing Commission, will receive quarterly funding based on average per unit subsidy expenditures as of August 2003, adjusted for inflation. One of the major areas of contradiction from the HUD offices is the method to be used in applying the inflation factor. The Director of the Financial Services Center stated that the inflation factor will be pro rated on a monthly basis; staff at HUD-Central have indicated that the entire inflation factor will be applied effective in January. Also, agencies will have an opportunity to appeal the inflation factor, but decisions are not expected until after the close of the Housing Commission's FY04. In addition, no information is being provided about the availability of funds to replenish past year's project reserve accounts, normally used by housing agencies to fund higher subsidy costs, or the method of calculating the current fiscal year administrative costs. There was also indication by senior HUD staff that funds already received and expended by housing agencies for legitimate subsidy costs may be retroactively calculated, possibly back through July 2003, and agencies may be forced to repay those funds, either from project accounts, if available, or by a "short funding" of upcoming subsidy allocation.

As expected, there is a strong nationwide reaction to what many housing advocates see as a draconian and punitive step from HUD. Affordable housing organizations as well as many bipartisan governors and members of Congress have called for rescission of the funding notice and re-examination of the funding method. Senior HUD staff have stated that they are merely enforcing the Federal Fiscal Year 2004 Appropriations Bill; opponents argue that Congress included sufficient funding in the Appropriations Bill to serve all assisted households at current costs and that the new method leaves as much as \$200 million unspent. Several House representatives have signed on to a bill that requires HUD to allocate funding to housing agencies based on current housing costs. Attachment 1 is a recent editorial on this topic that appeared in the New York Times.

Many housing agencies are already taking very serious steps to reduce the cost of the program including lowering payment standards, increasing subsidy standards, across-the-board lowering of subsidy payments to landlords and, in extreme cases, revoking vouchers of currently assisted families.

The Housing Commission staff has prepared several funding and program operational scenarios to prepare for the anticipated shortfall. Difficult decisions are required to continue to operate a successful program that assists families while at the same time providing a fair rent to landlords participating in this important program.

DISCUSSION

Issue 1: Funding shortfall in June 2004.

On May 7, 2004 the Housing Commission's finance staff was informally notified that the funding allocation for June would be \$6.5 million, \$3.9 million short of funds needed to pay full subsidy for the 12,000 families currently assisted under the Section 8 program. This action comes in June as HUD reconciles funding for the Housing Commission's fiscal year end. For

agencies with fiscal years on later cycles, the affect will be postponed, giving more time to prepare.

At the April 16, 2004, Board meeting staff presented several alternatives should there be a shortfall in the June housing assistance allocation. The Board favored Option 1, listed below, and asked that funding resources be proposed. The options include:

1. Use available Housing Commission resources to make up any funding shortfall.
Potential resources include:

Section 8 Reserves:	\$ 681,627
Section 8 Local Reserves:	\$1,152,867
PH Sale Proceeds:*	\$4.5 – 5 million
Housing Commission Reserves:	\$1.9 million

*Sales price for the public housing units are still being negotiated with the School District. Use of the proceeds for this purpose will have to be approved by HUD subject to disposition rules.

It is recommended that the Housing Commission seek replenishment of its Section 8 project reserve account. According to HUD rules, this account should contain approximately \$7 million. However, funds used in FY03 were not replaced at the beginning of FY04. If the HUD reserve were fully funded, it would be sufficient to cover the shortfall. On the other hand, if HUD reserves are not available, it is recommended that the Housing Commission use all of its local Section 8 reserves and a portion of the proceeds from acquisition of 35 public housing units by the School District through eminent domain. These proceeds were to be used to replace the public housing but may be used to fund the Section 8 program.

Although this action would deplete the Housing Commission's Section 8 reserves, agency contingency reserves totaling \$1.9 million (less than 1% of the FY05 Budget) will remain. To expend all reserves for this purpose would have a significant effect on the financial viability of the agency. In addition, lost public housing inventory will not be replaced.

This recommendation is based on the premise that the Housing Commission should honor its commitment to owners. For several years, the Commission worked with the San Diego County Apartment Association and others to strengthen the confidence of rental owners in the responsive and reliable administration of the Section 8 program. Partial payment or non payment would violate that trust and erode future owner participation. The success of the program relies on owner participation.

Note: The April 23, 2004 Board report identified HOME funds as a potential resource to fund a shortfall. Review of HOME program rules precludes the use of these funds for this immediate need.

2. Direct the staff to inform Section 8 assisted households and landlords that the June rent subsidy will be reduced proportionately to the amount of funding received from HUD to ensure every household receives some level of assistance.

Outcome: \$6.5 million is about 62% of the amount needed by the Housing Commission to fully subsidize all assisted households. Under this alternative, landlords would receive 62% of the housing assistance payment.

While there is no specific legal basis to pro rate subsidy, the housing assistance contract allows termination of the contract because funds are not available from HUD. This alternative is less drastic than termination of some housing assistance contracts and provides each landlord with some level of subsidy.

3. 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 action immediately.

Outcome: This alternative may result in landlords terminating the HAP agreement with the Housing Commission, which would effectively terminate the lease with the assisted household.

Both these alternatives will result in hardship to landlords and assisted households. However, the housing assistance contract and related documents prohibit a landlord from soliciting payment of the HAP from the assisted tenant; a landlord may not evict a tenant for failure of the housing agency to pay the HAP subsidy.

4. Direct the staff to use the funds received to provide subsidy to assisted households based on their income levels, e.g., all households earning at or below 50% of AMI receive 50% of subsidy.

Currently, there are 8,969 households at or below 30% AMI and 2,520 households with incomes between 31 – 50% AMI. A 50% subsidy payment for these households would almost deplete the anticipated June funding, leaving little or no funding available for the remaining assisted households earning between 50 and 80% AMI.

This alternative requires a great deal of administrative effort and may be perceived as discriminatory.

Issue 2: Cost containment and cost reduction recommendations to the Section 8 Housing Choice Voucher program in future fiscal years

In the past, housing agencies were provided funding for a specific number of vouchers. The funding was calculated on the average cost to lease vouchers in the housing agency's jurisdiction and was adjusted for bedroom/household size. Additional funds were provided mid year if actual HAP expenses exceeded the budget amount. Administrative fees were

earned based on the actual number of voucher months leased. The new funding method appears to provide funding based on subsidy costs in August 2003 with an adjustment for inflation. Administrative fees will be allocated based on some portion of the fees an agency was eligible to receive in Federal Fiscal Year 2003. Apparently no adjustment for inflation will be made to administrative fees.

This change in the funding methodology results in considerably less funds available to the Housing Commission for both rental subsidy and administrative fees. At this time, staff cannot accurately calculate the level of funding the Housing Commission will receive as Fiscal Year 2005 begins. Relying on information included in HUD's April 22nd notice, which is subject to interpretation, Commission staff has calculated that the Housing Commission will receive approximately \$5 million less funding than is needed to fully subsidy all assisted households in FY05 using current costs and rent trending. There is no information on the method that will be used to calculate administrative fees, retroactive to January 2004; this decision is being made by Assistant Secretary Michael Liu and is to be announced within the next few weeks. The Housing Commission received about \$9 million in administrative fees in FY2003 and projects receipt of \$9.3 million in administrative fees in FY04. The Proposed FY05 Budget includes both rent payments and administrative fees estimated at the FY04 level.

While there is no question that the Housing Commission's rental assistance program must be revised to operate with less Federal funding, the recommended program changes will impact owners, renters and the Housing Commission administrative costs. Program changes approved will be incorporated into the Section 8 Administrative Plan and implemented immediately upon appropriate notice. These changes represent aggressive efforts, first, at cost containment and second, at overall program cost reduction.

Recommended Section 8 Program Changes

The recent notification by HUD of the Section 8 renewal funding formula only applies through December 2004, or half of the Housing Commission's fiscal year. Assuming the same methodology is used, with costs based on August 2004 HAP levels, it is anticipated that FY05 will be approximately \$5 million short of current projections of rent payments for owners.

The approach taken in this report to control costs in FY05 includes maintaining service to the largest possible number of clients within HUD's Section 8 funding. This strategy has two objectives. First, clearly, to continue to help as many families as possible during San Diego's housing crisis. Second, program funding renewal each quarter is based on the number of units leased in the prior quarter. If the Commission were to continue to operate under current program guidelines and spend more per unit for fewer units (up to the number of units the funding amount can support) the subsequent quarter's funding would be reduced. It would be based on the HUD HAP amount times the smaller number of units leased. This produces a spiral of declining unit count each quarter. With a program waiting list of more than 30,000 households, decreasing program size is unresponsive to local needs.

Authorize the Chief Executive Officer to Adjust the Payment Standard As Needed to Respond to Available Funding and Local Trends

The payment standard is the maximum subsidy an agency will pay on a unit. Each October, HUD publishes an updated Fair Market Rent (FMR) schedule for a modest housing unit in the market area (San Diego County). A housing agency may apply the local payment standard (90-110% of the FMR) to the updated schedule or continue to use previous FMRs to calculate subsidy for assisted households. An assisted household must pay at least 30% of its income for housing cost. The Housing Commission pays the difference between the client's portion of the rent and the payment standard. If the rent exceeds the client's portion plus the Housing Commission's subsidy, the client must pay a higher portion of income for rent. Also, if there is a rent increase and the Commission is paying the maximum payment standard allowed, the client pays the increase in rent. A rent reasonableness test ensures that contract rent does not exceed rent for a comparable unit in the open market.

Fair Market Rents are established by region and frequently do not reflect actual rental cost. Using a payment standard above 100% of the FMR allows a housing agency to respond to local rental costs and enables assisted households more opportunities in the housing market.

In Fall 1999, the Board set the payment standard at 110% of HUD's Fair Market Rent (FMR). Until March 2004, rental assistance staff continued to use the FMRs published in October 2002 to calculate subsidy. In March, rental assistance staff began to apply the 110% payment standard to the FMR schedule published in October 2003 because the lease up pace was slowing for some households.

It is recommended that staff be given direction to study the payment standard and adjust it downward to the degree feasible. This will allow the staff to thoroughly analyze the effect the payment standard has not only on the level of subsidy but also consider clients' ability to lease units in the private market. Revisions to the payment standard will be reported to the Housing Commission Board whenever a change is made along with the projected impact to the program.

Revise the Subsidy Standards to require more household members in each voucher size.

"Subsidy Standard" is HUD's term for the methodology that housing agencies use to assign a voucher to a household based on number of persons in the household. The size of the voucher varies according to the number of bedrooms a family may lease using the Subsidy Standard as a guide. The voucher size determines the amount of subsidy the family will receive; the family may select a unit with more bedrooms but the Housing Commission's payment would be capped at the smaller unit size. The family could choose to pay a higher portion of the rent. At initial move-in, the unit must meet HUD affordability criteria that prohibits the family from paying more than 40% of its monthly adjusted income for rent.

Historically, the Housing Commission has used liberal subsidy standards to make it easier for assisted families to find housing. For example, under the current standards, a family consisting of head of household, son and daughter receive a three (3) bedroom voucher. The Commission may assign this family a two bedroom voucher. The recommendation is to revise the subsidy standards as follows:

SUBSIDY STANDARDS
INITIAL VOUCHER SIZE ISSUANCE CHART

Voucher Size	Persons in Household			
	Minimum		Maximum	
	Current	Proposed	No Change	
0 Bedroom	1	1	1	
1 Bedroom	1	1	2	
2 Bedroom	2	3	4	
3 Bedroom	3	5	6	
4 Bedroom	4	7	8	
5 Bedroom	6	9	10	
6 Bedroom	8	11	12	

If approved, the new subsidy standards will be implemented immediately for families joining the program and currently assisted households that move. All other Section 8 participants will receive a four month notification that the subsidy standard change will occur at their annual recertification.

Impact:

- The estimated cost reduction projected for Fiscal Year 2005 is between \$2.9 and \$3.8 million;
- Some families may have difficulty in locating units since owners prefer to rent to households with fewer people in each bedroom;
- Families with an increased rent burden may move to a more affordable unit. This also adds to the administrative cost of the program.

Establish a “rent cap” to restrict rent increases

Under Section 8 program regulations, owners may request rent increases according to their lease agreement with the tenant. The majority of owners execute six or twelve month leases that become month to month leases at the end of the initial term. This allows owners, after the initial term of the lease, to increase their rents anytime with a sixty-day notice as long as the rent is still considered “reasonable.” The rental assistance staff processes over 300 rent increases each month at an average of \$71 per increase.

Specifically, staff is recommending that owners be allowed one rent increase within a twelve month period and limit the amount of the rent increase to the current Consumer Price Index (CPI) (currently 2.2%).

NOTE: The CPI rate is not the separate inflation rate published on shelter cost (currently 7%).

Impact:

- A reduction in program costs of \$1.2 million in FY05;
- Likely decrease in owner participation, as many landlords identify restrictive rent increases as a disincentive;
- Potential increase in fraud; tenants may make “under the table” arrangement to compensate for lower rental increases;

If approved, this revision will be effective July 1, 2004. Owners will be advised of this change to Housing Commission policy through a notification included with the June HAP payment.

Request waivers to certain program regulations

The Section 8 program is a highly regulated program, allowing very little flexibility to housing agencies. Under certain circumstances, HUD will grant waivers to regulations or recommend statutory revisions. Rental assistance staff recommend requesting HUD assistance to waive the following regulations:

1. Income targeting. Currently, 75% of all households coming onto the Section 8 program must be in the extremely low income category. This requires “skipping” households on the list whose incomes are above 30% AMI. If waived, this change would result in assisting households based on date and time they applied for assistance.
2. Notification in change of payment standard. Should the CEO determine that the payment standards should be revised to a lower level, this change would not be applicable to most assisted households until their second annual recertification. A waiver would allow the Housing Commission to implement a lower payment standard at the household’s next annual recertification.
3. Limitation on participants paying more than 30% of their income for housing. The Housing Commission must monitor its payment standard to ensure that no more than 40% of assisted households pay more than 30% of their income for housing costs. As noted in the report, currently only 20% of assisted households pay more than 30% toward rent. This change would allow flexibility in revising the payment standard.

Other Issues

- Housing Commission staff intends to coordinate, to the extent possible, with other local housing agencies to achieve maximum consistency in the operation of contiguous Section 8 programs.
- It is likely that the new HUD funding procedure will affect administrative reimbursement to housing agencies. When the precise impact is known, further Housing Commission direction may be sought.
- Housing Commission staff is participating, along with other housing agencies, in advocacy and education about the impact of the funding changes. In addition, we are participating in policy discussions to develop a new rental assistance program design. This may also require further Board consideration.

Alternative

The Board may direct staff to reduce the number of households served under the Housing Choice Voucher program through attrition. A very preliminary estimate of the number of households that would have to be dropped from the program in FY05 is 580 of the households requiring the highest amount of subsidy. This alternative is not recommended at this time since future incremental funding is based on the number of households leased up to the baseline allocation (12,034 in San Diego) and the HAP cost, as calculated by HUD staff. Decreasing the number of households leased will result in continuing decrease in program size.

Respectfully submitted,

Signature on File Approved by
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The New York Times

Killing Off Housing for the Poor

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The Bush administration's tax cuts for the well-to-do have taken a heavy toll on the nation's most important social programs for the poor and working class. Prominent casualties include child care assistance for working mothers and federal aid for needy college students. The latest victim appears to be Section 8, the government's main housing program for the poor. The program provides rent subsidies for two million of the country's most vulnerable families and encourages private developers to build affordable housing.

Section 8 subsidies go primarily to families that live at or below the poverty level, in households that include children, disabled people or the elderly. These families pay 30 percent of their incomes toward rent and the Section 8 vouchers pay the rest. Some cities give priority to battered women, many of them with children, who have to find a new place to live to escape danger. The need is so great that families often wait years for vouchers, which become available when voucher holders die or become ineligible after getting better jobs.

Congress rejected an administration proposal that would have placed a financing cap on the program and turned the money over to the states. But the administration's assault continues, through the appropriations process in the House and through administrative rulings at the Department of Housing and Urban Development, which has been trying to put the brakes on the voucher program. Last month, the department issued new guidelines to the country's 2,500 public housing agencies declaring that it would no longer pay the full cost of the vouchers but would cap the federal contribution at the level of August 2003, adding an adjustment for inflation.

This has already caused some private builders and financiers to back away from projects that would have produced desperately needed affordable housing. In addition, public housing officials in many states have made it clear that the new policies will force them to raise rents or evict tenants. Having paid lip service to the goal of ending chronic homelessness, the Bush administration is now threatening to kill off the only program that could possibly achieve it.