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SUBJECT: Tax Credit Project Owners Are Allowed to Charge Higher Rents for Tenant-Based Section 8 Voucher Households than Non-Voucher Households

HIGHLIGHTS

What We Audited and Why

We initiated this review as a follow-up to previous Office of Inspector General (OIG) audit work at a public housing agency that noted low-income housing tax credit (tax credit) projects charged higher rents for tenant-based housing choice voucher households than to tenants without vouchers. The rents charged for voucher households also exceeded the rent restrictions established by the Internal Revenue Service for these tax credit projects. Our audit objectives were to 1) estimate the extent to which the tenant-based Housing Choice Voucher program was charged rents that exceeded the Internal Revenue Service's tax credit restricted rents and evaluate the potential impact of disallowing such unnecessary rent levels and 2) evaluate the extent to which tenant-based housing choice voucher households occupied units that also received a tax credit subsidy.

What We Found

Consistent with program regulations, tax credit project owners are allowed to charge the Housing Choice Voucher program more than $13.5 million annually for rents that exceed the Internal Revenue Service maximum rent when they lease rent restricted units to households with tenant-based housing choice vouchers (tenant-based vouchers). Without these vouchers, the same units would be available to the same households at the lower, Internal Revenue Service restricted rent. The restricted rents were established for all of the units in each project because the owners had proposed and agreed to them in exchange for a capital subsidy in the form of tax credits. The U.S. Department of Housing and Urban Development (HUD) has already disallowed similar rent levels for other subsidized affordable housing programs on the basis that the additional portion amounts to an extra subsidy. Further, use of tenant-based voucher funds to pay such unnecessarily high rents directly reduces scarce program funds that could be used to assist additional low-income families.

The tenant-based voucher program provides a significant amount of rental assistance to the tax credit projects. However, accurate and up-to-date information on the use and cost of tenant-based vouchers in tax credit units is not available because no agency monitors the overlap of these programs. To ensure the most effective use of taxpayer dollars, agencies should provide information that clearly, accurately and consistently tracks the extent of these programs' overlapping benefits. HUD has the mechanisms in place to capture data on the use of vouchers in tax credit units, but does not do so.

What We Recommend

We recommend that HUD change its regulations to cap gross rents at the Internal Revenue Service restricted rent for the 60 percent median income level when tenant-based vouchers are used for units in tax credit projects that have all of their units rent restricted. We also recommend that HUD track the use of tenant-based vouchers in tax credit-subsidized units by including this data in the family reports already submitted by the housing authorities. For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided the discussion draft report to the auditee on June 6, 2006, and held an exit conference on June 26, 2006. HUD's Office of Public and Indian Housing provided written comments on October 16, 2006. HUD, for the most part, disagreed with the report. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

Congress authorized the tenant-based Housing Choice Voucher program under Section 8 of the United States Housing Act of 1937 to help low-income households choose and rent safe, decent, and affordable privately owned rental housing. More than 2,500 state or local government entities called public housing authorities (housing authorities) administer the program and were authorized to receive $13.5 billion[1] to renew roughly 2 million vouchers in fiscal year 2005. The housing authorities enter into housing assistance payment contracts with the rental unit owners. The owner receives a monthly subsidy payment until the (tenant-based) voucher holder moves out, at which time the housing assistance contract terminates. Within U.S. Department of Housing and Urban Development (HUD) guidelines, the voucher holder can then take the voucher to another qualified dwelling and continue to receive Section 8 rental assistance.

The tenant-based Housing Choice Voucher (tenant-based voucher) program allows the assisted household to choose any housing that meets program requirements and, unlike project-based rental assistance, does not limit the choice to units in specified housing projects. Tenant-based vouchers are primarily used in nonfederally owned rental housing, but acceptable units may be in projects insured or financed by various federal subsidies, such as the Federal Housing Administration Single Family Loan program, HOME Investment Partnerships Program (HOME), the Rural Housing Service 515 program, and the Internal Revenue Service Low-Income Housing Tax Credit (tax credit) program.

The tax credit program was established by Congress in 1986 to encourage private development of affordable housing. Section 42 of the Internal Revenue Code governs the program and allows the Internal Revenue Service to allocate a limited number of tax credits to each state based on population. State agencies administer the program and award their tax credits to qualified proposals for affordable housing projects. The state agencies publish annual qualified allocation plans that detail criteria used to rank proposals and often award extra points for proposals that target certain locations or housing needs. Developers that are awarded tax credits sell the credits to investors to raise capital for their projects. This reduces the funds that they would otherwise need to borrow from other sources and eventually repay from project cash flows. In return for the tax credit subsidy, the projects must operate with predetermined rent restrictions for a minimum of 15 years. The developers' proposals must show that the projects will remain viable over that period at the predetermined level of restricted rents. Once the projects are completed, the state allocating agencies monitor their compliance with the restricted rents (and other program requirements) and annually review the projects' eligibility for tax credits.

To qualify for the tax credit subsidy, a project must irrevocably designate a percentage of rent-restricted units to be occupied by low-income households. The tax laws establish maximum rents for rent-restricted units according to the income level of tenants who will occupy the units. The minimum thresholds are:

[1] This amount is for voucher renewals under the tenant-based rental assistance account.

- 20 percent of the units are rent restricted and occupied by individuals whose income is 50 percent or less of the area median gross income, or
- 40 percent of the units are rent restricted and occupied by individuals whose income is 60 percent or less of area median gross income.

The maximum gross rent[2] for rent-restricted units is 30 percent of the income limitation applicable to the unit (adjusted for unit size). The Internal Revenue Code allows gross rent to exceed the tax credit maximum applicable to a unit only if the excess does not come from the tenant.

The remaining units are not rent restricted and can be leased at market rates. However, most tax credit projects agree to restrict rents for all of their units[3] because the competition for tax credits is great and state allocation plans tend to favor proposals that will serve more low-income families. In addition, many tax credit projects irrevocably set aside some units for families with very low income levels of 20, 30, and 40 percent of area median gross income. In accordance with the tax credit rules, the restricted rents for these units are very low, and such units are referred to as being "deeply skewed". State allocation plans often award more points for proposals that have deeply skewed units because they will serve the neediest families.

The regulations that govern the tenant-based voucher program (24 CFR [*Code of Federal Regulations*] Part 982) require housing authorities to approve rent subsidies within the following limitations. The housing authority must determine that the rent requested for the unit is reasonable in comparison to market rents charged for other comparable, unassisted units. The housing authority must then calculate the amount of rental assistance based upon the family's adjusted income, the unit's gross rent, and the housing authority's Section 8 payment standard.[4] Generally, the gross rent cannot exceed the Section 8 payment standard unless the family pays the additional amount.[5] Tenant-based voucher program legislation does not prohibit the gross rent from being lower than the payment standard as long as the unit meets HUD's housing quality standards.

Our overall audit objective was to estimate the extent to which the tenant-based voucher program was charged rents that exceeded the IRS restricted rent for units subsidized by tax credits to be affordable at the 60 percent median income level. We also looked at the overlap of the tenant-based voucher and tax credit programs and considered the significance of using both programs to maintain one unit of affordable housing.

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[2] Gross rent includes a utility allowance for utilities not paid directly to the owner.
[3] According to "Updating the Low-Income Housing Tax Credit Database Projects Placed in Service Through 2003," (HUD Office of Policy Development and Research, January 2006), the average percentage of low-income units was 95 percent nationwide.
[4] The Section 8 payment standard is the amount generally needed to rent a moderately priced dwelling unit in the local housing market. Housing authorities are allowed to set payment standards from 90 to 110 percent of HUD's fair market rent for the area. If warranted, HUD can approve exceptions upon request.
[5] However, the additional amount is effectively limited because, by law, the family's share of the initial rent cannot exceed 40 percent of its adjusted income. In general, the voucher family's income may not exceed 50 percent of the median income for the area in which the family chooses to live. In addition, a housing authority must provide 75 percent of its vouchers to applicants whose incomes do not exceed 30 percent of the area median income.

RESULTS OF AUDIT

Finding 1: Tax Credit Project Owners Are Allowed to Charge the Tenant-Based Voucher Program More Than $13.5 Million Annually for Rents that Exceed the Maximum Tax Credit Restricted Rent

Under current rules, tax credit project owners may charge higher rents for tenant-based Section 8 voucher households than non-voucher households. This is in spite of the fact that the project owners had proposed and agreed to restrict rents for these units in exchange for a capital subsidy in the form of tax credits, and underwriters determined the projects would be viable with those restricted rents because tax credit subsidized financing significantly reduced total financing costs over the project's operating period. HUD's policies regarding rental limitations for units that receive multiple subsidies have been imprecise or inconsistent, and HUD currently disallows similar extra rents for other subsidized affordable housing programs. Allowing tax credit projects to charge HUD more for units rented to tenant-based voucher holders is unnecessary and directly reduces the Section 8 funds available to assist other low-income families in need of affordable housing.

Housing Authorities Were Charged Unnecessary Rents Where Section 8 Payment Standards Exceeded Tax Credit Restricted Rents

Our analysis of approximately 1.2 million tenant records found that housing authorities were charged more than $13.5 million per year in unnecessary rents for tax credit subsidized units rented to tenant-based voucher holders. The higher rents were unnecessary because the same units would have been available to these households at the lower, tax credit restricted rent if the households were otherwise eligible but did not have voucher subsidies Moreover, the voucher household should not be charged higher rent just because it has a voucher, since, according to tax credit law, a tax credit project cannot refuse to rent to a voucher holder solely because he or she has a voucher.[6] Tax credit law does allow owners to count a voucher-occupied unit as rent restricted for the purpose of qualifying for the tax credit even if the gross rent exceeds the tax credit restricted rent level so long as the tenant's portion of the rent does not exceed the rent restriction.[7] However, neither the tax credit law nor the laws governing the Section 8 program provide that an owner is **entitled** to receive the higher

[6] 26 USC [*United States Code*] 42(h)(6)(B)(iv).

[7] In such a scenario, the tenant's portion of the rent would be capped at the tax credit restricted rent level and Section 8 funds would be used to fund the remaining rent up to the applicable Section 8 payment standard.

rent level. Finally, the tax credit projects can charge a non-voucher tenant no more than the tax credit restricted rent even when the household's income rises above its qualifying income level.[8]

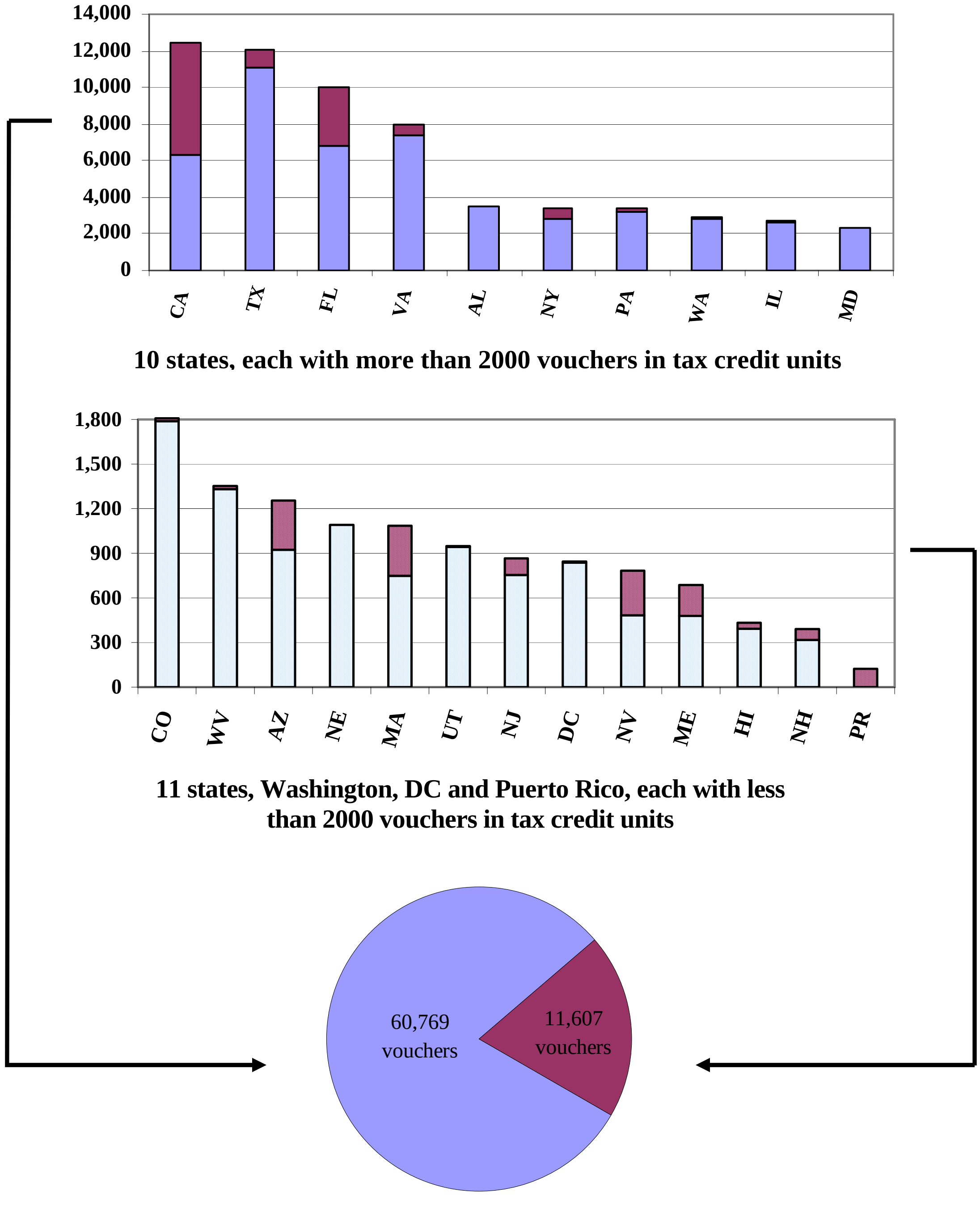
Overall, the average amount of rent that exceeded the tax credit restricted rent for the 60 percent area median income level (maximum restricted rent) was $85 per month, but in one state we reviewed, the average was more than $200 per month. In markets with very high rents, there were charges of up to $900 per month more than the maximum tax credit restricted rent (which was also high compared to fair market rents in other areas). We calculated the amount of rent charged that was more than the tax credit maximum from approximately 13,000 current tenant records in the Public and Indian Housing Information Center database, where we found that a tenant-based voucher unit (1) was located in a tax credit property with 100 percent restricted rents and (2) had a gross rent that exceeded the maximum tax credit restricted rent for the unit size.

The $13.5 million in unnecessary rents we identified should encompass most of the annual extra rent charged nationwide at the time of our review. Although we analyzed data for only 21 states, Washington, DC, and Puerto Rico, we designed our analysis to include all areas of the country where the unnecessary rents were most likely to occur; i.e., areas where Section 8 payment standards were generally more than the highest tax credit restricted rent. We also reviewed several states in which Section 8 payment standards were less than tax credit restricted rents and were able to confirm our expectation that these states had very little, if any, unnecessary rents charged to the tenant-based voucher program. These states were Alabama, Illinois, Nebraska, and Washington. Altogether, we identified 72,376 tenant-based voucher records for which the unit was in a tax credit property, including 59,035 for which the gross rent did not exceed the maximum tax credit limit (see finding 2). The following figure shows the number of tenant-based vouchers we found in tax credit units and the proportion that paid rent in excess of the tax credit restricted rent at the 60 percent median income level for the 23 states/areas analyzed.

[8] Internal Revenue Service regulations allow owners to charge the restricted rent and count the unit as rent restricted at that income level even if the household income rises. In 100 percent tax credit projects, there is effectively no limit on the amount the tenant's income can increase. However, projects that have market rate units must convert those units to rent-restricted units as the income for a low-income household increases above 140 percent of its initial qualifying income.

Figure 1: Total number of tenant-based vouchers in tax credit units by state

Darker portion of each bar represents the number of vouchers in the state that were charged unnecessary rent levels



72,376 vouchers in tax credit units identified in 21 states, Washington, DC and Puerto Rico

Our analysis also showed that tax credit projects that had at least one household with a tenant-based voucher comprised about half of the 9,626 projects we screened. We only screened tax credit projects that were 100 percent rent restricted—i.e., projects that had no market rate units—because, among other reasons, we could not identify which units were counted as rent restricted at the time of the rental assistance contract. Of the 4,466 tax credit projects that had at least one household with a tenant-based voucher, the average number of voucher households was 16.2. The tax credit projects charged housing authorities unnecessary rent for about one-fifth of those voucher households. However, these averages varied greatly by project and area.

The $13.5 million in unnecessary rents we found only represents amounts greater than the tax credit restricted rent for the 60 percent area median income level. Some tax credit projects may have agreed to restrict rents to lower amounts for some or all of their units to serve tenants with incomes that are 20, 30, 40 or 50 percent of the area median gross income. Our methodology did not distinguish between tax credit units that had restricted rents for the 60 percent income level and those with lower restricted rents. As a result, even if a unit's rent was restricted to a lower amount, we did not consider a unit's rent level as unnecessary until that rent rose to more than the tax credit restricted rent for the 60 percent income level (maximum tax credit restricted rent). In addition, we did not screen tax credit projects placed in service after 2003 because the data were not available. See the Scope and Methodology section for a more detailed discussion of our audit approach and the limitations on our data analysis.

Allocating Agencies Require Tax Credit Projects to Be Viable without Higher Rents from Tenant-Based Vouchers

Tax credit projects are planned and approved to successfully operate with rent restrictions that make units affordable to low-income families. In this regard, the Internal Revenue Code requires state allocating agencies to provide no more tax credits than necessary to ensure the project's financial feasibility and viability as a qualified low-income housing project throughout the tax credit compliance period (a minimum of 15 years). When evaluating the financial feasibility and viability of proposed projects, state agencies rely on prospective operating statements that use the restricted rents established by the tax credit rules. Officials from state allocating agencies and industry sources told us that underwriters would never approve projected rental income that included higher rents from tenant-based vouchers because the number of voucher families that would choose to live in the project over time is uncertain. Several state and housing authority officials we interviewed thought that tax credit projects might depend upon the higher rental income from the tenant-based voucher program to maintain housing quality or even to remain viable. These officials suggested that some tax credit projects had experienced unforeseen increases in operating expenses and that projected increases in tax credit restricted rents have been less than anticipated. Other state officials thought the overall impact of discontinuing higher rents for voucher households would be minimal because the projects were generally profitable and demand was high for tax credit allocations. We expected the impact could vary according to housing markets, but the scope of our review limited the extent to which we could follow up on these disparate views. However, the mission of the housing choice voucher program is to reduce the rent burden for eligible, low-income families, and not to subsidize owners who are already benefiting from the tax credit program.

Our audit does not address the issue of unnecessarily high rental subsidies for tax credit units with rents restricted for the 20 to 50 percent area median income levels—unless the gross rent charged to Section 8 exceeded the 60 percent level for the area.[9] Tax credit units with rents restricted for the 20 to 40 percent median income level households are referred to as deeply skewed, and, according to industry officials, the very low, tax credit restricted rents that apply to these units do not generate enough cash flow to make the projects viable despite the underwriting process. Officials we interviewed felt strongly that disallowing higher rents for voucher households in these units would have an adverse effect on the projects. They thought that some projects depended on the tenant-based voucher rental subsidies to make up the difference between the deeply skewed rents and tax credit restricted rents for the 60 percent (maximum) income level. As noted above, our methodology did not distinguish tax credit units that were set aside for income levels lower than 60 percent and did not count any rent for these units as part of our $13.5 million in unnecessary rent unless the unit's gross rent exceeded the tax credit restricted rent for the 60 percent (maximum) income level.

HUD Policies on Limiting Section 8 Rental Assistance Used in Tax Credit Projects Have Been Imprecise or Inconsistent

HUD has used its regulatory authority to limit rental assistance for units that receive other subsidies, but has applied this policy inconsistently when Section 8 rental assistance is used with tax credit projects. In the Housing Choice Voucher program introduced under Section 8 in 1998, HUD expressly gave housing authorities discretion to reduce the initial rent charged to tenant-based voucher households when the unit was subsidized by tax credits.[10] HUD dropped this provision when it issued comprehensive regulations that combined the Section 8

[9] The area's maximum tax credit restricted rent, adjusted for unit size.
[10] *Federal Register* 63, no. 83 (April 1998).

Certificate and Housing Choice Voucher programs in 1999.[11] The current guidance from HUD is Notice PIH 2002-22, which states that other tax credit units are considered assisted units and may not be used to determine comparable rents for the Section 8 voucher program.[12,13] Some officials maintain that this implies that tenant-based rents may exceed the tax credit maximum rent because, among other things, comparable unassisted units might be found with higher rents. Nevertheless, this guidance does not directly address whether the housing authorities cannot—or should not—routinely pay rents that exceed a unit's tax credit restricted rent and does not appear to consider tax credit projects that were subsidized to have 100 percent of their units rent restricted.

HUD changed policy direction again in 2005 when it finalized rules for its project-based Housing Choice Voucher program (project-based voucher program). Before the final rule, HUD's policy regarding limits on the amount of rental assistance available for vouchers used with tax credit projects was the same for both tenant-based and project-based vouchers. The new regulations for project-based vouchers are more restrictive than the original 1998 version, stating "rent to the owner may not exceed the … tax credit rent…."[14] In its response to comments on this section of the proposed rule, HUD "determined that it is inappropriate to allow owners to collect higher rents from voucher families than they are allowed to collect from tax credit families. HUD has determined that allowing higher rents would result in a duplicative subsidy."[15] However, in March 2006 HUD, in another policy reversal, proposed a regulatory change that, under certain circumstances, would again allow new project-based Section 8 voucher rents to exceed the tax credit maximum rents. OIG non-concurred with this proposed rule because HUD did not provide compelling evidence to justify paying voucher rents that exceeded the maximum tax credit rents.

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[11] *Federal Register* 64, no. 93 (May 1999).

[12] Extended under HUD Notice PIH 2005-20 (HA), June 22, 2005.

[13] HUD Notice PIH 2002-22, November 1, 2002.

[14] *Federal Register* 70, no. 197 (October 2005). Section 983.304, "Other subsidy: effect on rent to owner," contains two inconsistent references to the issue. Paragraph (c)(2) states, "The rent to the owner may not exceed the … tax credit rent as determined by the applicable federal program listed above (low-income housing tax credit)." Paragraph (e) contains the following, less restrictive language used in the 1998 regulations for the tenant-based voucher program: "At its discretion, a PHA [public housing authority] may reduce the initial rent to owner because of other governmental subsidies, including tax credit…financing." PIH Notice 2006-16 (HA), issued on March 29, 2006, made the new rule applicable only to units selected for project-based vouchers after the effective date of the rule.

[15] Ibid., page 59911.

Figure 2: Stakeholder comments on the application of HUD's policy

Officials we interviewed from the housing authorities, tax credit industry, and state housing agencies had a variety of views regarding HUD's policies in this area.

- Many housing authorities believed that, according to Notice PIH 2002-22, rent exceeding the tax credit maximum was allowed as long as the rent reasonableness standard was met. However, some housing authority officials—particularly those with smaller numbers of vouchers—observed that payment of such a rent level was either unfair (because a non-Section 8 tenant would pay less) or wasteful (because the excess could be used to fund vouchers for families on the waiting list). Officials from one large housing authority stated that they believed the rent level was not appropriate but felt pressured to pay it because other housing authorities in the area already did so.
- Managers of tax credit projects said that they abide by each housing authority's practice and that some housing authorities will agree to a housing assistance payment contract rent in excess of the tax credit maximum, while others would not.
- Officials from state allocating agencies were primarily concerned about whether projects were in compliance with the tax credit rules and that the tax credit program would not suffer as the result of any changes to HUD policies.

Other federal programs that subsidize affordable housing generally limit rental assistance when a unit already has another subsidy. These other programs generally limit the rent to the amount allowed by the stricter program requirement because allowing the higher rent would provide an excess payment. HUD's rationale was that excess payments amount to duplicative subsidies because the affordable housing projects were underwritten to be feasible with the restricted rents. For example,

- If a project unit is subsidized under both HOME and the tax credit program, HOME regulations allow only the stricter maximum rent; i.e., the project must set the rent at the tax credit maximum rent even if the HOME maximum is greater.
- If a project is subsidized under HOME and the occupant has a tenant-based voucher subsidy, HOME regulations require the project to set the rent at the stricter HOME rate if the voucher limit is greater.
- Similarly, if a project is subsidized under the U.S. Department of Agriculture Rural Housing Service 515 program and the occupant has a tenant-based voucher subsidy, Rural Housing Service regulations require any voucher rent that exceeds the program's limit to be remitted back to the program.

Payment of Higher Section 8 Rents for Tax Credit Units Is Unnecessary and Uneconomical

We agree with HUD's reasoning for its HOME program that tenant-based rental assistance in excess of rent restrictions established in return for a capital subsidy is an unnecessary subsidy. Therefore, any extra rent charged to the voucher program amounts to a taxpayer-funded windfall for the owner. The owner receives the additional income without providing any additional affordability to low-income tenants. We further note that there are numerous instances in which the housing authority itself is an owner or investor in the tax credit projects. In these instances, payment of higher rent for vouchers raises questions about spending priorities—should the housing authority limit rents to the tax credit maximum and thus have more Section 8 funds available to serve more voucher holders, or should it charge higher rents to maximize the tax credit project's profitability even though families remain on its voucher waiting lists.

Recent federal budget restrictions have put pressure on housing authorities to continue to meet affordable housing needs with fewer resources. Use of voucher program dollars to pay higher Section 8 rents for tax credit units worsens the problem by directly reducing the voucher funds available to other low-income families in need of affordable housing. In its budget authorization for 2005, Congress addressed the need for housing authorities to take steps that will help maintain the existing level of support to low-income families.[16] In response to the Conference Report for the Consolidated Appropriations Act, 2005, HUD issued guidance[17] to housing authorities that suggested cost-saving actions, including

- Lowering payment standards,
- Reviewing utility allowances to determine whether they are too high,
- Opting to deny portability moves (to higher cost areas or units), and
- Ensuring that reasonable rents incorporate leasing promotions (such as an initial two-month occupancy offered "rent free") and reducing rents immediately when warranted.

Disallowing rents that exceed the tax credit restricted rent for the 60 percent income level would be consistent with these suggested responses to current budgetary constraints.

Conclusion

Tenant-based voucher rental subsidies that exceed an applicable tax credit rent restriction are an unnecessary and uneconomical use of scarce Section 8 funds. The tax credit units are available to non-voucher holders at the lower rents, and the tax credit projects cannot refuse to rent to a voucher holder at the same, lower rent solely because he or she possesses a voucher. Use of voucher program dollars to subsidize rents that exceed the tax credit restricted rent directly reduces funds available to assist other low-income families in need of affordable housing.

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[16] Congress restructured the voucher program to a strictly dollar-based (or budget-based) program to provide housing authorities with administrative flexibility needed to effectively manage their fixed budgets while protecting the most at-risk families.
[17] HUD Notice PIH 2005-9, dated February 25, 2005.

Recommendations

We recommend that the Office of Public and Indian Housing

1A. Draft and implement tenant-based voucher program regulations that require housing authorities to limit housing assistance payment contract gross rent to an amount not to exceed the applicable area's tax credit restricted rent at the 60 percent median income level for units in projects that are 100 percent rent-restricted, thus increasing the availability of tenant-based Section 8 voucher funds by at least $13.5 million annually.

Finding 2: The Extent and Costs of Tenant-Based Voucher and Tax Credit Program Overlap Are Not Monitored

Complete, accurate, and up-to-date information on the use and cost of tenant-based vouchers in units subsidized under the tax credit program is not available to policy makers. The tax credit law delegates' administration of the tax credit program to the states and, therefore, no federal agency is responsible for centralizing cost or performance data. As part of its mission to address the nationwide need for affordable housing, HUD maintains a database of tax credit projects and analyzes the localities and populations served by the program. HUD also has the mechanisms in place to track data on the use and cost of its Section 8 vouchers in tax credit projects but it does not do so. As a result, policy makers (and taxpayers) are not able to monitor the cost of Section 8 voucher use in the tax credit program—possibly three-quarters of a billion dollars annually—and evaluate the cost-effectiveness or necessity of housing voucher families in tax credit projects when making affordable housing policy funding decisions.

Policy Makers Rely on Incomplete Information about Overlapping Housing Subsidies

Affordable housing studies generally recognize that the households served by the voucher and tax credit programs overlap; however, the lack of data in this area complicates any evaluation of affordable housing policy choices. For example, in its 2002 report that compared the costs of federal housing programs for low-income households, the Government Accountability Office noted that "The absence of comprehensive and consistent data is an impediment to monitoring and evaluating housing programs," and "For the tax credit program, no data were available on the amount of rental assistance provided by the federal government."[18]

Information on the extent of Section 8 rental subsidies used in tax credit projects has not been available to policy makers when they consider cuts to the voucher program budget—the largest source of federal funds for housing assistance. For example, the National Council of State Housing Agencies (an organization that represents state tax credit allocating agencies) has consistently advocated full funding for the voucher program because "the voucher program is essentially the only mainstream program that serves extremely low-income households without excessive rent burden….While Housing [Tax] Credits and HOME serve very low- and extremely low-income households, they do so most successfully *when paired*

[18] "Federal Housing Assistance: Comparing the Characteristics and Costs of Housing Programs," GAO-02-76, January 2002.

with vouchers;" (italics added by OIG for emphasis). However, no specific data were reported to show, for example, the potential effect of reduced voucher funds on rental income for tax credit projects in specific localities.

No Federal Agency is Designated To Monitor the Effectiveness of the Tax Credit Program

No federal agency is responsible for monitoring the tax credit program's efficiency and effectiveness even though the program consumes taxpayer dollars and is the most significant source of affordable housing construction. The tax credit law delegates administration of the program to the states while the Internal Revenue Service primarily oversees compliance with the federal regulations for using tax credits. It does not oversee the program's impact on national housing policy, including its relationship to other federal housing programs. State agencies are not required to track or report specific, uniform cost or performance data that could be used to compare and contrast the program's effectiveness, and no other federal agency is responsible for collecting such information. Finally, the tax credit industry has not developed its own comprehensive data source.

HUD Has the Best Access to Information Regarding Voucher Use in Tax Credit Projects

Although not formally responsible for its monitoring or use, HUD has recognized that the tax credit program is important to HUD's mission to increase access to affordable housing. Through its Office of Policy Development and Research, HUD maintains the only comprehensive database of low-income housing tax credit projects—the Low-income Housing Tax Credit database (tax credit database). Since 2001 HUD has issued annual reports that update and summarize characteristics and locations of the projects. Despite their comprehensive coverage, the database update reports generally exclude projects placed in service within the last two years largely because data are gathered by a time-consuming survey process. A contractor mails an annual survey to the 59 state allocating agencies and compiles the information for HUD. The report notes that intensive follow-up with the agencies is required to obtain data that is usable, complete, consistent, and timely.

As of January 2006, the database contained information on tax credit projects placed in service only through 2003.[19] The database contains no information about specific costs for tax credit projects. However, the most recent survey asked whether the project combined the use of tax credits with other sources of financing such as tax exempt bonds, Rural Housing Service 515 loans, HUD HOME or Community Development Block Grant funds.

<u>HUD merges two databases to estimate voucher use in tax credits</u>

The tax credit survey also limits its questions to project level information. As a result, to report on the use of tenant-based vouchers in tax credit projects, analysts had to merge the tax credit database with voucher tenant records that HUD maintains in its Public and Indian Housing Information Center database (tenant record database). Analysts then matched voucher unit addresses to project addresses to identify voucher occupied units. This address matching procedure has limitations: not only is it complicated, but the results are not verified and, until the latest survey (which added projects placed in service in 2003), the tax credit database did not contain complete address information for projects with multiple buildings.

<u>HUD's voucher record database could easily capture which tenants are housed in tax credit units</u>

Analysts must rely on the address match procedure because HUD does not identify tax credit subsidized units in its voucher tenant record database, despite having the following mechanisms in place to do so.

- The Office of Management and Budget has already approved HUD's request for tenancy approval form[20] that asks property owners to report the tax credit status of the voucher unit.
- HUD's tenant record database already captures more than 230 different data elements for each voucher including: unit address, rent, inspection date and owner identification, applicable payment standards, utility allowances, and housing assistance payments. A yes/no field for tax credit status could easily be added to the database.
- Housing authorities already collect and periodically submit this information to the database using HUD's family report (form HUD 50058).
- The housing authorities have an annual opportunity to identify and update a unit's tax credit status in the tenant record database when they perform the required unit inspections, recertify the tenant's eligibility and annually update the housing assistance payment contract with the owner/landlord.

[19] "Updating the Low-Income Housing Tax Credit Database Report Projects Placed in Service Through 2003," HUD Office of Policy Development and Research, January 2006.
[20] Form HUD 52517 (06/2003), line 10, has a box that can be checked to indicate the unit has a tax credit subsidy. OMB Approval No. 2577-0169 (exp. 07/31/2007).

Many housing authority officials we interviewed thought it would not be too burdensome to identify and track the tax credit units from this time forward.

- Officials from about three-quarters of the housing authorities we contacted had an opinion on this matter. Most of them thought it would be relatively easy to identify and track vouchers used in tax credit units, but some thought it would be difficult.
- Officials from the remaining group of housing authorities did not know how they could track tax credit units, but most thought they could identify them.

Housing authority officials generally knew that the HUD request for tenancy approval form asked for a unit's tax credit status. Several stated that they could consult HUD's tax credit database online to determine tax credit status, or that they could contact their state tax credit allocating agency. Some suggested that the easiest approach would be for HUD to have the housing authorities report a voucher unit's tax credit status during their annual updates to HUD's tenant record database. They also commented that their commercial software providers would be more likely to modify the programs used to electronically update the database if HUD required the change.

Policy Makers Need More Complete Information on Program Overlap

When tenant-based rental subsidies are used in tax credit projects instead of being used to convert market rate units into affordable housing, programs designed to provide two units of affordable housing instead provide only one. When this occurs, the actual cost of providing that unit of housing is more than what either program alone reports. In its 2002 report the Government Accountability Office recognized the need for taxpayers to understand the total cost of the tax credit program, including to what extent other sources of funding are being leveraged and stated, "The tax credit program consumes real taxpayer resources, and, as with any government program, taxpayers deserve to know what is being purchased with their dollars and at what cost." The report also noted that "…since housing subsidies are not an entitlement and only about one-third of eligible households receive assistance, it is imperative that scarce subsidies [sic] dollars be used as efficiently as possible."[21]

Based on the estimates of program overlap referenced in Appendix D of this report, the tenant-based voucher program provides roughly three-quarters of a billion annually in rental subsidies to the tax credit projects. This additional cost is significant when compared to the $5 billion that is widely cited as the annual cost of the tax credit program. A more current and precise estimate of the additional cost of using tenant-based voucher subsidies in tax credit projects

[21] "Federal Housing Assistance: Comparing the Characteristics and Costs of Housing Programs," GAO-02-76, January 2002.

would be readily available if HUD's tenant record database identified tax credit units as described above. In addition, the data could be compared and contrasted by localities to help policy makers determine where the combined use of these programs is, or is not, a necessary and cost-effective use of tax dollars.

Conclusion

Taxpayers, through HUD's tenant-based voucher program, provide significant rental subsidies that add to the cost of housing provided through the Internal Revenue Service's tax credit program, but taxpayers and policy makers do not have the information necessary to monitor and evaluate the extent of this program overlap. As the primary federal agency charged with the responsibility to address housing needs of the nation, HUD should use tools it already has at its disposal to track data on overlapping affordable housing subsidies.

Recommendations

We recommend that the Office of Public and Indian Housing

2A. Track the use of tenant-based Section 8 vouchers in tax credit units by including the voucher unit's tax credit status in the family report to the Public and Indian Housing Information Center database during the regular reporting cycle.

2B. Establish controls to ensure that available data on the costs of using multiple program subsidies to provide affordable housing are tracked and reported.

SCOPE AND METHODOLOGY

Our analysis of tenant-based voucher data should capture the largest part of the rental charges that exceeded tax credit restricted rents for the 60 percent area median income level even though it does not represent the entire country. We tested tenant records for 21 states, Washington, DC, and Puerto Rico (see appendix C).[22] All but four of these states/areas were selected because they contained fair market rent areas as defined by HUD where the corresponding Section 8 payment standards for a two-bedroom unit were generally higher than the tax credit restricted rent that applied to the 60 percent median income level for the area (the maximum tax credit restricted rent).[23] We presumed that voucher holders in the areas with relatively higher fair market rents were (1) most likely to be charged a gross rent that was higher than the tax credit restricted rents and (2) more likely to afford, and therefore occupy, a tax credit unit. To support these presumptions, we analyzed data from four additional states (Alabama, Illinois, Nebraska, and Washington) that contained no areas with fair market rents higher than the maximum tax credit restricted rent. The first assumption was supported; 13 percent of all voucher records screened were in the four states, but they accounted for 0.9 percent of the rents in excess of the tax credit maximum. However, results for the second assumption were inconsistent. The proportion of tenant-based vouchers used in tax credit units ranged from 3 to 11 percent in the four states, compared to an average of 6.1 percent for the other 19 states/areas analyzed. Among other reasons, this result could be due to our methodology, which did not address the extent to which tax credit units with rents restricted at the lower levels (20 through 50 percent income levels) were affordable to voucher holders (i.e., less than fair market rents).

Using current tenant-based voucher records reported in HUD's Public and Indian Housing Information Center database (tenant record database), we matched voucher unit addresses to addresses for tax credit projects that HUD's Office of Policy Development and Research maintained in a separate database.[24] For matched units we also looked for other nearby units with the same project name and owner identification. For each unit matched to a tax credit project, we

- Compared the gross rent recorded in the tenant record database to the tax credit restricted rent at the 60 percent median income level (adjusted for unit size) for the unit's location. If we computed an excess, we multiplied the monthly amount by 12 to obtain the amount of unnecessary rent that was charged to the voucher program over the course of the annual housing assistance payment contract.
- Counted the unit toward the proportion of program overlap, regardless of the gross rent charged.

The amount of unnecessary rent we found charged to the voucher program is likely to be understated as a result of the following constraints and conservative assumptions:

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[22] We selected entire states to delineate sample areas for simplicity and because tax credits are allocated and administered by state. For the most part, housing authorities have jurisdictions, and therefore tenant records, that fall completely within a state but not necessarily within one county or city.
[23] We used HUD's fair market rent areas in effect for 2003, 2004, and 2005.
[24] HUD officials provided OIG with a preliminary copy of the Low-Income Housing Tax Credit database, updated through 2003, that contained 23,855 projects nationwide.

- We only screened tenant-based vouchers against tax credit projects that we determined operated with 100 percent rent-restricted units (no market rate units).[25]
- The most up-to-date tax credit project database available contained projects placed in service through 2003. As a result, we could not match current voucher records to an estimated 2,500 projects placed in service after that time. According to HUD, the newer projects tend to have more units than older ones and probably account for 100,000 additional units per year.[26]
- To compute the amount of unnecessary rent, we used the highest possible tax credit restricted rent (adjusted for unit size) for a given location, even if a lower rate was effective at the time of the housing assistance contract.
- We relied upon current tenant-based voucher records in the Public and Indian Housing Information Center database, which is known to be incomplete (HUD accepts an 85 percent reporting rate from housing authorities). We obtained current records for approximately 1,173,000 tenant-based vouchers, compared to about 1,391,000 vouchers listed as the inventory for the housing authorities we reviewed.[27]

In addition, because the address matching methodology was prone to errors, we verified our results for a limited number of matches. In each state reviewed,[28] we selected several matches with the highest amount of rent that exceeded the area's tax credit restricted rent for the 60 percent median income level and asked housing authority officials to verify the address, gross rent, payment standard, and unit bedroom size and to confirm that the unit was in a 100 percent rent-restricted tax credit project. We adjusted or excluded from our analysis the rent and/or match results for those records in which housing authority officials provided corrections or could not verify the data. We also excluded other tenant records with units that were matched to projects that officials told us were not 100 percent rent restricted, even though we had not selected these tenant records for verification. Finally, in some cases, officials found that vouchers were incorrectly reported in the tenant record database as tenant-based vouchers when they were actually project-based. We also deleted those records from our results. Despite our effort to improve the reliability of our analysis, our verification sample was not statistical and only tested for false positives. Consequently, the verification results do not apply to the entire analysis.

To gain some perspective on the practical application of HUD's policy, we interviewed officials at one or more housing authorities in each state/area reviewed (except Nebraska and Puerto Rico). Officials at many housing authorities had not previously focused on the issue of tax credit rent restrictions, and some were not aware their voucher holders sometimes paid more than non-voucher holders for tax credit units. Most officials we interviewed considered the use of tenant-based vouchers in tax credit projects as necessary to provide meaningful housing choices to

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[25] By comparing the number of low-income units reported to the total number of units for each project, we determined that about 88 percent of the tax credit properties in the nationwide database were effectively 100 percent low income. HUD reported that 95 percent of the units in tax credit properties placed in service from 1995 through 2003 qualified as low-income units.

[26] "Updating the Low-Income Housing Tax Credit (LIHTC) Database Projects Placed in Service Through 2003," HUD Office of Policy Development and Research, January 2006, p. ii.

[27] Based on the number of authorized vouchers in HUD's inventory of vouchers by housing authority.

[28] We did not verify any data for Nebraska because that state had no rents exceeding the tax credit limit.

voucher holders, and many were pleased to provide some input to our review. Nevertheless, it should be noted that we only interviewed housing authorities that had placed voucher holders in tax credit projects, and some had ownership interest in those projects. Accordingly, their views do not represent the situation in all localities. We also interviewed officials from a limited number of state agencies responsible for either allocating tax credits or for developing affordable housing. Finally, we visited seven tax credit projects that charged higher rents to Section 8 tenants and interviewed the project managers or owners.

We reviewed HUD's regulations and guidance regarding the use of tenant-based vouchers in tax credit properties and interviewed HUD officials responsible for the tenant-based voucher program including officials from HUD's Office of General Counsel. We also reviewed the applicable Internal Revenue Code and information available from the state allocating agencies that implement the tax credit program. In response to concerns expressed by HUD officials, we consulted the Office of Inspector General (OIG) Office of Counsel regarding the relation of the Internal Revenue Service tax credit laws and regulations to HUD's voucher program laws, regulations and policies on rent limitations.

We performed our review from September 2005 through April 2006 in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined the following internal controls were relevant to our audit objectives:

- Controls to ensure that available data on the costs of using multiple program subsidies for the same goal are tracked and reported.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- HUD does not have effective controls to ensure that available data on the costs of using multiple program subsidies to provide affordable housing are tracked and reported.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1A	$13,500,000

1/ “Funds to be put to better use” are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. While these savings will occur indefinitely upon implementation of our recommendations, we have only included the initial year in our estimate.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-5000

ASSISTANT SECRETARY FOR
PUBLIC AND INDIAN HOUSING

October 16, 2006

MEMORANDUM FOR: Joan S. Hobbs, Regional Inspector General for Audit, 9DGA

FROM: Orlando J. Cabrera, Assistant Secretary for Public and Indian Housing, P

SUBJECT: Tax Credit Project Owners are allowed to Charge Higher Rents for Tenant-Based Section 8 Voucher Households then Non-Voucher Households

Thank you for the opportunity to comment on this draft audit report. As you know these comments have been provided after several meetings between my staff, your auditors, and myself. In fact in our final meeting, Mr. Donohue participated in our discussion. While we disagree on many of the conclusions arrived at the draft audit report, I look forward to the successfully resolving each finding.

If you have any questions, please contact Milan Ozdinec, Deputy Assistant Secretary, Office of Public Housing Choice Voucher Programs, at (202) 708-1380.

cc Milan Ozdinec, Deputy Assistant Secretary, Office of Public Housing Choice Voucher Programs, PE
David Vargas, Director, Office of Housing Voucher Programs, PE
Michael Mangahas, Deputy Comptroller – PIH Office of Planning, Resource Management and Admin Services, PC

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Comment 1

Comment 2

Comment 3

We have reviewed the Discussion Draft Report entitled "Tax Credit Projects Charged Higher Rents to Tenant-Based Section 8 Voucher Households than to Non-Voucher Households" (the "Report") and we offer the following comments:

GENERAL COMMENTS:

We closely reviewed the Report and have concerns about the findings, recommendations, underlying policy assumptions, and legal basis of the conclusions reached and recommendations made.[1] As an initial matter, we are concerned that the recommendations would both assume legislative intent that is not established in law and, over time, will result in greater cost per voucher per month in the Housing Choice Voucher program.

Secondly, during our "exit" interview with the staff that prepared the Report on this subject, PIH staff attempted to encourage the drafters of this Report to revisit some of the assumed facts in their Report. Institutionally speaking, HUD's experience with the low income tax credit has been somewhat limited. Some of these mistakes, many of them basic, were corrected in this draft, while other conclusions about Section 42 – many of them more pertinent to this debate - were not. We have noted those instances in this report.

The more difficult task is addressing policy conclusions made in the Report that were reached in a manner that contradicts longstanding tax and housing choice voucher law and policy as set by Congress. As a general proposition, any opinion reached by anyone at HUD (including the Inspector General) about the meaning and Congressional intent behind Section 42 or any other provision of the Internal Revenue Code or the Code's interaction with the Housing Act of 1937 would be of limited value without a wholesale examination of both Section 42 and the Act together – and that analysis is entirely absent in the Report. The absence of a discussion of the interplay between the two statutes is, in our view, an insurmountable flaw with the Report.

For these reasons and those set forth below, we disagree with Finding 1 of the Report and partially agree with Finding 2.

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[1] The Report states two findings:

FINDING 1: TAX CREDIT PROJECT OWNERS ARE ALLOWED TO CHARGE THE TENANT-BASED VOUCHER PROGRAM MORE THAN $13,000,000 ANNUALLY FOR RENTS THAT EXCEED THE MAXIMUM TAX CREDIT RENT

FINDING 2: THE EXTENT AND COSTS OF TENANT-BASED VOUCHER AND TAX CREDIT PROGRAM OVERLAP ARE NOT MONITORED

Finally, as a point of clarification, we do not address any aspect of the Report that deals with project based rental assistance simply because it is an entirely different program and not the subject of this Report.

GENERAL ORGANIZATION OF THESE COMMENTS:

I. Finding 1

We have organized our comments with respect to Finding 1 in four (4) sections addressing each respective concern as follows:

Comment 4

1. General Comments with respect to the section entitled Background and Objectives, Results of Audit, Scope and Methodology, Internal Controls, and Appendices.The Report incorrectly assumes that (A) a subsidy overlap exists between Section 42 of the Internal Revenue Code (a Program designed to provide the incentive to *construct* affordable housing units in the form of a tax credit) ("the Code") and/or the Housing Act of 1937 (the "Act") which created the Housing Choice Voucher program (which is an allocation of tax dollars appropriated by Congress to landlords designed to provide tenants who meet a particular statutory parameter with housing and is therefore a *property management tool* and unlike the low income housing tax credit program *not* a construction program) and (B) voucher holders have a near entitlement to redeem vouchers at developments that manage low income housing tax credit units.

Comment 5

2. No express provision of the Code and/or the Act enables the United States Department of Housing and Urban Development's Office of Public and Indian Housing to limit the payment of rent in connection with the redemption of vouchers at developments constructed using the low income housing tax credit.

Comment 6

3. The Report makes assumptions of policy and attempts to inject the Office of the Inspector General's policy conclusions into Public and Indian Housing policy with no basis in law and reaches conclusions that cannot be sustained either by policy or economics.

Comment 7

4. General Comments with respect to the section entitled Background and Objectives, Results of Audit, Scope and Methodology, Internal Controls, and Appendices.

II. Finding 2

III. Conclusion

Comment 8

Comment 9

Comment 10

Comment 9

I. Finding 1

1. **The Report incorrectly assumes that (A) a subsidy overlap exists between Section 42 of the Internal Revenue Code (a Program designed to provide the incentive to *construct* affordable housing units in the form of a tax credit) (hereinafter "the Code") and/or the Housing Act of 1937 (the "Act") which created the Housing Choice Voucher program (which is an allocation of tax dollars appropriated by Congress to landlords designed to provide tenants who meet a particular statutory parameter with housing and is therefore a *property management tool* and unlike the low income housing tax credit program *not* a construction program) and (B) voucher holders and/or landlords have a near entitlement to redeem vouchers at developments that manage low income housing tax credit units.**

No subsidy overlap whatsoever exists between tenant based rental assistance and/or voucher utilization (a property management issue because it represents revenue to a unit owner) and the low income housing tax credit (a tool used to build units to serve tenants that earn 60 percent and less of area median income); they are two distinct and independent tools used to execute upon the Nation's affordable housing policy. These distinctly different tools are used in a complementary way for different policy (and other) purposes. They are wholly unrelated and distinct subsidies, but are occasionally supplementary in terms of the *process* of constructing and, thereafter, managing and maintaining affordable units, particularly, in the case of the voucher system, for very low income tenants.

The Report incorrectly assumes that tenant-based rental assistance (a source of revenue related to the *management* of a unit that provides voucher holders with a place to live) is somehow related to tax credit subsidy (a subsidy that is related to the construction cost of actually *building* a unit) and contends that there is a subsidy "overlap" of the two.[2] The Report's assumption that these distinctly different subsidy streams are intrinsically related evinces a flaw in understanding the different programs and the construction and property management process, generally. The financial ability to construct units and the practical reality of managing units are two wholly and entirely unrelated concepts that the Report connotes are somehow the same. Moreover, those who assess the viability of constructing units using the low income housing tax credit assess it from different perspectives depending on what the assessment seeks to accomplish.

A. Section 42 Can Fund Construction Costs Only, Not Operational Costs

As noted above, the low income housing tax credit program is a tool that encourages the private sector to invest in tax credits and thereby finance the construction

[2] We note that the General Accounting Offices cited by the Report in support of certain propositions expressly avoids linking the low income housing tax credit and tenant based voucher assistance because, the GAO report notes, they are difficult to link.

of affordable units. The process requires an examination of viability before allocation of tax credits and stringent compliance with the Code and the rules and regulations of the Internal Revenue Service after the units are placed in service. Further, most of the 56 jurisdictions that undertake competitive cycles for allocating the tax credit recognize that the low income housing tax credit is essentially a commodity, albeit one created by the Code.

The Report fails to recognize the distinction between competing for allocation and underwriting a transaction. Additionally, the Report fails to recognize that there is a vast difference between the qualified allocation plans of the various jurisdictions that allocate tax credits and how those jurisdictional and market differences impact tax credit allocation. The low income housing tax credit program effectively creates units that serve those up to 60% of area median income, but unless targeted, does not easily create units for those at or below 30% of area median income without deep subsidy at the point the unit is placed into service after construction is complete. That subsidy comes in very few forms: tenant based rental assistance, state subsidy or local subsidy. It is difficult to develop and construct units serving those Americans earning 0 to 30% of area median income without tenant based rental assistance or project based rental assistance. Adopting the recommendations set forth in the Report causes greater stress on the delivery of units that serve tenants that earn 30% of area median income or less.

Comment 11

Comment 12

The Report incorrectly assumes that the *initial* analysis that is required under the Code is the *only* analysis used to assess viability. Viability is always evaluated because the Code requires such an evaluation; that analysis bears on the viability of the development over the 15 year compliance period and allows the various stakeholders in a deal to assess whether or not to undertake the deal. Again, the developer, investor, housing finance agency, underwriter, and lender all focus on viability from sometimes very different perspectives because the deal needs to sustain itself. Those perspectives differ most greatly when the qualified low income housing project ("QLIHP") will serve any number of tenants earning 30% of area median income and below.

Secondly, the Report confuses viability from the perspective of meeting the Code's requirements with viability in a more complex financial risk setting.[3] If a developer applies for tax credits on the basis of serving very low income and wins an allocation, but develops units that do not serve that population, violate a qualified allocation plan, or otherwise misrepresents the application submitted, then (depending on the circumstance) one or both of the Internal Revenue Service and HFAs have tools that would address such a situation: in the Service's case, an audit of the developer, investor and (if different) the owner, and in the case of most HFAs, sanction with respect to future ability to compete.[4] As previously noted, many parties assess a development's viability.

[3] Incidentally, even FHA underwriting guidelines with respect to mark-to-market allow assumptions about income from tenant based and project based vouchers to be used in the underwriting process, thus further illustrating how different stakeholders in a transaction might use voucher assistance in order to assess viability.

[4] The Internal Revenue Service may have sanctioning tools against the HFA as well. Those tools are not addressed in this response.

The analysis set forth in the Report presumes that the HFA will focus on management feasibility when, more critically, the issue for HFAs is feasibility to construct units where they are needed. This is because most HFAs presume that the private sector (which includes non-profits) will carry the risk of operation and will assess that risk carefully. Most developers and investors who are about to construct low income housing tax credit financed units that will serve tenants earning 30% of area median income and below, from any financially responsible perspective, *must* examine how voucher utilization will help subsidize the operation of the units that they intend to construct. If a developer constructing units for those earning 30% or less of area median income fails to undertake such an analysis on voucher use, they do so at their own peril because no investor would buy the tax credits that finance that development.

Comment 13

B. Voucher holders Do NOT Have an Unqualified Right to Live in a Tax Credit Unit

The Report assumes that voucher holders utilizing their vouchers at a tax credit property must have their vouchers accepted simply because they are voucher holders. The Report incorrectly argues that "unnecessary waste" occurs because vouchers must be accepted by all landlords that own units financed with the low income housing tax credit and, therefore, landlords that own those units are obligated to charge rents that are lower than fair market rents pursuant to the Code or, at the very least, the terms of the representations made in the applications made for allocation of the tax credit or the use restriction agreements that are entered into when the units are placed in service. Furthermore, the Report concludes that there would less "waste" in the voucher program if only HUD policy acknowledged that the owner was compelled to offer voucher holders rents that were capped as asserted in the Report. The Report's assumption both contradicts the current provisions of the Code and Act and, further, contradicts the policy underpinnings of the Code.

Section 42 (h) of the Code prohibits a manager of a property financed by tax credits (hereinafter, a "Landlord") to decline a voucher holder *simply on the basis of that prospective tenant being a voucher holder*. It does not prevent a Landlord from declining a prospective tenant for any other lawful reason. There is no legislative, policy or other link between the negotiability of a voucher and rent. Congress' intent was twofold: first, to assure that people who received a voucher under the Act were not impeded from renting low income housing tax credit units simply because they proffered a voucher for rent payment and, second, to provide owners who might otherwise be reticent to take vouchers with the financial incentive to rent to voucher holders by permitting the owner to receive higher rents from tenants that use vouchers to exceed rent standards that are applicable to all other units. In other words, Congress wanted to assure that units financed by low income housing tax credits were available to voucher holders to the maximum practicable extent possible and wanted to create a monetary incentive for low income housing tax credit unit owners to accept the voucher. The Code's language asserts no further policy objective relating to anything else on this issue other than voucher negotiability. Accordingly, the Report's wrongly concludes that Section 42 contemplates a result that would allow a finding that rent paid under Section 8 is

5

somehow wasteful when, in fact, Congress intended precisely the result that the Report recommends be proscribed.

Comment 14

2. **No express provision of the Code and/or the Act enables the United States Department of Housing and Urban Development's Office of Public and Indian Housing to limit the payment of rent in connection with the redemption of section 8 vouchers at developments constructed using the low income housing tax credit.**

If the Report is to address the issue of rents at developments constructed with the low income housing tax credit, the first issue is to determine whether HUD has the statutory authority to bifurcate rent payment standards as the Report recommends. Assuming arguendo, that the Report's finding was not an express attempt to create policy within PIH, while the Report states that PIH has the legal authority to undertake the policy recommended in the Report, the Report fails to cite the law that would support the policy position and enable HUD, and specifically PIH, to promulgate rules that would create the limits on rent that the Report recommends.

Comment 15

As an initial matter, the Report cites the HOME Investment Partnership Program as an example that the Section 8 program should emulate with respect to restricting rents. But the HOME Program rent limitations have a *statutory basis for existence*.[5] The Report favorably references the HOME program restrictions on rent and asserts that PIH adopt the policies in a similar manner and limit the maximum rent that can be paid under various provisions of those respective laws, yet no such restriction or authority is provided under Section 8 of the Act.

Similarly, one might attempt to wrongly conclude that Section 8 rents could be capped as they are in other programs, such as, Section 202, Section 221(d)(3), Section 236, and Section 515, but similarly, those programs have a statutory basis that permits rents in units that are insured or financed using each of those respective programs as well.[6] The Report seems to seek a "consistency" between programs but disregards the fact that each of these respective programs is created by specific law and regulation is promulgated pursuant to those laws and regulations. No such statutory authority exists under Section 8 of the Act.

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[5] See Section 215 of the HOME Investment Partnership Act.

[6] Congress has not hesitated to express its intent with respect to how rent is to be set, restricted, accounted for or limited in a variety of housing acts or in the Code. Section 202 of the Housing Act of 1959 provides capital advances and project based rental assistance to elderly housing projects and provides specific limits on how rent is to be calculated; Section 202(c)(2) of the Housing Act of 1959; Section 236 of the National Housing Act also provides the Secretary with the authority to approve rent levels. Section 236(f)(1)(A); Similarly, in Section 221(d)(3) rents are set *and* Congress proscribed the use of tenant based rental assistance at those units. Section 221(d)(3) of the National Housing Act; and Section 515 of the Rural Housing Act sets forth specific language and authority for the Secretary to act with respect to the use of vouchers under Section 521 and rent increases. As previously noted, Section 42 limits rents for all tenants covered by Section 42 except voucher holders and project based rental assistance. No such similar language supporting the proposition that rent payments made to owners of low income tax credit units may be in an amount less than that available to other unit owners exists in the Act or in the Code.

Comment 16

As a general statement of law, HUD has no authority to undertake a limit on tax credit rents under the Code.[7] Certainly, the Office of Public and Indian Housing does not have the statutory authority to do so under the Code. Nonetheless, the Report seems to reach conclusions about the Code's provisions and intent that deserve discussion.[8] One of the Report's conclusions is that no clear policy statement exists in the Code for the proposition that the Code treats section 8 voucher holders (or project based rental assistance) differently than any other tenant otherwise qualified to live in a tax credit development that earns income within the income strata stated therein.[9]

The Code expressly treats voucher holders (and project based units) differently than all other tenants in connection with assuming compliance with the Code's provisions relating to the low income housing tax credit.[10] The Code's first assumption is that the

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[7] The Secretary of the Department of the Treasury (by and through the Commissioner of the Internal Revenue Service) promulgates all rules relating to the Code except Congress authorized the Secretary of the Department of Housing and Urban Development and the Secretary of Agriculture to make certain determinations. Specifically, the Secretary of HUD has the authority to (a) decide who will receive a qualified basis bump of 130%, and (b) which metropolitan service areas with receive difficult development area status. The Secretary of the Treasury must also consult with the Secretary of HUD (and Agriculture) on certain waivers relating to 221(d)(3) transactions and 515 transactions.

The Code's other reference is to the publishing of area gross median incomes and fair market rents by HUD. These are the only junctures where HUD actually possesses Congressional authority to act in the context of Section 42 of the Code. The remaining issues of income and rent are actually undertaken for the Section 8 program and utilized as a matter of ordinary course in the context of Section 42. They are not independently based decisions by the Secretary of Housing and Urban Development that are based in law (i.e., the Code).

[8] Ibid.

[9] Pursuant to the Code, either 50 or 60% of area median income as may be applicable.

[10] The Report seems inclined to visit the issue of how "gross rent" is defined in the Code. The term "gross rent" in the context of Section 42 only applies to qualified low-income housing projects ("QLIHP"). Section 42(g)(1).

The general rule in the Code is:

For purposes of paragraph (1), a residential unit is rent-restricted if the gross rent with respect to a unit (a) does not exceed 30% of the imputed income limitation applicable to such a unit. The Code then creates an exception for the definition of income for both tenant based rental assistance and project based rental assistance. Code at Section 42(g)(2)(B)(i). The policy underpinning of the language was to essentially underscore the need to treat all federal assistance under Section 8 distinctly from the assistance otherwise provided under Section 42. The idea was that under circumstances in the ordinary course, an income qualified tenant would pay rent not to exceed 30% of their income. Federal assistance could, under the Code, be imputed as income, thereby increasing the rent to be paid by a Section 8 tenant or a recipient of project based Section 8, which would create a *disincentive* for units that are constructed to serve a particular income strata from being made available to recipients of federal assistance.

> The gross rent paid by families in units included in qualified basis may not exceed 30% of the applicable qualifying income, adjusted for family size…[I]f any utilities are paid directly by the tenant, the maximum rent that may be paid by the tenant is to be reduced by a utility allowance prescribed by the Treasury Department, after taking into consideration the procedures for making such adjustments under Section 8 of the Housing Act of 1937.

statement of law made in *the Act*, specifically, that vouchers would be redeemed in exchange for rent to be paid under a reasonable standard as indicated in Section 8(o)(10).

> The gross rent limitation applies only to payment directly by the tenant. Any rental assistance payments made on behalf of the tenant, such as through Section 8, or any other comparable federal assistance, are *not to be included in gross rent* [Emphasis added]. Congress also further intended that any comparable State or local government rental assistance not be included in gross rent.[10]

The commenter also recorded a footnote stating:

> A technical amendment may be needed so that the statute reflects this intent. Such an amendment was included in Cong. Res. 395 which passed the House of Representatives and Senate in the 99th Congress.

In fact, the technical amendment was made and became Section 42(g)(2)(E) of the Code, which clarified that Section 42(g)(2)(B)(i) was intended to cover both recipients of tenant based rental assistance and recipients of project based rental assistance (i.e., property managers). Section 42(g)(2)(E) states:

> If the gross rent with respect to a residential unit exceeds the limitation under subparagraph (A) but reason of the fact that the income of the occupants thereof exceeds the income limitation applicable under paragraph (1)[10], such unit shall, nevertheless, be treated as a rent-restricted unit for purposes of paragraph (1) if
>
> (i) a Federal rental assistance payment described in subparagraph (B)(1) is made with respect to such unit or its occupants, and
>
> (ii) the sum of such payment and the gross rent with respect to such unit does not exceed the sum of the amount of such payment which would be made and the gross rent which would be payable with respect to such unit if –
>
> (I) the income of the occupants thereof did not exceed the income limitation applicable under paragraph (1), and
>
> (II) such units were rent-restricted within the meaning of subparagraph (A). *The preceding sentence shall apply to any unit only if the result described in clause (ii) is required by Federal statute as of the date of the enactment of this subparagraph and as of the date the Federal assistance is made.* [Emphasis added.]

In other words, focusing on Congress's intent as articulated in the General Statement and Section 42(g)(2)(E), Congress understood that federal assistance used in order to provide units to those that qualify to use tenant based rental assistance and those that would qualify to live in units receiving project based rental assistance would, first of all, need to be treated differently than tenants that otherwise qualified for QLIHP units but received no assistance and, secondly, that the rental payment exceeded for those tenants receiving one type of federal assistance or the other would *exceed* tax credit rents. Essentially, Congress intended that the benefit that the voucher provided to tenants would not require those tenants to report those benefits as income for purposes of computing their income and, therefore, gross rent.

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The Code limits the maximum amount of all other rent payment expressly *except* rent paid in connection with voucher holders (and project based units), for which it relies on the Act's provisions. The distinction made between voucher holders and project based units and every other kind of tenant is based on the calculation of income and the amount of rent paid.

The Report fails to examine the definition of gross rent in a way that is consistent with its legislative intent. Those residential units ("units") in a QLIHP (hereinafter, "QLIHPs" in the plural) that a developer commits to meet its affordable set aside must be leased by tenants and also must (a) not earn greater than a particular gross income, and (b) not pay in excess of 30% of their income in "gross rent."

The Code makes a distinction between the kinds of tenants to be served because (a) otherwise, those receiving vouchers would not qualify to live in low income housing tax credit units, and (b) Congress wanted to encourage that low income housing tax credit units be made available to tenants that earn between 0 and 30% of area median income.

The Report alleges that a windfall will continue to go to developers if the current policy continues. The Report confuses developers with investors and, further, fails to recognize Congress' intent which is to allow and encourage the use of units at developments that are financed using the low income housing tax credit precisely the regulatory rubric that the Report seeks to label as unnecessarily wasteful. QLIHP are not planned based on the ability to capture voucher holders. If they were, the statistics compiled by HUD as asserted in the Report would demonstrate that voucher holders

Comment 17

constitute a much higher percentage of overall tenancy than approximately 5 to 10% of all units financed with low income housing tax credits.

Comment 18

The Report fails to examine the economic underpinnings set in the Code. In exchange for investing in the QLIHP receipt of the credit, the tax credit investor is receiving a dollar-for-dollar reduction in gross tax liability and usually a 99% interest in a pass through, single asset entity that actually owns the QLIHP. The Code recognizes that the tax credit investor is also entering into a transaction that it knows mitigates the value of the land that they own because the value of the land and improvements will be mitigated during the affordability period due to the contractual restrictions that determine rent levels and, therefore, cash flow that supports the units. The Code recognizes that the benefit for the tax credit investor to invest is the tax benefit provided by the Code and the cost is that in exchange for the present value of tax credits, the investor will not realize a capital return on the real estate for a very long time, if ever and will lease to a group of tenants that will pay less rent than a market rate rental unit would otherwise pay. The benefit to the public is the production of units that serve Americans earning less than 60% of area median income and the cost is the loss in revenue generated by the actual utilization of the tax credit which is remarkably lower than the theoretical maximum amount of tax credits that are authorized annually by Congress.[11] The economic model

[11] Not all tax credits created by the Code are used, which further distinguishes them from appropriation. The Report fails to recognize the distinction between appropriation and incentives. The Report assumes that (a) only 9% tax credits are relevant and not state or other appropriation, (b) all tax credits are allocated, and (c) all allocations are uniformly competitive. None of these assumptions are accurate. First, there are

that the Report would encourage would make it difficult to serve very low income tenants unless rent paid on a voucher holders behalf is at the reasonable payment standard.[12]

Comment 19

With the foregoing as a predicate, Congress refined the definition of gross rent in order to clarify Congress' intent with respect to the calculation of gross rent and, further, expressly noted its intent in the form of legislative history.[13] First, Congress noted that there could be only two kinds of rents paid at a QLIHP, market rent (completely unrestricted) and rent that those that the credit are intended to serve will pay. For purposes of this response, we will only focus on those tenants that Congress intended to serve – those tenants earning either 60% of area median income in some cases, or those earning 50% of area median income in other cases – as the landlord elects, who are not receiving tenant based rental assistance but do pay tax credit rent.

Comment 20

Congress could have decided that all tenants in units constructed with low income housing tax credits would pay tax credit rent, but instead, Congress expressly subdivided the low income housing tax credit-financed unit tenant population further into two categories: those that receive tenant based rental assistance from Section 8 of the Housing Act of 1937 and those that do not. This response to the Report will not deal with those tenants that do not receive rental assistance from Section 8. Accordingly, this response will focus entirely on that part of the Code that Congress expressly drafted in order to address Section 8.

The net effect of this existing bifurcation in the Code is that Congress intended to treat tenant based rental assistance differently than all other income qualified tenants at QLIHP. Moreover, Congress intended that the amount that the *tenants* pay not be a reflection of the amount that of the *voucher's* value pursuant to the Housing Act of 1937.[14] We note that the statement is not made glibly: in Section 42, for example, and in

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Comment 18

9% (70% present value) tax credits that are competitive and 4% (30% present value) tax credits that are issues solely in conjunction with private activity bonds and have been severely underutilized for the past several years because of market conditions. Secondly, not all 9% (much less 4%) tax credits are allocated. Most years a national pool is funded by tax credits from states that do not fully utilize them and allocated to states that do, in fact, allocate all of their ordinary course tax credit allocation. Thirdly, competitive cycles differ between states depending a state's housing policy. Many states do not favor multifamily rental and instead favor homeownership, thus their qualified allocation plans are less robust and harder to use than other states for which multifamily rental is an integral part of a state's housing policy. Thus, tax credits generally are not treated as full appropriation for budget purposes because tax credits are not always fully utilized and are not direct dollar investments by the government -- they are actual investment by the private sector that is provided with the incentive to invest by the government.

Comment 19

[12] This assumes the Report's premises that tax credit rents are less than the reasonable payment standard in the Section 8 program.

[13] We do not deal with technical aspects of the income restrictions in this response to the Report because they are, for all purposes, moot. All Section 8 voucher holders are qualified to live in QLIHP units *by definition*. Nonetheless, the reader should be aware that for all tenants except tenants receiving tenant based rental assistance and landlords receiving project based section 8, the Code essentially sets forth a two part test for a unit to be considered a low income tax credit unit -- that the tenant be income qualified and that the tenants rent not exceed the rent ceiling ("tax credit rent" as referred to in the Report) published by HUD annually.

Comment 20

[14] There is no other tenable conclusion in the case of either tenant based rental assistance or project based rental assistance. In the case of tenant based rental assistance. Congress then, as now, understood that the

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addition to Section 8 of the Act, Congress deliberately and carefully created policy accommodations for the use of Native American Housing and Self Determination Act, HOME programs, money lent through funds created by Community Development Block Grants ("CDBG"), Section 515, and specific disincentives from direct federal grants with the low income housing tax credit (the Community Development Block Grant is one of those federal grants). Thus, Congress has been consistently circumspect in how it deals with specific programs and how they relate to Section 42 of the Code. Similarly, Congress created incentives to use the tenant based voucher program with Section 42.

Moreover, Congress deliberated and carefully created incentives in the Code to assure that voucher holders holding vouchers issues pursuant to the Act had access to units at QLIHPs and has certainly never created limits to rent as contemplated in the recommendation made in the Report under any congressional act, be it the Code and/or the Act. Twenty years have passed since the Tax Reform and Fiscal Responsibility Act of 1986 that created the low income housing tax credit and eighteen years have passed since the technical amendment to section 42(g) and no change has been made to the language encouraging a result that would be consistent with the Reports recommendations. In light of the other limits to the use of federal funds with the low income housing tax credit, one can safely assume that Congress would have passed such limits if it had intended to do so. Finally, in the last twenty years, neither Congress nor the Internal Revenue Service have capped the amount of rent to be paid pursuant to the Code or rule promulgated under the Code, further undermining the conclusions and recommendations made by in Report.

In the case of the tenant based rental assistance program, one can discern Congress's intent by the plain language of the Act and by what Congress has not done. Section 8(o)(10)(A) sets forth the language that determines how rent is charged under the Section 8 program with respect to tenant based rental assistance and it states: "The rent for dwelling units for which a housing assistant payment contract is established under this subsection shall be reasonable in comparison with rents charged for comparable dwelling units in the private, unassisted local market." Unlike other laws that govern the administration of other HUD programs, there is no other pertinent provision in the Act that would create the authority to bifurcate the rent structure as the Report recommends. The Act's very terms set forth the reasonable payment standard and how rent is to be paid in connection with the voucher (and project based units) and makes no distinction between units constructed with the low income housing tax credit and any other kind of unit. Concluding that a two tier rent system should be imposed for the tenant based rental program by regulation is unsupported by law and is not supported by congressional intent. At a time when HUD is actively trying to encourage local prerogative and less regulation, Finding 1 would encourage a policy change that is inimical to both.

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value of the voucher was essentially the difference between the amount of rent the tenant based rent assistance that the recipient paid and fair market rent in the area where the voucher was being used. If Congress had intended to cap the voucher, this is the section of the Code where it would have articulated its intent and it did not.

Comment 21

3. **The Report makes assumptions of policy and attempts to inject the Office of the Inspector General's policy conclusions into Public and Indian Housing policy with no basis in law and reaches conclusions that cannot be sustained either by policy or economics.**

The Report argues that savings would be captured by adopting the recommendations set forth therein. Actually, over time, the recommendation made with respect to Finding 1 would cause fewer families to be served at higher cost. If property managers of QLIHPs have a disincentive from leasing to voucher holders, that would mean that there would be fewer, not more, units available in the supply of units, thereby increasing price over time. Rent will likely increase because demand for units will be greater when tax credits that were formerly available no longer are made available due to the recommendation. The simple and more likely effect would be that vouchers that would typically have been used at a tax credit unit would now be used at another rental unit that was not constructed with financing from the low income housing tax credit.

The Report contradicts basic economics and the motivation behind its own recommendations. If the recommendations in the Report were undertaken, the only conclusion would be that there would be *fewer* units available for voucher holders to rent, meaning unit supply would *decrease*. Over time, a decrease in supply would cause the Housing Voucher Program to pay higher rents because fewer units available to voucher holders would *increase* rent. Moreover, most low income housing tax credit units are newer units, therefore, voucher holders would also have less access to newer units.

Comment 22

Secondly, the Report seems to assert that property managers and developers (or, perhaps, PIH) are somehow making the argument that they are *entitled* [reemphasizing the Reports original emphasis on that word] to fair market rent. The Report misses the point. Congress has already decided that a tenant based voucher program is national policy, that voucher holders are the intended beneficiaries, that rent be paid in a manner set forth in the Act, and that those beneficiaries should both have access to QLIHP units and that the law should make it easier for them to live in those units. Those beneficiaries benefit from having greater access to newer units, not less access and the Reports conclusion would unquestionably result in fewer, not more, units being available to very low and extremely low income families.

Comment 23

4. **General Comments with respect to the section entitled Background and Objectives, Results of Audit, Scope and Methodology, Internal Controls, and Appendices.**

The report sets forth bright line language with respect to Section 42 of the Code and the Act that is anything but bright line. Several of the assertions made in the Background and Objectives all incompletely stated that result in a policy judgment made in the report that is unsupported by law. For example, a significant exception to the rule on rent restrictions in Section 42 applies when a voucher holder utilizes vouchers for a

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low income housing tax credit unit.[15] The Report asserts that the tenant-based voucher program "does not prohibit the gross rent from being lower than the payment standard as long as the unit meets HUD's housing needs[.]" or inferring that a lack of prohibition makes it possible to take an affirmative step toward Finding 1[16] either in the Act or in the Code. Yet the Report fails to state that the Code relies on rent payment standards set forth in Section 8 (o)(10)(A) of the Housing Act of 1937 in order to address the utilization of Section 8 vouchers in QLIHPs.

A third example of how the Report represents an issue as clear when it is actually nuanced is practical in nature. For example, the Report states that "[T]his in spite of the fact that the project owners had proposed and agreed to restrict rents for these units in exchange for a capital subsidy in the form of tax credits[...]" may seem correct on its face, however fails to recognize that the commitments made to rent units to qualified tenants, usually contractual, is typically subject to Section 42 of the Code. Thus, the Report implies that a predicate to a developer receiving tax credits from a housing finance agency, the commitment to keeping units affordable at some rent level, is somehow undermined after the application process. The problem with the Report's assumption is that it simultaneously omits the existence of law that makes the statement unlikely (i.e., Section 42) and misunderstands how tax credit deals work. Also, the statement fails to recognize the more nuanced practical reality that the units are generally restricted contractually through use restriction agreements that typically state that, first and foremost, rent shall be charged in compliance with the law (i.e., the Code) and, if applicable, other federal law (e.g., the Act) and then that rent restrictions apply as agreed to by and between the HFA and the owner. The Report asserts other statements that are similarly broad, but incongruous with the Code and the Act.[17]

Comment 24

The Report seems to assert that the voucher program is providing a "windfall" to owners and that the difference between the amount paid to unit owners and the amount of rent paid by the voucher holder is perceived as an entitlement. We have dealt with the "windfall" allegation above as a policy matter, but there is a second issue. In addition to the our explanation above, it is difficult to address the basis for this language as PIH has never asserted that payments under the current policy are an entitlement nor do has PIH advocated that any party benefit from a "windfall" – nor do we agree that the current policy creates a "windfall." As explained above, Congress sought to create an incentive

Comment 23

[15] Thus, the statement "In return for the tax credit subsidy, the projects must operate within predetermined rent restrictions for a minimum of 15 years[.]" is incomplete because Section 42 treats tenant and project based rental assistance differently than rent payments made by tenants that do not benefit from those programs. This may seem trivial, but the statement as made in the Report illustrates the Report's limitations. It assumes a policy change that is unsupported by the Code or the Act.

[16] We do not address the actual language of Section 8(o) that, we believe is clear and would not permit the reading preferred by the Report's authors.

[17] A second issue is that the Report relates to language that is somewhat difficult to discern, so we did not address statements that were difficult to understand. For example, The Report makes statements that are difficult to respond to because they are difficult to understand, like the following: "Of the 4,466 tax credit projects that had at least one household, with a tenant-based voucher, the average number of voucher holders was 16.2 [households, we presume]." We were uncertain about what the Report meant to convey to the reader, and therefore did not address the issue.

for owners of low income housing units to rent to very low income tenants. PIH is implementing policy in order to achieve specific Congressional intent with respect to housing very low income tenants as set forth in the Code and the Act. We have never asserted that the "windfall" was somehow created by PIH, yet the Report seems to imply just that. The fact is that there is no PIH caused "windfall," and it is simply Congressional intent with which the Report disagrees.

Comment 25

The Report wrongly asserts certain conclusions that are unsupported by law. For example, the Report seems to imply that Section 8 voucher holders are protected more so than any other tenant in a tax credit unit, even if their income increases. The Code, to a considerable extent, provides considerable latitude to *all* tenants if they happen to live in a tax credit unit and their economic circumstances improve while they live in the unit.

Comment 26

Another major flaw in the Report is that it assumes that the policy sense of one jurisdiction might apply to all jurisdictions. Again, as an example, the Report states that "[O]ther state officials thought the impact of discontinuing higher rents for voucher households would be minimal and pointed to the intense competition for tax credits as evidence of the program's profitability." This statement captures most of the misgivings that are set forth herein about the Report.

Tax credit competition is not intense because of voucher use,[18] yet the implication is that somehow ceasing fair market rent payments on tax credit units would somehow diminish tax credit demand. That implication illustrates the Reports failure to recognize that these are not complementary programs – they are wholly and entirely independent of one another are used in different phases of the affordable housing process.

The Report also fails to take into consideration market reality and each jurisdiction's policy prerogative in the form of each jurisdiction's QAP. The Report notes that representative from Alabama, Nebraska, Illinois, and Washington were interviewed but fails to reveal what they were asked nor does the report account for the remarkable policy differences between the cited PHAs. Alabama and Nebraska are HFAs that focus more so on homeownership strategies than Illinois and Washington yet the Report implies that the seemingly axiomatic statement made above would hold as true for the former two as for the latter when the latter two are vocal supporters of the current payment methodology (or, for that matter, the remaining unmentioned 52 jurisdictions). The irony, of course, is that the Report illustrates this shortcoming best: the charts used at Figure 1 in the Report demonstrate that the greatest differential between fair market rent and tax credit rent are in California, Florida, Arizona, Massachusetts, Nevada, Maine, New Jersey, New York (State), and Virginia. Every one of those states is currently struggling with providing affordable housing to its residents because demand outstrips supply in their urban areas.[19] If Recommendation were adopted, those states would suffer a loss in existing supply thus

[18] The Report states that section 8 vouchers constitute approximately 5-10% of all tenants in LIHTC units. The problem is that vouchers have no bearing on tax credit competition. Thus, reaching the conclusion that premiums are attached to vouchers in any competitive cycle, as the Report implies, is unsupported by facts.

[19] The second part of the analysis relates to the allocation of the tax credit, is directly related to the cost of construction; the meat of the policy concern for the tax credit allocating agency (and investor) is compliance with its respective state's qualified allocation plan ("QAP") and the components of the Code. It is helpful to the allocating agency to know that the investor, lender and/or developer believe in a deal's viability, but the real issue is does the deal structure comply with the state's QAP and the Code.

14

exacerbating an already stretched unit supply capacity while the states that were referenced in the Report, for distinctly different reasons, would not.

Comment 27

II. Finding 2

The Report states that HUD should impose a duty on PHAs to collect information on the use of vouchers in tax credit units. While Congress has not authorized HUD to collect such information or impose on PHAs a duty to collect such information, we agree that there is always value in having more robust data. Additionally, HUD's ability to collect data has limits. While we agree that current systems need to be improved to better collect data on *all* programs, including the low income housing tax credit, we stop short of accepting this finding because it implies regulatory steps should be taken that would require reporting that is not currently required by statute.

For that last two decades HUD has attempted relieve PHAs from their regulatory burden, not increase it. PIH disagrees with this finding because PIH and, indeed, HUD have no statutory authority to direct PHAs to collect data in connection with the use of vouchers on tax credit properties. If PHAs were to attempt to collect such data, their immediate response would be to inquire about two issues: first, their statutory authority to inquire and, secondly, their compensation for collecting the date and reporting the data to HUD. Moreover, Congress has not authorized HUD, and more specifically, PIH, to monitor that tax credit program's efficiency and effectiveness.

On the other hand, PIH agrees that some kind of uniform data standard should be developed in order to improve the metrics that measure housing utilization across the spectrum. Creating a data "Lengua Franca" would help all stakeholders in better assessing and discussing policy options. The data that the Report maintains must be collected may already exist within HUD. Moreover, if the data to be collected were simple to collect, certainly PIH would agree with that portion of this finding. HUD's Policy, Research and Development department collects data that seems to correlate to what the Report recommends HUD collect.

Comment 28

III. CONCLUSIONS

In conclusion, for all of the reasons set forth above in this section and in these comments generally, PIH cannot and will not undertake the recommendation. In light of the fact that Congress has not made a policy determination that would support Finding 1, we struggle with the idea that Finding 1 should be PIH policy. We do not struggle, though, with the fact that Finding 1 is a de facto intrusion on policy and one that is unsupported by legal authority that would allow or encourage that Findings suggested

As a technical matter, Section 42 only requires a 15-year compliance period. Any commitment by a developer to a longer affordability is generally related to the requirements of the respective jurisdiction's QAP and competitive cycle, not the Code. It is true that in order to compete more effectively, developers are committing to 30 or more years of affordability. In the case of Florida, for example, it is common to have 50-year affordability periods.

policy position. We would encourage the authors of the Report to reexamine the policy underpinnings and interplay between Section 42 of the Code and Section 8 of the Act.

With respect to Finding 2, we too would like a more robust data set. Much of that data set already exists and, assuming Congress were willing to allow PIH to keep data of the kind that the Report addresses and further assuming that resources were available, we would support the culling of data as suggested.

OIG Evaluation of Auditee Comments

Comment 1 In response to HUD's concerns regarding the legislative intent of certain provisions of the IRS Code on housing tax credits, we were unable to substantiate the legislative intent or meaning asserted in HUD's response. We concluded that it was appropriate to evaluate the effectiveness and efficiency of HUD's policy based on the law as written and the interpretation that HUD has used in the past, i.e., that HUD has the legal authority to decide whether it should limit Section 8 voucher payments to tax credit projects when those payments exceed the IRS rent-restriction applicable to the occupied unit.

HUD's response does not provide any evidence to support its assertion that implementing our recommendations will, over time, result in greater cost per month in the Housing Choice Voucher program. We further discuss both issues addressed in this comment under comment numbers 13, 14 and 21.

Comment 2 We appreciate the PIH staff's willingness to express concerns regarding the facts and conclusions in our report. However, no factual corrections were provided, and officials did not provide compelling evidence to support any changes to other conclusions about Section 42 in the report.

Comment 3 Under the Inspector General's Act of 1978, OIG's purpose is to promote the integrity, efficiency and effectiveness of HUD's programs and operations. When we identify potential waste, fraud or abuse in the implementation of HUD's programs, our job is to point that out even if the situation appears to be caused by confusing interplay of multiple laws that govern the program. We agree that the interaction of the IRS Code Section 42 and the Housing Act, as amended, is complex. However, we based our audit on our understanding of these laws and the interpretation that HUD has used in the past. If we were to avoid auditing or making recommendations on potentially wasteful policies simply because they stem from the interplay of laws whose meaning is not transparent, then we would not be fulfilling the requirements of the Inspector General's Act of 1978.

Comment 4 We disagree with the assertion in HUD's response that no subsidy overlap exists between the IRS tax credit program and the Housing Choice Voucher Program when tenant-based vouchers are used in tax credit units. See comment 9. We also disagree with the assertion that the tax credit program is only a construction subsidy and that tax credit financing does not affect the operations and property management of a project. See comment 10. Although we do not characterize it as a near entitlement, the report does point out that tax credit projects should not need an incentive (as HUD's response describes the payment of rent that exceeds the IRS rent restrictions) to rent to voucher holders because the IRS Code prohibits tax credit projects from refusing to rent to a voucher holder *solely* because he or she has a voucher. See comment 13. We also note that in some areas this requirement is moot because a local "sources of income" law prevents landlords from discriminating against a rental applicant simply because they possess a voucher or some other subsidy to their income or rent payment.

Comment 5 We disagree with the assertion in HUD's response that HUD needs the express authority of the IRS Code or the Housing Act to implement the report's recommendations. First, we interviewed officials from HUD Counsel who stated that nothing in the IRS Code or the Housing Act prohibits HUD from limiting the amount of Section 8 rental assistance it will pay for tax credit subsidized units. Second, we noted that HUD has already used its regulatory authority to limit project-based Section 8 rental assistance for units with rents restricted under the tax credit program. HUD's response does not explain how the IRS Code or Housing Act enable it to limit rents with respect to project-based Section 8 vouchers but not for tenant-based Section 8 vouchers. See comments 14 and 28.

Comment 6 See comments 21 and 22.

Comment 7 See comments 23, 24, 25 and 26.

Comment 8 See comments 9, 10 and 13.

Comment 9 We disagree with the assertion in HUD's response that no subsidy overlap whatsoever exists between tenant based rental assistance and/or voucher utilization and the low income housing tax credit. In its 2002 report the Government Accountability Office stated "Computing the costs of federal housing assistance programs is further complicated when subsidies **overlap—**that is, when rental assistance is combined with development subsidies to make units affordable for very-low-income households, both in older and in newly developed properties"[29] (bold added by OIG for emphasis). The term overlap in our report means the same thing. We are not able to address the comment made in footnote two of HUD's response because HUD does not provide the specific reference. We note that our report cites the 2002 GAO report that compares the characteristics and costs of six active federal programs that provide affordable housing. GAO describes five of the programs, including the low income housing tax credit

[29] "Federal Housing Assistance: Comparing the Characteristics and Costs of Housing Programs," GAO-02-76, January 2002, 80.

program, as housing production programs and describes the voucher program as a supplement to tenant rental payments in privately owned moderately priced housing chosen by the tenants. GAO notes that *all six* of the programs were selected for its review because they "continue to increase the number of households assisted by the federal government".[30]

Comment 10 We disagree with HUD's assertion that "the financial ability to construct units and the practical reality of managing units are two wholly and entirely unrelated concepts…" when applied to projects financed under tax credit law. The express purpose of the tax credit program is to provide affordable rental housing, i.e. affordable rents over a defined period of time. It does so by reducing the financing costs (with tax credits) so that the project can operate with less debt load and thus remain viable while collecting less than market rent. This subsidy mechanism works precisely because repayment of finance debt (mortgage) is typically a significant operating cost. Project management has to pay the mortgage and other operating costs from the project's operating revenues which are largely derived from the rents charged. Therefore, the ability to meet mortgage payments while maintaining rent restrictions is a practical reality of project management.

Furthermore, the IRS Code expressly links the amount of tax credits to the restricted rent level by requiring allocating agencies to provide no more tax credits than necessary to ensure the project's financial feasibility and viability as a qualified low-income housing project [i.e. operation in compliance with restricted rents and tenant income levels] throughout the tax credit compliance period.

Comment 11 We disagree with the assertion in HUD's response that adopting the report's recommendations "causes greater stress on the delivery of units that serve tenants that earn 30 percent of area median income or less." Our methodology, report and recommendation do not distinguish between tax credit units targeted (i.e. rent-restricted) for tenants that earn 30 percent (or any amount less than 60 percent) of area median income and the tenants that qualify for assistance at the 60 percent median income level (the maximum income level that qualifies a tenant to live in a tax credit subsidized unit). Accordingly, adopting the report's recommendation would have the *same* impact on the 30 percent area median income voucher household as on a 60 percent area median income voucher household—the tenant-based Section 8 voucher assistance would not be used to subsidize gross rent that exceeds the *maximum* IRS restricted rent—the rent restriction that applies to a unit set aside for a household at the 60 percent income level, adjusted for unit size.

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[30] HUD's Office of Policy Development and Research also refers to the use of tenant-based Section 8 vouchers in tax credit projects as an overlap of the two programs. See "Updating the Low-Income Housing Tax Credit (LIHTC) Database Projects Placed in Service Through 2003," HUD Office of Policy Development and Research, January 2006, p. 47.

In fact, our report and recommendation disregard the fact that allowing the tax credit project to charge the maximum restricted rent (rent established for the 60 percent income level) for a unit that qualifies as rent restricted at the 30 percent level results in a duplicative subsidy for the portion of rent that exceeds the 30 percent rent level. This occurs because the project was underwritten to be viable with the rent for that unit restricted at the 30 percent income level, and the developer made a contractual agreement with the IRS to comply with that restriction after the unit was placed in service. The reasons we did not distinguish between the maximum and lower tax credit qualifying income levels and rents were primarily because 1) the data required to identify a unit's income level is not readily available to HUD and 2) implementing a requirement to track each voucher unit's tax credit compliance level and associated rent limit would be burdensome for housing authorities.

Comment 12 HUD's response incorrectly states that the report presumes that viability of a tax credit project is only assessed initially. The IRS Code requires state allocating agencies to assess the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period on the following three occasions: the application for the housing credit dollar amount, the allocation of the housing credit dollar amount and the date the building is placed in service.[31] The extent to which stakeholders focus on viability from different perspectives or perform additional analyses is not relevant to the requirements of the IRS Code, and does not change the tax credit project's contractual agreement with the IRS to provide affordable housing at specified rent levels over a specified period of time.

We agree with HUD that developers and investors who propose tax credit financed units that will serve very low-income tenants may consider voucher availability and use in the proposed market area. However, this does not imply that the developers expect or deserve to receive higher rents for units occupied by voucher holders. The state allocating officials we interviewed were adamant that tax credit proposals they receive never project operating revenues based on rents that exceed the IRS rent restrictions for voucher-occupied units, because the number of voucher families that would choose to live in the project over time is uncertain. Accordingly, underwriters certify that these tax credit projects appear to be viable with rents set at IRS restricted levels for very low-income households, and investors or other stakeholders should not need or expect to charge higher rents simply because the units are occupied by voucher holders. If

[31] 26 CFR [*Code of Federal Regulations*] Section 42 (m)(2)(c)(i)

the state allocating agencies determine that the underwriting is unrealistic for very low-income targeted tax credit units, as implied by HUD's response, then they have the ability to impose the sanctions referred to in HUD's response and/or require underwriting that reflects more realistic operating costs.

Comment 13 Contrary to the assertion in HUD's response, the report makes no assumptions or statements that tax credit projects must accept voucher holders simply because they have a voucher. The report does state—as HUD's response reiterates later—that a tax credit project cannot refuse to rent to a voucher holder *solely because he or she has a voucher* (see page eight of the report). Obviously, the landlord may decline a prospective tenant for any other lawful reason, as HUD notes in its response. The report argues that, if an *otherwise qualified* prospective tenant *does* have a tenant-based Section 8 voucher, then the tax credit project cannot refuse to rent to that voucher holder *on the basis that the tenant and issuing housing authority will not agree to a rent that is higher*—simply because the prospective tenant has a voucher—than the IRS rent restrictions that apply to the unit. Further, the report states clearly that, for the purpose of qualifying for the tax credit, IRS code allows the rent to exceed the restricted level as long as the excess does not come from the tenant's pocket (see report pages six and nine). However, *allowing* the rent to exceed the IRS rent restricted level is not the same as the landlord *requiring* a higher rent *only* because the prospective tenant has a voucher that can pay the excess rent without jeopardizing compliance with IRS affordability requirements. It is OIG's position that the IRS Code leaves the matter to HUD (or any other entity that provides tenant-based rental assistance) as to whether or not its voucher subsidy should exceed the IRS restricted rent that applies to the unit.

HUD's response provides no evidence to support its assertion that "Congress wanted to create a monetary incentive for low income housing tax credit unit owners to accept a voucher". Furthermore, our review of Congressional intent could not substantiate HUD's assertion. Instead, the language in the IRS Code seems aimed at ensuring that a tax credit unit will not lose its qualifying status if the tenant receives other rental or income subsidies. If Congress wanted to require HUD to utilize Section 8 funds as an incentive for tax credit owners to rent to voucher holders, then it could plainly say so. Moreover, HUD Counsel we interviewed did not believe that the IRS Code mandated such a financial incentive. In the absence of a documented, clear need or mandate to do so, OIG believes it is unnecessary and uneconomical for HUD to have a standard policy that uses Section 8 funds to pay incentives in the form of excess rent to tax credit owners. Doing so reduces the scarce funds available to provide vouchers to low-income households already waiting for affordable housing. Accordingly, this report recommends that HUD eliminate these unnecessary incentives as a matter of standard policy. If HUD documents specific circumstances that warrant payment of Section 8 voucher rents that exceed IRS rent restrictions for certain units or projects, then HUD would continue to have the discretion to do so under the IRS Code and the Housing Act.

Comment 14 We do not agree with HUD's response that it needs an express provision of the IRS Code and/or the Housing Act to enable HUD to limit Section 8 rental subsidies for units that already have rents restricted under the tax credit program. Based on our review of the pertinent sections of both the IRS Code and the Housing Act, we found no legal impediments to HUD's implementation of the reports' recommendations. Indeed, HUD has already used its authority to limit its project-based Section 8 voucher payments for rents that exceed IRS rent restrictions for tax credit units (see report pages 13 and 14). HUD's response does not explain how the IRS Code or Housing Act enables it to make the same policy change with respect to project-based Section 8 vouchers but not for tenant-based Section 8 vouchers. (We recognize that other arguments have been made against limiting rent subsidies for project-based Section 8 vouchers in tax credit units, but those arguments have to do with contractual agreements between HUD and the projects—not HUD's authority to set limits for its subsidies under the Section 8 voucher program.)

Comment 15 HUD's response correctly points out that the rental limits under the HOME Investment Partnership and other programs cited have a statutory basis for existence. However, the report cites these programs to illustrate how they recognize the nature of the duplicate subsidy created when tenant-based rental assistance is used in a unit that already has its rent restricted under an affordable housing production program. HUD's own website for the HOME program provides the following explanation for its rental limitations, which is precisely the reasoning behind our finding and recommendation regarding excess rents charged to Section 8 for tenant-based vouchers used in tax credit units:

"Because tenant-based assistance is portable and does not provide a guaranteed income stream to the project, the underwriting of these projects is based upon rents no higher than the maximum HOME rents. If the Department permitted higher rents to be charged in HOME-assisted units occupied by tenant-based rental assistance recipients, there would be a duplicative subsidy. The HOME program would have provided a capital subsidy to reduce rents to a certain level

(High and Low HOME rents), but the owner would be charging rents higher than the HOME rents with the additional amount being paid to the owner from another governmental source. The result would be a publicly funded windfall to the project owner with no additional affordability achieved for the low-income tenant."
Source: HOMEfires - Vol. 3 No. 10, November 2001
http://www.hud.gov/offices/cpd/affordablehousing/library/homefires/volumes/vol3no10.cfm

Comment 16 As discussed under comments 14 and 15, although the rent limitation under the HOME program is statutory, there is no statute or regulation that prohibits HUD from limiting its voucher rents.

Comment 17 HUD's response incorrectly quotes statistics in the report regarding the percentage of voucher-occupied tax credit units in all units financed with low income housing tax credits. We clarified text in Table 1 of Appendix D in case it was misleading.

Appendix D of the report presents the following statistic compiled by the Government Accountability Office in its 1999 report titled "Tax Credits: The Use of Tenant-Based Assistance in Tax Credit Supported Properties":

- 16,532 households (+/- 2,981 households) received tenant-based assistance out of 142,865 (+/- 2,912) households occupying tax credit units. (Using theses statistics, OIG computed that the proportion of households with tenant-based rental assistance was 9.3 to 13.9 percent of all households in tax credit units.)

The GAO's report further notes that the above data was estimated from data gathered for tax credit projects placed in service from 1992 through 1994. GAO used the same data to estimate that 36 percent (+/- 10 percent) of tax credit properties housed at least one tenant that received tenant-based rental assistance.

More recent data show that voucher use in tax credit units is increasing. HUD's most recent study and data OIG analyzed for this audit showed that, for tax credit projects placed in service through 2003, the portion that had at least one resident receiving tenant-based rental subsidies through the Section 8 program increased to approximately 46 percent. HUD also reported that the average size of tax credit projects increased from 42 units to 82 units per project. It is likely that the percentage of voucher-occupied tax credit units in all tax credit projects has also surpassed the 9 to 14 percent estimated from data gathered in the early 1990s.

Comment 18 See comment 12.

Comment 19 HUD's response states that Congress *expressly* (italics added by OIG) noted its intent (with respect to the calculation of gross rent) in the form of legislative history, but the response does not provide any source for that history in its text or in the accompanying footnote 13.

Comment 20 As discussed under comments 13 and 14, the language in the IRS Code seems aimed at ensuring that a unit will not lose its tax credit qualifying status if the tenant receives other rental or income subsidies. Furthermore, the IRS Code does not state that the tax credit project should receive market rent for a voucher-occupied unit. HUD's response argues that Congress could have passed an amendment to limit the rent for voucher-occupied units, but likewise, Congress could have passed an amendment to ensure projects receive market rents when rent-restricted units are rented to voucher holders.

Comment 21 We disagree with the assertion in HUD's response that disallowing Section 8 rental assistance that exceeds the maximum tax credit rent results in a disincentive for managers of tax credit projects to rent to voucher holders. Instead, the result would be neutral: tax credit projects would charge the same rent to an applicant with a voucher as they would to any other prospective tenant (with the notable exception that tax credit projects could continue to collect higher rents for units with rents restricted at levels less than 60 percent, as long as the rent did not exceed the maximum IRS restricted rent—the rent for the 60 percent median income level.)

HUD's response does not provide any evidence to support its main economic assumption that, in areas where Fair Market Rents exceed the IRS maximum restricted rents, allowing tax credit projects to charge the same rents to qualified voucher holders and non-voucher holders will result in fewer tax credit units available to the voucher holders. This assertion implies that tax credit projects generally prefer non-voucher holders. However, vouchers are more attractive to some landlords because the voucher portion of the rent is a secure income stream. HUD's response does not take this into account and does not cite any studies that have addressed landlord preferences.

Moreover, the presumption of preference to voucher holders when they can pay higher rent raises the following question. Does allowing tax credit projects to collect higher rents from voucher holders result in fewer tax credit units available to the 50 and 60 percent median income level tenants without vouchers—the income group the tax credit program was envisioned to serve? If there are not other income-qualified prospective tenants in the area, it seems unlikely that the tax credit project would leave a unit vacant if a qualified voucher holder will rent it, albeit at the IRS restricted rent. Nevertheless, our audit and report did not address the issue of whether, in certain areas, the present policy tends to displace income-qualified non-voucher holders with voucher holders (in tax credit units).

Comment 22 The assertion in HUD's response goes too far by stating that Congress has already decided that the law should make it easier for tenant-based voucher holders to live in tax credit units, and therefore giving voucher holders greater access to newer units [we assume the response means tax credit units] is apparently the highest policy goal. Instead we believe the Section 8 voucher program has a duty to expend its funding in the most economical, efficient and effective manner possible. That duty includes making its own determination as to whether payment of rent in excess of IRS maximum is, or is not, the most beneficial policy for the housing authorities and voucher holders it serves.

Comment 23 HUD's response incorrectly quotes the report. The last sentence in the third full paragraph on page five actually states "Tenant-based voucher program legislation does not prohibit the gross rent from being lower than the payment standard as long as the unit meets HUD's *housing quality standards*." The response's substitution of the word "needs" for "housing quality standards" does not adequately convey that in order to qualify for a Section 8 subsidy, a unit must meet physical specifications to ensure health and safety standards are met as opposed to meeting an unspecified housing "need".

HUD's response also incorrectly states that the report failed to note that the IRS Code relies on payment standards set forth in Section 8(o)(10)(A) of the Housing Act. This paragraph of the Housing Act pertains to reasonable rents. The background section of the report notes (in paragraph six) that "the housing authority must determine that the rent requested for the unit is reasonable in comparison to market rents charged for other comparable, unassisted units". The report also notes, under Finding One, that the current practice by housing authorities—allowing Section 8 payments in excess of IRS rent restrictions—is based on guidance issued by HUD under Notice PIH 2002-22 which states that other tax credit units are considered assisted units and may not be used to determine comparable rents for the Section 8 voucher program.

Comment 24 HUD's response states that "PIH has never asserted that payments under the current policy are an entitlement". At the same time, HUD's response maintains that HUD does not have any authority to limit its Section 8 subsidies to tax credit projects. Semantics aside, if HUD cannot refuse to pay the excess, then it appears the tax projects are entitled to it. See comment 13.

The term "windfall" was first used by HUD to describe tenant-based rental subsidies that exceeded the maximum rent established for projects that received capital subsidies under the HOME program. See comment 15.

Comment 25 The report does not intend to imply that, in the event the tenant's income rises above the IRS limit, the law protects Section 8 voucher holders more than any other tenant. HUD's response correctly notes that all tenants are protected from higher rents even if their incomes rise. The report was simply making the point that, in contrast to voucher holders, the law does not permit tax credit projects to exceed the IRS rent restrictions for non-voucher holders in *any* circumstance, including a rise in household income.

Comment 26 HUD's response appears to interpret the report as saying voucher use increases tax credit competition. OIG did not mean to imply that ceasing fair market rent payments (i.e. payments in excess of IRS restricted rent in some areas) on tax credit units would somehow diminish tax credit demand. At the entrance conference, HUD officials raised this question and insisted that we ask officials in industry or state allocating agencies how disallowing excess rents for vouchers in tax credit units would affect development of tax credit projects. We revised the report language to better reflect their responses. As the report notes, the responses were inconclusive and further investigation on the subject was beyond the scope of our audit. To the extent we understand this section of HUD's response; we agree that the impact of our recommendation would vary according to housing authority jurisdiction. Nevertheless, we believe the recommendation reflects a conservative approach to Section 8 spending, and is therefore the preferred standard (default) policy.

Comment 27 We disagree with the assertion in HUD's response that HUD needs statutory authority to direct PHAs to collect data in connection with the use of vouchers with tax credit projects. As the report notes on page 19, HUD already requires housing authorities to use Form HUD 52517. As approved by OMB, the form already gathers data to indicate if a unit has a tax credit subsidy. Accordingly, we do not see why HUD now needs additional statutory authority to inquire about a voucher unit's tax credit status. We also disagree with the implication in HUD's response that Congress must authorize HUD to monitor the tax credit program's effectiveness, specifically the extent to which HUD's Section 8 funds are used in conjunction with the tax credit subsidy. First we note that Congress passed the Government Performance and Results Act in 1993 that requires agencies to generate the information congressional and executive branch decision-makers need in considering measures to improve government performance and reduce costs. Second, as the report notes on pages 19 and 20, HUD already tracks data on the tax credit program because the program is important to HUD's mission to increase access to affordable housing. HUD's Office of Policy Development and Research maintains the tax credit project information, and already utilizes data maintained by HUD's Office of Public and Indian Housing to estimate voucher use in tax credit projects. Implementation of the report's second recommendation would greatly simplify this portion of the research.

Comment 28 We do not concur with HUD's concluding remarks stating that the Office of Public and Indian Housing cannot undertake the (OIG's) recommendation as Congress has not made a policy determination that would support Finding 1. Based upon available documentation and information, as discussed above in comments 1, 5, 13, 14, and 22, HUD does have the legal authority to implement the report recommendation limiting Section 8 Housing Choice Voucher payments.

We are aware of no Congressional action that would preclude implementation of the recommendation.In regards to HUD's claim that Finding 1 of OIG's report is an intrusion on policy unsupported by legal authority, it should be noted that OIG's mandate under the Inspector General Act is to promote the integrity, efficiency and effectiveness of HUD programs. This includes review of HUD policies, and recommending policy changes where such changes would result in a more efficient use of HUD funds. In this instance, implementation of the subject recommendation would result in an estimated annual savings of $13.5 million in Section 8 Housing Choice Voucher funds.

Appendix C

SUMMARY SCHEDULES OF TENANT-BASED VOUCHERS IN TAX CREDIT PROJECTS BY STATE/AREA REVIEWED

The following table contains the data related to finding 1.

	Total number of Section 8* records screened	Number of Section 8 vouchers in tax credit projects that pay unnecessary rent**	Total number of tax credit projects screened	Number of tax credit projects with one or more Section 8 vouchers	Average amount of unnecessary rent charged per month	Unnecessary rent per year
Alabama	31,496	58	389	182	$ 31	$ 21,252
Arizona	20,884	296	187	101	$ 40	$ 142,044
California	250,858	6,136	1,407	871	$ 106	$ 7,811,352
Colorado	31,485	19	216	126	$ 50	$ 11,364
Florida	89,844	3,214	625	406	$ 57	$ 2,187,000
Hawaii	13,937	41	36	24	$ 144	$ 71,028
Illinois	78,455	72	708	239	$ 43	$ 37,248
Maine	13,213	191	155	45	$ 79	$ 181,068
Maryland	40,754	30	252	139	$ 63	$ 22,716
Massachusetts	46,900	335	233	99	$ 243	$ 975,180
Nebraska	9,949	-	279	91	$ -	$ -
Nevada	7,612	129	74	46	$ 53	$ 81,960
New Hampshire	9,387	74	83	47	$ 79	$ 70,320
New Jersey	46,970	111	211	88	$ 90	$ 120,336
New York	144,116	638	905	407	$ 110	$ 840,720
Pennsylvania	68,317	146	1,202	307	$ 31	$ 55,044
Puerto Rico	21,222	123	99	6	$ 120	$ 177,432
Texas	132,134	1,004	1,126	475	$ 35	$ 419,448
Utah	12,003	3	133	63	$ 17	$ 624
Virginia	43,035	600	568	360	$ 40	$ 287,148
Washington	33,631	97	531	217	$ 50	$ 58,152
Washington DC	8,460	9	37	27	$ 28	$ 3,048
West Virginia	17,860	15	170	100	$ 24	$ 4,332
Total	**1,172,522**	**13,341**	**9,626**	**4,466**	**$ 85**	**$ 13,578,816**

*Section 8 records refers to records for tenant-based Section 8 vouchers.
**Section 8 records in tax credit projects where the rental assistance contract gross rent exceeded the tax credit restricted rent for the 60 percent area median gross income level, adjusted for unit size.

The following table contains the data related to finding 2.

	Number of Section 8 tenants in tax credit projects (unit address matches)	Percentage of Section 8 tenants in tax credit projects	Total housing assistance payments
Alabama	3,529	11.2	$ 12,410,808
Arizona	1,218	5.8	$ 6,265,812
California	12,489	5.0	$ 75,531,828
Colorado	1,807	5.7	$ 10,230,348
Florida	9,983	11.1	$ 55,225,536
Hawaii	433	3.1	$ 2,102,568
Illinois	2,693	3.4	$ 14,626,356
Maine	669	5.1	$ 3,341,736
Maryland	2,322	5.7	$ 12,937,332
Massachusetts	1,084	2.3	$ 7,929,828
Nebraska	1,090	11.0	$ 4,188,744
Nevada	782	10.3	$ 4,595,700
New Hampshire	391	4.2	$ 2,148,480
New Jersey	865	1.8	N/A
New York	3,433	2.4	$ 16,288,548
Pennsylvania	3,366	4.9	$ 12,169,116
Puerto Rico	123	0.6	N/A
Texas	12,091	9.2	$ 61,748,208
Utah	949	7.9	$ 3,938,652
Virginia	7,943	18.5	$ 46,097,076
Washington	2,920	8.7	$ 13,228,536
Washington DC	845	10.0	$ 6,612,732
West Virginia	1,351	7.6	$ 4,660,212
Total	**72,376**	**6.2**	**$ 376,278,156**

Appendix D

ESTIMATES OF THE OVERLAP BETWEEN THE VOUCHER AND TAX CREDIT PROGRAMS

Early estimates on the use of tenant-based vouchers in tax credit supported projects were reported by the Government Accountability Office in 1999;[32] however, these estimates were based on data gathered for projects placed in service from 1992 through 1994. The data were obtained from a survey of about 400 projects that statistically represented about 4,000 projects placed in service during those three years. The Government Accountability Office reported the results of that survey in a 1997 report that examined characteristics of tax credit properties and their tenants.[33] In response to a request from HUD's Office of Policy Development and Research, the Government Accountability Office further analyzed the same data for the 1999 report. This report cautions that some of the sampling errors were very large because the original sample was designed to produce estimates for tax credit properties and households as a whole but not subgroups such as tenants who receive rental subsidies. The Government Accountability Office estimated:

- In 36 percent (+/- 10 percent) of the tax credit properties, at least one tenant received tenant-based rental assistance.
- 16,532 households (+/- 2,981 households) received tenant-based rental assistance in 1,502 projects (+/- 466 projects) that had at least one household receiving tenant-based rental assistance (and no project-based rental assistance).
- 16,532 households (+/- 2,981 households) received tenant-based assistance out of 142,865 (+/- 2,912) households occupying tax credit units. Using these statistics, OIG computed that the proportion of households with tenant-based rental assistance was 9.3 to 13.9 percent of all households in tax credit units. The report did not estimate what proportion of Section 8 program vouchers the 16,532 households might represent.

In 2002, the Government Accountability Office compared costs of six active federal programs that address the serious housing needs of low-income households, including the tax credit program and the Housing Choice Voucher program.[34] The report did not focus on the overlap of these programs other than to note that any overlap complicated the interpretation of results, but it did state that about 6 percent of voucher households rent units developed under production programs, particularly under tax credits. This was apparently a broad estimate based on the Government Accountability Office's previous work and the HUD estimates described below. In its estimates of federal outlays for the various programs, the Government Accountability Office

[32] "Tax Credits: The Use of Tenant-Based Assistance in Tax Credit Supported Properties," GAO/RCED99-279R September 17, 1999.
[33] "Tax Credits: Opportunities to Improve Oversight of the Low-Income Housing Program," GAO/GGD/RCED-97-55, March 1997.
[34] "Federal Housing Assistance: Comparing the Characteristics and Costs of Housing Programs," GAO/02-76, January 2002.

continued to rely on data from 1992 to 1994 when it noted that "according to our 1999 estimate, about 10 to 14 percent of households in tax credit units also receive tenant-based housing vouchers." The report noted that such use of federal rental assistance caused the per-unit cost of federal outlays for tax credit units to be understated.

Since 2000, HUD's Office of Policy, Research, and Development has issued annual reports that update and summarize its tax credit database, including estimates of the overlap between tenant-based vouchers and the tax credit program. As previously noted, the tax credit database information is gathered and compiled by a contractor, which mails an annual survey to the 59 state tax credit allocating agencies. Because the database does not have tenant-level data, analysts estimated program overlap by merging its project address data with voucher unit data maintained by HUD in its tenant record database. One problem with this approach has been the existence of multiple tax credit supported buildings listed under one address in the tax credit database.[35,36] The most recent tax credit database update report, issued in January 2006, summarized data for tax credit projects placed in service from 1987 through 2003.[37] Three conclusions in this report addressed the overlap of tenant-based Section 8 vouchers and tax credit projects:

- About 46 percent of all tax credit projects (placed in service through 2003) have at least one resident receiving tenant-based rental subsidies through the Section 8 program.
- For more than 1.7 million records analyzed, 4.7 percent of tenant-based Section 8 households occupied a tax credit unit, based upon matching addresses.
- Because the accuracy of the address matching procedure was questionable, the report used another approach to calculate an expected proportion of program overlap. For this approach, analysts relied on census data pertaining to rental rates, fair market rents, and tenant and project location by census tract. Based on the expected proportion of voucher households in tax credit units and the number of voucher households in each 2000 Census tract, the analysts expected 9.7 of the tenant-based vouchers to occupy tax credit units.[38]

For the current report, OIG also matched tenant addresses in HUD's tenant record database to project addresses in the tax credit database. However, because our first objective focused on rents that exceeded tax credit rent restrictions, our analysis differed from HUD's latest tax credit database update report in several important ways. As noted in the Scope and Methodology section, OIG's review was not a statistical sample, but instead covered 100 percent of the available tenant records in 23 states/areas. In addition, OIG screened about 88 percent of the tax

[35] To address this problem, the 2003 data survey form requests agencies to provide all addresses for projects with multiple buildings.
[36] We relied on the same tax credit data to answer our objective, and thus our conclusions have some of the same limitations that applied to the HUD report.
[37] "Updating the Low-Income Housing Tax Credit (LIHTC) Database Projects Placed in Service Through 2003," HUD Office of Policy Development and Research, January 2006, p. ii.
[38] Ibid p. 55. The report states that certain assumptions used in the computation tend to increase the expected proportion of program overlap.

credit projects, eliminating those that did not appear to be 100 percent rent restricted. Both studies omitted data for about 2,500 new tax credit projects (equivalent to roughly 200,000 units) that HUD estimated were placed in service from 2004 through 2005. Nevertheless, the program overlap OIG found was consistent with the database update report:

- 46 percent of the tax credit projects screened had at least one resident with a tenant-based Section 8 voucher.
- 6.2 percent of about 1.2 million tenant-based vouchers were used for units in tax credit projects.

In addition, OIG's breakdown of the program overlap showed that it varied significantly by state. The highest statewide proportion of tenant-based Section 8 voucher use in tax credit projects was almost 19 percent in the state of Virginia. Its neighbor state of Maryland had 6 percent, while Washington, DC, had a 10 percent overlap. The lowest statewide proportion of program overlap we found was less than 2 percent in the state of New Jersey. Appendix C provides the detailed results of program overlap in the states we analyzed.

Although the proportion of tenant-based vouchers used in tax credit projects was estimated to be less than 10 percent of all Section 8 vouchers authorized, the cost of those vouchers is roughly three-quarters of a billion annually. This is a significant amount compared to the cost of the tax credit program to the taxpayer—widely cited as $5 billion in annual tax revenue foregone. Depending on the overlap estimate used, the cost of using vouchers in tax credit units added from 12.6 to 26 percent to the annual cost of the affordable housing provided through the IRS tax credit program. The following table illustrates how seemingly small changes in the estimated percentage of tenant-based vouchers used with the tax credit program have a significant impact on the total taxpayer cost.

Table 1: Sensitivity analysis of estimated tenant-based voucher support for the tax credit program

	HUD[a] address match	OIG address match[b]	HUD-expected overlap based on census data[c]
Proportion of tenant-based vouchers in tax credit units as a percentage of all tenant-based vouchers	4.7	6.2	9.7
2005 budget authority for all tenant-based voucher renewal (millions)	$13,400	$13,400	$13,400
Calculated annual voucher dollars (millions) paid to tax credit projects	$630	$831	$1,300
Generally cited 2005 tax credit cost to taxpayers (millions)	$5,000	$5,000	$5,000
Tenant-based voucher contribution as percentage increase in cited tax credit program cost	12.6	16.6	26.0

[a] "Updating the Low-Income Housing Tax Credit Database Report Projects Placed in Service Through 2003," HUD Office of Policy Development and Research, January 2006.
[b] Based on OIG review of tenant data for 21 states, Washington, DC, and Puerto Rico and tax credit projects with 100 percent rent-restricted units, see appendix C.
[c] "Updating the Low-Income Housing Tax Credit Database Report Projects Placed in Service Through 2003," HUD Office of Policy Development and Research, January 2006. The report noted that certain assumptions in this methodology tend to increase the expected proportion of vouchers in tax credit projects.

We concluded that the tenant-based voucher program provides roughly three-quarters of a billion dollars annually in rental subsidies (see calculated annual voucher dollars in Table 1) that add to the cost of affordable housing provided through the tax credit program. It should be noted that, to the extent the estimated percentages of program overlap are inaccurate, additional taxpayer costs could be significantly understated or overstated.

The actual cost of tenant-based housing assistance paid to tax credit projects would be available from HUD's tenant record database if HUD captured the tax credit status of each unit in its family report as discussed under finding 2. For example, OIG also summed the annualized housing assistance payments in the matched tenant records to determine the total tenant-based voucher assistance to tax credits in the states we reviewed. In 21 of the states/areas we analyzed,[39] tenant-based Section 8 rental assistance for 71,388 households provided $376 million

[39] The amount of housing assistance payments (rental subsidies) was not available for Puerto Rico or New Jersey at the time of our analysis.

annually to tax credit projects. We expected the total rental assistance paid to the tax credit projects to be greater because most of the states we analyzed contained areas with high fair market rents. However, the average rental assistance paid to the tax credit projects in the four states we selected because they had relatively low fair market rents—Alabama, Illinois, Nebraska, and Washington—was about $4,300 annually per voucher compared to about $5,430 per voucher in 17 states/areas we analyzed because they contained some areas with higher fair market rents. We concluded that it was reasonable to use the proportion of overlap we found in 23 states/areas and the budget authorization amount to roughly estimate the amount of rental assistance that tax credit projects receive nationwide from tenant-based vouchers.