



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548



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B-171630

JUN 16 1977

The Honorable Robert S. Walker
House of Representatives

Dear Mr. Walker:

AGC 00023

In accordance with your request of January 12, 1977, we have reviewed certain aspects of the fair market rents established by the Department of Housing and Urban Development for new housing units in Lancaster, Pennsylvania. These rents are used in connection with the Department's section 8 leased housing program. We examined the documentation which the Department has to support its determinations that:

--Rents charged to tenants in adjacent York County approximate those charged in Lancaster County and, therefore, should be used in Lancaster because specific comparable rents were not available for Lancaster.

--York County rents should be increased by 12 percent in computing fair market rents for the Lancaster area.

Although not requested to do so, we examined some aspects of the Department's section 8 rental assistance contracts for Lancaster County and elsewhere in eastern Pennsylvania.

We examined records and talked to officials at the Department's regional and area office in Philadelphia and at its headquarters office in Washington, D.C. We also talked to officials of the Pennsylvania Housing Finance Agency. Additional information was obtained from management personnel of several nonsubsidized apartment projects in the Lancaster area. Our work was confined primarily to a review of the adequacy of documentation which the Department has to support the fair market rent schedules published in the Federal Register on April 6, 1976, for new construction and substantial rehabilitation in Lancaster County. We made no attempt to examine the leasing of existing housing under the section 8 program.

CED-77-84

Generally, we found that there was an absence of documentation supporting the April 1976 fair market rent determinations for the Lancaster area. Area office officials generally relied on comparable market rent data from areas outside of Lancaster and did not maintain documentation supporting the rents that were established. Because of the absence of documentation, the reasonableness of the fair market rents published in the April 6, 1976, Federal Register for Lancaster County cannot be readily determined. We found comparable units were available in Lancaster which could have been considered in determining fair market rents for some of the rental categories.

We also found that the Department's Philadelphia area office has approved rental assistance contracts for two projects in Lancaster County that were being planned at March 30, 1977. The rental rates established for these projects will exceed the fair market rent limitation established under the section 8 program by about \$2 million over the contract period, if contingency fees are paid. The contingency fee will be paid if the cost of permanent financing is higher than the estimated financing cost used in negotiating the rental assistance contracts. In addition, we were informed that the area office has approved 30 other projects in eastern Pennsylvania which may have the same problem. Department officials have agreed to take action nationwide to (1) prevent a reoccurrence in the future and (2) determine what recourse is available to the Department with respect to projects already approved.

We recommend that the Secretary of Housing and Urban Development:

- Direct that the fair market rent instructions be revised to clearly require that adequate documentation be maintained in support of fair market rent determinations.
- Emphasize to the Philadelphia area office the need to obtain and develop comparable rent data in support of future fair market rent determinations.
- Immediately notify field offices that contingency fees should be included in determining whether or not monthly rental assistance for particular projects exceeds the section 8 fair market rent limitation.

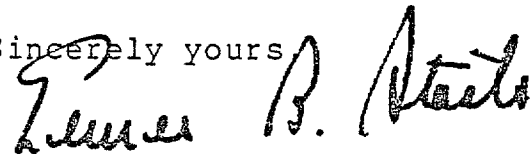
--Determine the extent that projects have been approved that contain rents in excess of the section 8 fair market rent limitation and the recourse that is available to the Department for such projects.

As you requested, we did not give the Department an opportunity to formally comment on this report. Its contents, however, were reviewed and discussed with key officials who are responsible for administering the program, and their comments were incorporated where appropriate.

Copies of this report are being sent today to the Director, Office of Management and Budget; the Secretary of Housing and Urban Development; the House Committee on Government Operations; the Senate Committee on Governmental Affairs; and the House and Senate Committees on Appropriations.

A detailed summary of our findings is presented in the enclosures to this letter.

Sincerely yours,

A handwritten signature in cursive script that reads "Luther B. Starks". The signature is written in dark ink and is positioned to the right of the typed name.

Comptroller General
of the United States

Enclosures - 2

SUMMARY OF RESULTS OF
INQUIRIES INTO CERTAIN ASPECTS OF THE
FAIR MARKET RENT SCHEDULES FOR LANCASTER, PENNSYLVANIA

BACKGROUND

The Housing and Community Development Act of 1974 (Public Law 93-383, Aug. 22, 1974) amended the United States Housing Act of 1937 (42 U.S.C. 1437 et seq.) and added, under section 8, a new lower income housing assistance program. Section 8 provides financial assistance to lower income families enabling them to lease existing, newly constructed, or substantially rehabilitated housing.

The act requires the Secretary of Housing and Urban Development to periodically establish fair market rents for existing or newly constructed rental dwelling units of various bedroom sizes and structure types suitable for occupancy by lower income persons. Fair market rents are intended to provide adequate financial incentives to attract owner participation in the section 8 program. Market areas for establishing new construction and substantial rehabilitation fair market rents were defined as the same areas for which the Department had previously established construction prototype 1/ costs for public housing. York and Lancaster Counties are separate market areas.

Departmental instructions for the new construction and substantial rehabilitation programs provide that fair market rents be based on a sampling of rents paid in each market area, such as Lancaster and York Counties for comparable newly constructed units of modest design. The instructions provide that 12 comparable units from different projects or developments be used in establishing the rents. However, in the absence of relevant market rental data, rents may be established through some other logical means. In addition, fair market rent schedules are to provide a reasonable progression of rents according to bedroom size and structure type.

1/ The Department defines "prototype area" as a geographic area where trade conditions and economic influences make construction costs similar. The area is usually a city but in most cases extends beyond the city's boundaries.

The regulations provide in 24 C.F.R. 888 (1976) that the fair market rent limitations for rental units specifically designed for the elderly would be increased by 5 percent over that applicable to lower income families due to the special amenities and design features built into units occupied by the elderly. Section 8 of the act provides that the maximum monthly rents for a particular project may exceed the published fair market rents by not more than 20 percent.

The Philadelphia area office made its fair market rent determinations for the Lancaster area on December 11, 1975. These determinations were subsequently forwarded to the Department's headquarters office for review and approval. The headquarters staff made two adjustments to the recommended rent schedules. Final approved fair market rents, as published in the Federal Register on April 6, 1976, for Lancaster and York Counties, are included in enclosure II.

Department instructions also provide that revised estimates of fair market rents shall be made at least annually. Every other year a revision may be made by application of trend factors to the previously published rent schedules. Trend factors are to take into account certain changes, such as construction costs and utility expenses.

The Philadelphia area office submitted revised fair market rent recommendations for new construction to the Department's headquarters on November 12, 1976, for review and approval. The proposed rent schedules published for comment in the Federal Register on April 25, 1977, represented a 9.2 percent increase over the April 1976 published rents. Also, Philadelphia area office officials plan to initiate a new market rent comparability study in November 1977 to determine the revised fair market rents for 1978.

ADEQUACY OF DATA SUPPORTING
APRIL 1976 RENTS PUBLISHED FOR LANCASTER

Fair market rents were published in the Federal Register in April 1976 for 15 different rental categories of new construction and substantial rehabilitation for Lancaster County ranging from \$190 a month for an efficiency walkup to \$448 a month for a four-bedroom or more detached home.

In determining the fair market rents for the 15 rental categories, the Department utilized the following data:

- Comparable rents from 12 Lancaster housing projects were used for one-bedroom walkup units.

- Lancaster data for one-bedroom walkup units was projected on a square foot basis for efficiency walkup units.
- York rents were increased from 9.1 percent to 11.7 percent in Lancaster for two-, three-, and four-bedroom or more walkup units.
- For the remaining 10 rental categories (elevator, semidetached, and detached structure types) average rental costs per square foot for typical units found in "similar communities" outside the Lancaster market area were used.

Lancaster rental data used
for two rental categories

The fair market rent for one-bedroom walkup and efficiency units were based on rents charged for existing one-bedroom walkup units in Lancaster. The \$245 a month fair market rent for one-bedroom walkup units in Lancaster was based on an analysis of rents charged for comparable nonsubsidized units in 12 different projects within the Lancaster area. The rent determinations were documented.

The fair market rent for efficiency walkup units of \$190 was projected from the square foot rental cost for one-bedroom walkup units in the 12 Lancaster projects.

York rental data used to determine
rents for three rental categories

The determinations of fair market rents for two-, three-, and four-bedroom or more walkup units in Lancaster were established by increasing the fair market rents established for the same type units in York County. Philadelphia area office officials informed us that Lancaster rents were set higher than York rents for these units because their evaluation of rents for one-bedroom walkup units in the two areas showed that Lancaster was higher. Except for the information on rents for one-bedroom walkup units in the two areas, these officials had no source documentation to support their determination of the amount by which York rents were increased to arrive at rents for Lancaster. According to these officials, Lancaster fair market rents for walkup units follow an orderly progression in bedroom sizes in accordance with Department guidelines.

In establishing the Lancaster County rents, the York County rents were increased by 11.7 percent for a two-bedroom walkup, 9.1 percent for a three-bedroom walkup, and 9.6 percent for a four-bedroom or more walkup.

Source documents for 10 rental categories not maintained

The Lancaster area fair market rents for elevator, semidetached, and detached structure types (10 rental categories) were based on the average rental costs per square foot for typical units found in similar communities, according to Philadelphia area office officials. They stated that ranges of square foot rental costs were used for the various rental categories and some point in the range was arbitrarily selected as the basis for the Lancaster fair market rent computations. These officials also told us that upward adjustments were made to the initially computed fair market rents for elevator units in order to provide a reasonable progression of rents according to structure types.

Area office officials did not maintain source documents in support of the range of rental costs used nor could they tell us the names of the similar communities from which the data was obtained. They stated that the data was extracted from informal notes gathered by various Department appraisers; however, copies of the notes were not maintained in the area office. They said that the notes were probably thrown away.

Headquarters officials made two downward adjustments to the rent schedules submitted by the area office. The rent for the one-bedroom elevator unit was adjusted from \$295 to \$291, and the rent for the two-bedroom elevator unit was adjusted from \$360 to \$339. Headquarters officials were not able to provide us with an explanation for these adjustments.

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In April 1977 we discussed with key Department headquarters officials the absence of documentation to support the fair market rents set for the 10 Lancaster rental categories and the increases made in the 3 rental categories for which York rents were used. They informed us that the intent of applicable Department instructions is that documentation to support fair market rent determinations be maintained. The instructions require that in preparing fair market rent schedules adjustments be based on some logical and defensible basis.

However, they acknowledged that Department instructions needed clarification on this matter. In June 1977 these officials informed us that they would revise Department instructions to clearly state that such documentation be maintained in the future.

Comparable Lancaster units available
but not used in determining rents.

We could find no evidence that Philadelphia area office officials attempted to identify whether comparable rental units were available in Lancaster for some rental categories that could have been used for comparison purposes as required by Department instructions. For 6 of the 15 rental categories, we found that some comparable units were available in Lancaster but not used in determining fair market rents.

The 12 nonsubsidized Lancaster projects used to determine fair market rents for one-bedroom walkup units had comparable units which could have been used to set fair market rents. These units were efficiency, two- and three-bedroom walkups and two-, three-, and four-bedroom semidetached units.

After we brought this matter to the attention of Philadelphia area office officials, they agreed that these units were comparable and should have been considered when the fair market rent determinations were made. This was not done because the staff was involved in higher priority work.

FAILURE TO CONSIDER CONTINGENCY
FEES IN DETERMINING MAXIMUM
FAIR MARKET RENTS

Area office officials advised us that three section 8 projects are underway or planned for Lancaster County. Two of these projects have been approved and contain a provision for the payment of contingency fees to the Pennsylvania Housing Finance Agency. Generally, this provision permits the Department to contract with a State agency on the basis of the estimated costs for permanent financing, and subsequently adjust the contract rents 1/ if the actual cost of permanent financing is greater than estimated. For instance, the State agency may estimate financing costs of 8 percent, however, when the bonds (permanent financing instrument) are sold, financing costs actually incurred may be 10 percent.

1/ Rent payable to the owner under his contract, including the portion of the rent payable by the tenant.

The Department has entered into contracts to provide section 8 rent subsidy payments for two Lancaster area projects--Prince Street Towers and Millersville Manor--that will be mortgaged through the Pennsylvania Housing Finance Agency. It is considering a contract to provide rent subsidies for the third project--Jaycee-H.D.C. Senior Citizens Housing--that will be financed by the Department under section 202 of the Housing Act of 1959, as amended, which provides housing for the elderly or handicapped. The Department has agreed to a contingency fee for the two projects on which contracts have been executed, which, if paid, will result in rent subsidy payments of \$2 million in excess of the section 8 program fair market rent limitation over the 40-year contract period.

According to Philadelphia area office officials responsible for administering the program in eastern Pennsylvania, there were 30 contracts with the Pennsylvania Housing Finance Agency, each containing a contingency fee, which, if paid, would result in assistance contracts which exceed the section 8 fair market rent limitation. For example, three other contracts--in addition to the contracts for the two Lancaster projects--contain a contingency fee which, if paid, would result in assistance payments that exceed the fair market rent limitation by \$2.5 million over the 40-year contract period.

Headquarters officials advised us that contract rents, including contingency fees, cannot exceed the rents published in the Federal Register by more than 20 percent and furnished us a copy of a decision to this effect by their Office of General Counsel, dated July 23, 1976. The officials advised us that this decision was made known to the field office general counsels by reference to the decision in a monthly memorandum addressed to all field and headquarters-office attorneys. The contract for the two projects in Lancaster and the three outside of Lancaster were all executed after July 1976. Officials of the area office advised us that they were not aware of the decision or that contingency fees were subject to the 20 percent limitation. Headquarters officials also stated that other field offices were experiencing similar problems with the regulations. They agreed with our proposal to alert all regional offices immediately to the problem and to look into what recourse is available to the Department on those contracts which may exceed the fair market rent limitation.

In a June 1977 discussion, headquarters officials said that they had emphasized, during training sessions of the field staff, the need to recognize contingency fees within the 20 percent limitation. They also agreed that their

regulations are not clear as to whether contingency fees are to be included within the 20 percent legislative limitation and stated that the regulations would be clarified in the future--which they estimated would be about 6 months.

Extent of contingency
fee in Lancaster County

Section 8 of the act provides that monthly assistance for a particular project may exceed, by no more than 20 percent, the fair market rents published in the Federal Register. In the case of a project for the elderly, Department regulations provide that a 5 percent adjustment be made to the published fair market rents before the 20 percent limitation is applied. The two projects with approved rental assistance are for elderly housing. The Department has agreed to adjust contract rents if the cost of permanent financing is higher than the costs on which the contract rents are based.

The rental assistance is within the 20-percent limitation if the full amount of the finance contingency fees are not included in the contract rent. If the finance contingency fees are included, however, it appears payments in excess of the fair market rent limitation--\$4,200 annually and \$169,000 in total for the Millersville project and \$45,600 annually and \$1,824,000 in total for the Prince Street Towers--will be made, as discussed below.

Prince Street Towers (new construction)

This 13-story elevator building will provide 200 one-bedroom elevator elderly housing units for low-income persons. The project will be permanently financed by the Pennsylvania Housing Finance Agency. The estimated cost for completing the construction is about \$6.3 million. On January 28, 1977, the Department approved total annual rental assistance of \$924,000 over a 40-year period or about \$37 million in total. The estimated completion date for the project is January 1979.

The published fair market rent for a one-bedroom elevator unit in Lancaster is \$291 a month. Because the project is for the elderly, a 5 percent increase is permissible under the Department's regulations which results in a fair market rent of about \$306. For a particular project, if the \$306 is increased by 20 percent the monthly rent would be limited to \$366.

The monthly contract rent approved was \$352 plus a finance contingency fee of \$33 per month per unit or up to \$19 more than the 20-percent limitation. If the contract rent is adjusted to include the full amount of the contingency fee, the 20-percent limitation will be exceeded by \$45,600 annually and \$1,824,000 over the 40-year contract period.

Millersville Manor (substantial rehabilitation)

This project will substantially rehabilitate the former University Apartments located in Millersville, Pennsylvania. The project will provide a total of 121 elderly housing units of varying types for low-income persons. This project will also be permanently financed by the Pennsylvania Housing Finance Agency. The estimated cost for completing the substantial rehabilitation is about \$3.2 million. On August 6, 1976, the Department approved total annual rental assistance of about \$477,000 over a 40-year period or about \$19.1 million in total. The estimated completion date for the project is November 1977. The approved maximum monthly per unit rent follows.

Number of units	Type unit	Fair Market Rents			Approved Contract Rents		
		Existing	Adjusted for elderly allowance 5 percent	Adjusted for maximum allowance of 20 percent	Gross rents	Finance cost contingency	Monthly per unit assistance
32	Efficiency elevator	\$225	\$236	\$283	\$259	\$27	\$286
57	One-bedroom elevator	291	306	366	336	27	363
32	One-bedroom walkup	245	257	301	282	27	309

If the full contingency fee is paid, the fair market rent limitation would be exceeded by \$4,200 annually and \$169,000 over the 40-year contract period.

FAIR MARKET RENTS FOR NEW CONSTRUCTION
PUBLISHED ON APRIL 6, 1976, FOR
LANCASTER AND YORK COUNTIES, PENNSYLVANIA

Type unit (notes a and b)	<u>Fair Market Rents</u> <u>Lancaster County</u>		<u>Fair Market Rents</u> <u>York County</u>		<u>Percent Increase</u> <u>Lancaster over York rents</u>	
	<u>Area office</u> <u>recommendation</u>	<u>Federal Register</u> <u>April 6, 1976</u>	<u>Area office</u> <u>recommendation</u>	<u>Federal Register</u> <u>April 6, 1976</u>	<u>Based on</u> <u>area office</u>	<u>Based on</u> <u>Federal Register</u>
Walkup:						
Efficiency	\$190	\$190	\$185	\$185	2.7	2.7
1 Bedroom	245	245	225	225	8.9	8.9
2 "	295	295	272	c/ 264	8.5	11.7
3 "	360	360	337	c/ 330	6.8	9.1
4 "	410	410	378	c/ 374	8.5	9.6
Elevator:						
Efficiency	225	225	220	220	2.3	2.3
1 Bedroom	295	c/ 291	275	c/ 266	7.3	9.4
2 "	360	c/ 339	330	c/ 305	9.1	11.1
Semidetached:						
1 Bedroom	259	259	237	237	9.3	9.3
2 "	304	304	289	289	5.2	5.2
3 "	378	378	352	c/ 349	7.4	8.3
4 "	437	437	399	399	9.5	9.5
Detached:						
2 Bedroom	340	340	320	320	6.3	6.3
3 "	410	410	400	400	2.5	2.5
4 "	448	448	440	440	1.8	1.8

a/ Fair market rents for three- and four-bedroom elevator, efficiency, semidetached, and efficiency and one-bedroom detached units were not established.

b/ Four-bedroom fair market rents are also used for four or more bedrooms.

c/ Rents were adjusted by headquarters officials.