Background of Project-based Section 8 Shortfall *(excerpted from testimony presented to Senate Banking Committee on March 12, 2008 by the National Leased Housing Association (NLHA, National Multi Housing Council (NMHC and the National Apartment Association (NLHA)..*

In the mid-to-late 1970s and early 1980s, when the Section 8 project-based programs were first developed, the monies for the HAP contract (be it 20, 30 or 40 years) were funded up front. For example, the costs of a 20-year contract were appropriated during the first year of the contract. Further, the subsidy amounts were based on the total rental costs at the time and did not consider the tenant contribution, which left wiggle room for rent increases during the contract term. When the first of the 20-year contracts started to expire around 1994, it was the first time in twenty years that Congress needed to make an appropriation to subsidize the properties. Congress agreed to fund the renewals, but only at rents not to exceed comparable market rents (hence the Multifamily Assisted Housing Restructuring Act (MAHRA), which provided the Mark-to-Market program and ultimately the Mark-Up-to-Market program).

As the number of HAP contracts renewing under MAHRA continued to increase and more appropriations were needed, instead of HUD requesting additional funds in its budget request, the Department chose to ask for less funding than was actually required to renew the contracts. This approach masked the true costs of contract renewals, but it was successful for a number of years because HUD was able to recapture previously appropriated funds remaining in HAP contracts that were about to expire. When most of the 20-year contracts expired around 2001 and 2002, the availability of recaptured funds diminished. HUD's need for increased funding for Section 8 renewals should have been reflected in its budget proposals around that time, but again HUD chose to mask the true costs.

To enable the renewal of contracts without sufficient appropriations, HUD chose to renew the HAP contracts with less than one year of funding. For example, if a contract expired in December of 2005, HUD would provide 9 months of funding until September 30 (the end of the fiscal year) instead of providing the full 12 months of funding up front. Essentially, it was bifurcating the 12 months of funding over two fiscal years. In this example the remaining funding for the contract would have been provided after October 1 (the new fiscal year) at which time 3 months of funding would be added to the contract for a total of 12 months. Until last year, this practice was invisible to the owners. However, in the fall of 2006, HUD's Chief Financial Officer (CFO) determined that such partial funding of contracts could not continue as the CFO believed this approach to be a violation of the Antideficiency Act (ADA), a law that is intended to ensure that appropriated funds are not mishandled. This new interpretation of the law by the CFO (which, incidentally, was not put into writing until requested by Members of Congress more than a year later) resulted in HUD reverting to funding renewals for the full twelve months in advance and not in increments.

Because the HUD FY07 budget request was based on its previous practice of partially funding contracts, there were insufficient funds appropriated by Congress, thus creating a large shortfall. The result of the shortfall was a delay in funding to thousands of Section 8 properties. When HUD realized in May of 2007 that it would not have sufficient funding to renew all of the contracts expiring in FY07, HUD's Office of Housing eventually reached a compromise with its CFO office to revert to partial or incremental funding of renewal contracts as long as the renewal HAP contract was amended to reflect the fact that partial (and not 12-month) funding was being provided at the time the renewal contract is executed. In other words, if HUD disclosed to the owner that only partial funding was being provided, the CFO deemed that HUD was not in violation of the ADA.

HUD's policy of incrementally funding (or funding for less than 12 months) continues in the current fiscal year (FY08) because of insufficient appropriations. Further, the President's FY09 request does not include sufficient monies to put Section 8 contract renewals back on a 12-month funding track. Insufficient funding coupled with HUD's inefficient payment process and questionable disbursement systems is likely to create financial disruptions to Section 8 properties for the foreseeable future.

The perception a partially-funded contract creates is devastating. It is of a government struggling to keep its financial house in order. Until recently, several years of predictability and stability in the Section 8 renewal process have led purchasers, lenders and investors in Section 8 properties to rely on long-term Section 8 renewal contracts, even though they are subject to annual appropriations, as sufficient backing for their investment. They assumed the appropriations risk in these contracts because they thought the risk was minuscule. They are not so sure anymore.

There are other more technical, but serious, concerns with short funding commitments. These contracts purport to bind an owner to providing Section 8 housing for one year. If HUD funding stops after 4 months, is the owner bound to continue to comply with Section 8 rent and other rules without receiving assistance payments? If the owner can get out of the contract will it be bound by the one-year tenant notice statute, which will prevent the owner from raising rents for one year after an opt-out notice to the tenants? Will the tenants be eligible for enhanced vouchers if the contract is abrogated? Will HUD wait until the one-year notice period has elapsed before awarding enhanced vouchers to the tenants, as has been its recent policy? Will there be sufficient funding for all enhanced vouchers?

All of these concerns will influence an owner's decision to remain in the program or to opt out, as well as decisions about whether to purchase and rehabilitate Section 8 projects. At a minimum, owners will more likely give routine notices to tenants that they intend not to renew a Section 8 contract, in order to reduce their exposure period during which they do not receive assistance payments but cannot raise rents. These opt-out notices will cause anxiety among tenants who will be placed in a continual state of uncertainty as to whether they will lose their homes or not.

Unless the industry has confidence that the government is committed to adequate and timely funding, the Section 8 inventory is likely to shrink in size. Nor will it get the new investment needed to preserve these properties as affordable housing and to keep them affordable far into the future.