

PROPERTY COMPLIANCE REPORT

A MONTHLY PUBLICATION ON LOW-INCOME HOUSING TAX CREDIT COMPLIANCE

January 2007, Volume X, Issue I, Published By Novogradac & Company LLP

HUD Office of Inspector General Issues Audit Report on LIHTC/ Section 8 Overlapping Subsidies

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On November 8, 2006, the Office of Inspector General (OIG) for the Department of Housing and Urban Development (HUD) issued an audit report to Orlando J. Cabrera, assistant secretary for the Office of Public and Indian Housing (PIH). In the report, OIG asserted that low-income housing tax credit (LIHTC) project owners are able to receive a double subsidy by receiving LIHTCs and receiving rents equivalent to market rents under the tenant-based Section 8 vouchers. The OIG report focuses on the first and second programs listed below where projects can receive Section 8 rent greater than the LIHTC limit if the tenant portion of the rent is not greater than the LIHTC limit. The limit of Section 8 rent to LIHTC rent under HUD Notice 2006-16 applies only to the third program listed below for project-based vouchers.

1. Section 8 Tenant Based Housing Choice Vouchers,
2. Section 8 Project Based Contract and
3. Section 8 Project Based Vouchers (when a PHA converts tenant vouchers to project based).

The ultimate resolution of the OIG report could have far-reaching ramifications on this practice and therefore on the economics of developing and investing in LIHTC projects with the first and second programs listed above.

Background on the Office of Inspector General

For those not familiar with OIG, the office became statutory with the signing of the Inspector General Act of 1978 (Public Law 95-452). OIG is intended to promote the integrity, efficiency and effectiveness of HUD programs and operations; to assist HUD in meeting its mission; detect and prevent waste, fraud and abuse; and seek administrative sanctions, civil recoveries and/or criminal prosecution of those responsible for waste, fraud and abuse in HUD programs and operations. To accomplish its mission, OIG conducts independent and objective audits,

investigations, and other activities relevant to the HUD mission.

Report testing methodology, findings and recommendations

The OIG audit was initiated due to a discovery during an OIG audit of a public housing agency. During that audit, OIG noted that LIHTC projects were receiving market-based rents for tenants with Section 8 vouchers, but received only the LIHTC restricted rents for non-voucher tenants. The OIG audit was undertaken to estimate the extent to which the Section 8 voucher program was paying rents for LIHTC units in excess of the LIHTC restrictions and to determine the extent to which voucher households occupied LIHTC units.

In the performance of the audit, OIG analyzed information on 1.2 million tenant records. The scope of the audit was restricted to 21 states, Washington D.C. and Puerto Rico because under the Section 8 program these areas were most likely to exceed the rents at 60 percent of AMI. Additionally, OIG restricted the scope of the audit to include only those LIHTC projects with 100 percent of the units subject to income restrictions, due to difficulty in identifying which units were rent-restricted in mixed-income projects. Finally, projects placed in service after 2003 were not included in the testing, as data for those projects was not yet available. Of the 1.2 million tenant records analyzed, and based on the scope limitations above, 13,000 current tenant records were found to be using tenant-based vouchers for a LIHTC unit. Of these 13,000 tenants, OIG found that the average amount of rent collected exceeded the 60 percent of area median income (AMI) level by \$85 per month. Furthermore, in markets with very high rents, the market rent paid under the Section 8 voucher program exceeded the 60 percent AMI rents by \$90 per month.

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Based on the information uncovered during the OIG audit, the report estimated that annual payments under the Section 8 tenant-based voucher program for rents in excess of the LIHTC restrictions were more than \$13.5 million. Based on the findings, the report recommended that HUD change its regulations to cap gross rents paid to LIHTC project owners under the Section 8 tenant-based voucher program at the 60 percent of AML. The report also recommended that HUD track the use of tenant-based vouchers for LIHTC units.

PIH response

In response to the findings and recommendations in the report, the Office of Public and Indian Housing disagreed with the recommendations, but conceded that PIH would also like a more robust data set if authorized by Congress to collect such data. The PIH response to the report's findings and recommendations centered on the arguments that PIH does not have the authority to implement the recommendations, the recommendations violate implicit and explicit congressional intent, and that implementing the recommendations would lead to unintended adverse consequences to voucher holders.

PIH specifically indicated that no express provision of the Internal Revenue Code (IRC) or the Housing Act of 1937 enables PIH to limit the amount of rent paid under the Section 8 voucher program. PIH recognized that although other programs such as the programs under sections 202, 221(d)(3), 236, and 515 of the Housing Act and the HOME Investment Partnership program, have specifically granted permission for HUD to cap Section 8 rents, no such authority is granted in relation to the LIHTC program.

PIH argued further that the IRC expressly treats voucher holders differently than all other tenants, as the code limits the maximum amount of all other rent payments except rent paid in connection with voucher holders and project-based rents. Instead of limiting Section 8 rents paid for the rental of LIHTC units, the IRC relies on the provisions of the Housing Act for the calculation of these rents. In addition to these arguments, PIH also argued that the nature of the two subsidies was fundamentally different, as the Section 8 payments subsidized the operations of the property, and the LIHTC subsidized the construction of the property.

Finally, PIH argued that the recommendations would create a disincentive for LIHTC property owners to rent to tenants with vouchers, which could theoretically result in fewer units available for rent by voucher holders. The decrease in available units would, therefore, lead to increasing prices over time, as the demand for units would remain constant, but the supply would decrease due to the asserted disincentive for LIHTC owners to rent to voucher holders.

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Based on these responses, PIH concluded that adopting the recommendations was not only legally impossible, but would result in unintended consequences that would undermine the effectiveness of the Section 8 voucher program.

Ultimate resolution of the recommendations

OIG counter responded to many of the PIH responses, generally disagreeing with the conclusions reached in the PIH response. The report concludes without reference to a mechanism to resolve the disagreements between the position held by OIG and the position held by PIH. However, the author of the OIG audit report, Joan S. Hobbs, explained in a telephone conversation that because the two sides could not reach an agreement on their own, the matter has been referred to the Deputy Secretary of the Department of Housing and Urban Development Roy Bernardi. Hobbs says that under existing protocol, the secretary has 180 days to make a management decision regarding the unresolved recommendations. Accordingly, it is unknown when a final management decision will be made by HUD to adopt all or a portion of the recommendations made in the OIG audit report.

In the event that HUD was to adopt the recommendations made in the OIG audit report, current owners of LIHTC properties collecting rents under the Section 8 voucher program in excess of the 60 percent AMI limits could experience a material reduction in gross rental income, potentially resulting in financial difficulties for the properties. Industry participants desiring to express their opinion on the recommendations made in the OIG audit report are encouraged to contact Bernardi. ❖

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