



To: Unabyrd Wadhams, Deputy Assistant Secretary, Office of Field Operations, PQ
Milan Ozdinec, Deputy Assistant Secretary, Office of Public Housing and
Voucher Programs, PE

//signed//

From: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

Subject: HUD Subsidized 10,119 Units for Tenants Who Were Undercharged Flat Rents

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the public housing program's flat rent requirement.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG website. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 913-551-5870.



Audit Report Number: 2017-KC-0007

Date: September 12, 2017

HUD Subsidized 10,119 Units for Tenants Who Were Undercharged Flat Rents

Highlights

What We Audited and Why

We audited public housing agency compliance with the U.S. Department of Housing and Urban Development's (HUD) flat rent requirements. We initiated this audit based on multiple external audits conducted by the HUD Office of Inspector General, which showed that housing authorities were unaware of or did not properly implement the flat rent requirements. Our objective was to determine whether housing authorities complied with HUD's flat rent requirements.

What We Found

Housing authorities did not properly implement HUD's flat rent requirements for more than half of the flat rent tenants reviewed. They undercharged flat rents for 18 of the 60 tenants, which projects to a total of 10,119 undercharged flat rent tenants. Additional housing authorities used the incorrect methodology to calculate flat rents for 10 tenants but complied with the minimum requirements, and 4 others incorrectly calculated flat rents but were correct for the sampled tenant during December 2016. As a result, housing authorities undercharged flat rent tenants by an estimated \$527,052 nationwide during December 2016 and could undercharge flat rent tenants by approximately \$6.3 million during the next year if HUD does not correct this problem. Housing authorities could also collect increased operating subsidies from HUD.

What We Recommend

We recommend that HUD finalize and implement monitoring procedures to ensure that approximately \$6.3 million is put to better use over the next year. We also recommend that HUD clarify guidance to enhance housing authority understanding of the requirement and follow up with the housing authorities in our sample to ensure that their rents have been properly adjusted.

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Background and Objective

The U.S. Department of Housing and Urban Development (HUD) established its public housing program to provide decent and safe rental housing for eligible low-income families, the elderly, and persons with disabilities. There are approximately 1.2 million households living in public housing units, managed by approximately 3,300 public housing agencies. HUD's Public Housing Operating Fund program provides operating subsidies to public housing agencies to assist in funding their operating and maintenance expenses.

Once each year, public housing agencies must offer families the choice between a flat rent or an income-based rent. Flat rents are intended to reflect market values. When a family's income-based rent is above market value, the family may elect to pay a flat rent instead. According to HUD guidance, higher flat rent levels will ensure that families with higher income pay an appropriate market-based rent. Lower rents are a disincentive for tenants to become self-sufficient and move into unassisted housing, which can keep public housing resources from going to those most in need of assistance. HUD encourages public housing agencies to provide a balance between the important goals of supporting the sustained self-sufficiency of families with the increasing demand for affordable housing units among families on their waiting lists.

On May 19, 2014, HUD's Office of Public and Indian Housing (PIH) issued Notice PIH 2014-12 (HA). This notice introduced the requirement that flat rents be at least equal to 80 percent of the applicable fair market rent. Fair market rents are gross rent estimates that cover the shelter rent plus the cost of all necessary utilities. The notice also provided the discretion to public housing agencies to phase in rent increases of 35 percent or less over a 3-year period.

On September 8, 2015, HUD issued Notice PIH 2015-13 (HA). This notice continued the provision that flat rents must be at least equal to 80 percent of the applicable fair market rent but removed the ability for public housing agencies to phase in flat rent increases of 35 percent or less over a 3-year period. This notice also allowed housing authorities to use the applicable small area fair market rents or the unadjusted rents instead of the standard fair market rents to calculate flat rent. Not all areas have small area fair market rents and unadjusted rents. This notice also gave housing agencies the ability to apply for a flat rent exception amount as an alternative flat rent setting option.

Notice PIH 2015-13 (HA) allowed housing authorities 90 days from the date fair market rents were published to update and implement needed adjustments to their flat rents. The updated rents were required to be used at the tenants' next annual reexaminations. Annual reexaminations are documented on the family report (form HUD-50058), on which those paying a flat rent are designated as "F" for type of rent. The reexamination can be coded as either "2" for annual or "12" for flat rent update. HUD expected full housing authority compliance with these updated requirements by December 2016.

Our objective was to determine whether public housing authorities complied with HUD's flat rent requirements.

Results of Audit

Finding 1: Housing Authorities Undercharged 10,119 Flat Rent Tenants

Housing authorities did not properly implement HUD's flat rent requirements for more than half of the flat rent tenants we reviewed. HUD had not implemented monitoring procedures and did not always clarify guidance. As a result, housing authorities undercharged flat rent tenants and could collect increased operating subsidies from HUD.

Housing Authorities Did Not Properly Implement Requirements

Housing authorities did not properly implement HUD's flat rent requirements for more than half of the flat rent tenants in our sample. We reviewed a statistical sample of 60 of 50,597 flat rent tenants to test compliance for December 2016. Housing authorities undercharged flat rents for 18 of the 60 tenants, which projects to a total of 10,119 undercharged flat rent tenants. Additional housing authorities used the incorrect methodology to calculate flat rents for 10 tenants but complied with the minimum requirements, and 4 others incorrectly calculated flat rents but were correct for the sampled tenant during December 2016. We identified nearly 30,000 additional tenants that were not coded as flat rent but were subject to flat rent requirements.

Undercharged Flat Rents

Housing authorities undercharged flat rents for 18 of the 60 tenants reviewed. HUD's flat rent requirements state that housing authorities must annually review and adjust their flat rents so rents are at a minimum of 80 percent of the lowest of fair market rent, small area fair market rent, or unadjusted rent, less any utility allowance the public housing agency has set for the unit. Errors included the use of the incorrect fair market rents, improperly phasing in flat rents, and setting flat rent too low in order to comply with maximum rents for low-income housing tax credit properties.

Housing authorities used the incorrect fair market rents to calculate their flat rents. They used fair market rents from prior years, proposed fair market rents instead of final fair market rents, or the wrong location's small area fair market rents. Housing authorities incorrectly phased in flat rents. HUD requirements at Notice PIH 2014-12 (HA) allowed housing authorities to phase in flat rent increases over a 3-year period for existing flat rent tenants. This general ability to phase in flat rent increases was removed in 2015 when HUD issued Notice PIH 2015-13 (HA); however, an existing flat rent tenant could not experience an annual increase in flat rents greater than 35 percent. Housing authorities were still using phased-in flat rents from the earlier requirements or phased-in flat rents for new admissions or tenants switching from an income-based flat rent. This allowed tenants to pay flat rents that were lower than the required minimum amounts. One housing authority with a low-income tax credit property set its flat rents at the maximum rents allowed according to the low-income housing tax credit requirements set by the

Internal Revenue Service, but this rent was less than the minimum rent required by HUD's flat rent requirements.

Incorrect Methodology

Other housing authorities used an incorrect method to calculate flat rents but were considered compliant with requirements because the amount charged exceeded the minimum required amount. HUD allowed housing authorities to use, when available, small area fair market rents and unadjusted rents to calculate flat rents instead of the standard fair market rents. When these alternative rents are available, they are often lower than the standard fair market rents. We found 10 additional instances not included in the 18 errors, in which housing authorities incorrectly set their flat rents using outdated fair market rents, improperly phased in flat rents, or did not properly apply the requirements to the fair market rents. However, they complied with requirements because lower small area fair market rents or unadjusted rents were available for use, even though the housing authorities were not trying to calculate their rents using these amounts. While these errors did not result in noncompliance during our audit period, these housing authorities could become noncompliant if they continue to use the incorrect methodology.

Nonprojectable Errors

In 4 other instances not included in the 18 errors, the rents were correct for the sampled tenant during December 2016, but the flat rent schedule was incorrect or improperly implemented.

- One tenant paid an income-based rent during December 2016, the month we projected. If this tenant had paid a flat rent for that month, that payment could have been incorrect based on the flat rent schedule.
- Two housing authorities correctly set flat rents for some of their unit sizes but incorrectly set flat rents for other unit sizes. While we sampled two tenants with a unit size with the correct flat rent, according to the flat rent schedules, other unit sizes at these housing authorities had flat rents below the minimum amount required by HUD.
- For one tenant, the housing authority updated tenant rent amounts at interim reexaminations instead of annual reexaminations, resulting in an underpayment during certain months. The sampled tenant was paying the correct rent by December 2016.

Flat Rent Coding

An additional 29,985 ceiling rent tenants should follow HUD's flat rent requirements. These tenants were not included in our universe because they were not coded as flat rent tenants but as income-based tenants and paying a ceiling rent. The ceiling rent amount for a unit should follow the same requirements as flat rent amounts.

Nearly 75 percent of these additional ceiling rent tenants were from the New York City Housing Authority. We reviewed the Authority's annual plan and flat rent schedule from 2016. Based on the flat rent schedule and policy, the Authority allowed current flat rent tenants to pay phased-in amounts that were lower than required.

HUD Had Not Implemented Monitoring Procedures

Because the requirement was fairly new, HUD had not implemented monitoring procedures and did not always clarify guidance. HUD was working to finalize and implement monitoring procedures and did not have all of the information it needed to monitor compliance. Since HUD was not monitoring, it did not identify issues it needed to clarify, including how the requirements apply to low-income housing tax credit properties.

HUD was working to finalize and implement monitoring procedures for housing authority compliance. HUD's Policy Development and Research Division was working to develop a monitoring tool that would allow HUD headquarters to identify likely instances of noncompliance with flat rent requirements. HUD headquarters planned to communicate these likely instances of noncompliance to the field offices, which would follow up with the individual housing authorities. HUD planned to have the final monitoring procedures ready by fiscal year 2018.

HUD did not have all of the information it needed to monitor compliance, such as utility allowances and current rent amounts for flat rent annual updates. Utility allowance amounts are required to determine whether housing authorities comply with minimum flat rent amounts, but these allowances are not always included on form HUD-50058. In addition, flat rent annual updates do not properly update the rent amount in the Public and Indian Housing Information Center system (PIC). Flat rent annual updates allow public housing agencies to perform a limited reexamination every year and a comprehensive review every 3 years for flat rent tenants. In this situation, year 1 is coded as an annual update, while years 2 and 3 are coded as flat rent annual updates. Flat rent annual updates show outdated flat rent amounts for years in which housing authorities conduct a more limited review.

HUD's ability to monitor is also impacted by whether housing authorities correctly code tenants paying a flat rent as such in PIC. Formerly, HUD allowed housing authorities to set ceiling rents. Ceiling rents are maximum rents for a unit, similar to flat rents, except ceiling rents are coded as income based on form HUD-50058. The ceiling rent for a unit should follow the same requirements as a flat rent. Some housing authorities continued to set ceiling rents rather than flat rents, and this could be more difficult to detect by the monitoring reports. Absent a monitoring tool, HUD could not identify noncompliance with flat rent requirements and provide housing authorities with feedback on their errors and clarification on the requirements from Notice PIH 2015-13.

HUD guidance did not address how to properly comply with requirements when low-income housing tax credit properties have Internal Revenue Service-mandated maximum rents that are lower than the minimum amount according to flat rent requirements. HUD initially explained in its questions and answers published in association with Notice PIH 2014-12 that housing authorities should comply with the low-income housing tax credit maximum rents instead of the flat rent minimum rents. HUD later removed this guidance from its website and did not explain to housing authorities which requirement they should follow.

Housing Authorities Undercharged Tenants

Housing authorities undercharged flat rent tenants and could collect increased operating subsidies from HUD. Housing authorities undercharged flat rent tenants by an estimated \$527,052 during December 2016. The amount of the undercharge equaled the difference between the actual amount housing authorities charged and the minimum amount they should have charged during our review period. The minimum amount was the lower of the minimum required flat rent (using the fair market rent, small area fair market rent, or unadjusted rent, less any applicable utility allowance) or the rent amount based on the tenant's income. Housing authorities would undercharge flat rent tenants by more than \$6.3 million next year if HUD does not correct this problem. Lower rents discourage tenant moveouts, block the waiting list, and do not accomplish the objective of the requirement.

Housing authorities could collect increased operating subsidies from HUD. HUD's operating subsidy calculation is based on rental income received from tenants during prior years. The undercharged flat rent during our review period would cause HUD to calculate the housing authorities' future operating subsidies based on lower rental income amounts than if the housing authorities had properly set flat rents. HUD's operating subsidies would be increased to make up for lower rental income amounts. We were not able to calculate the actual amount that subsidy would be overpaid because the nature of the sample means the projection cannot be attributed to individual housing authorities and some factors of the calculations have not been determined.

Conclusion

Housing authorities undercharged flat rent tenants by an estimated \$527,052 during December 2016, could undercharge flat rent tenants by approximately \$6.3 million during the next year if HUD does not correct this problem, and could collect increased operating subsidies from HUD because HUD had not implemented monitoring procedures and did not always clarify guidance.

Recommendations

We recommend that the Deputy Assistant Secretary, Office of Field Operations,

- 1A. Finalize and implement monitoring procedures to ensure that \$6,324,625 in flat rents are appropriately charged to tenants over the next year.
- 1B. Follow up with the housing authorities in our sample, identified as noncompliant with flat rent requirements, to ensure that their rents are properly adjusted.

We recommend that the Deputy Assistant Secretary, Office of Public Housing and Voucher Programs,

- 1C. Clarify guidance to better enhance housing authority understanding of the requirement, including explaining that housing authorities must code ceiling rent tenants as flat rents and explaining what housing authorities should do when maximum rents for low-income housing tax credit properties are lower than the minimum flat rent amounts required by HUD.

Scope and Methodology

We performed our audit work between April and August 2017. We conducted onsite work at HUD headquarters, 451 7th Street SW, Washington, DC. Our audit period covered January 1 through December 31, 2016.

To accomplish our objective, we

- reviewed relevant HUD requirements;
- reviewed audited financial statements;
- interviewed HUD staff to gain an understanding of relevant monitoring controls;
- reviewed a working version of future HUD monitoring reports;
- selected and reviewed a statistical sample of households to determine public housing authority compliance with flat rent requirements; and
- reviewed physical records maintained by public housing authorities, including flat rent schedules, utility allowance schedules, and relevant documents in tenants' files.

We relied in part on data maintained by HUD in its PIC system. Specifically, we relied on the system to identify households that paid a flat rent occupying public housing units during our audit period. Although we did not perform a detailed assessment of the reliability of the data, we determined that the computer-processed data were sufficiently reliable for our purposes because we verified the data with documentation provided by housing authorities in our sample.

Using data from PIC as of January 24, 2017, we identified an audit universe of 50,597 households: 47,320 households with a monthly flat rent payment effective through December 2016 and 3,277 households with a monthly flat rent payment effective January 2017, which we included to test compliance for December 2016. The total of flat rent payments in this audit universe was more than \$25.5 million.

In order to project the results of our review to the audit universe, we selected a statistical sample of 60 households as described in appendix E. We contacted the 55 housing authorities where the 60 households lived to obtain documentation related to the flat rent rate for each household. We asked for specific details from individual tenant files, such as forms HUD-50058, lease agreements, housing authority flat rent schedules, methodology for determining flat rent amounts, and any guidance received from HUD. We evaluated the information provided to determine whether housing authorities set flat rents in accordance with HUD requirements.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Internal Controls

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- effectiveness and efficiency of operations,
- reliability of financial reporting, and
- compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Controls over monitoring compliance with flat rent requirements.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

We evaluated internal controls related to the audit objective in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of HUD's Office of Public and Indian Housing's internal controls.

Appendixes

Appendix A

Schedule of Funds To Be Put to Better Use

Recommendation number	Funds to be put to better use 1/
1A	\$6,324,625
Totals	6,324,625

- 1/ Recommendations that funds 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. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified.


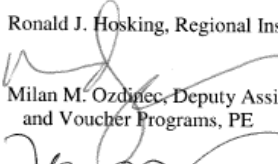
In this instance, if HUD implements our recommendations, it will ensure that public housing agencies set flat rents in accordance with HUD's requirements. Housing authorities will not undercharge flat rent tenants, resulting in increased operating subsidies from HUD. Our estimate reflects only the initial year of this benefit. These amounts do not include potential offsetting costs incurred by HUD to implement our recommendations to strengthen controls.

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	
OFFICE OF PUBLIC AND INDIAN HOUSING	
August 31, 2017	
MEMORANDUM FOR:	Ronald J. Hosking, Regional Inspector General for Audit, 7AGA
FROM:	Milan M. Ozdinec, Deputy Assistant Secretary for Public Housing and Voucher Programs, PE  Unabiyah L. Wadhams, Deputy Assistant Secretary for Field Operations, PQ
SUBJECT:	Comments on Office of Inspector General Draft Report: <i>Compliance With Flat Rent Requirements (HUD Subsidized 10,119 Units for Tenants Who Were Undercharged Flat Rents), OIG Audit Report Number: 2017-KC-000X</i>
<p>This memorandum is in follow-up to the exit conference that was held with your team on August 25, 2017. The Office of Public and Indian Housing has reviewed your Discussion Draft Audit Report.</p> <p>We in PIH appreciate the discussions that were provided during the conduct of this audit from your staff. Your staff was very professional in the handling of all aspects of this audit.</p> <p>Based on our discussion, PIH has decided to provide comments to the OIG Draft Report on the attachment to this memorandum.</p> <p>If you have any questions, please don't hesitate to contact us.</p>	
Attachment	
www.hud.gov espanol.hud.gov	

ATTACHMENT

PIH Consolidated Comments on the OIG Draft Report: Compliance
With Flat Rent Requirements (HUD Subsidized 10,119 Units for
Tenants Who Were Undercharged Flat Rents),
OIG Audit Report Number: 2017-KC-000X

PIH provides the following comments:

During the conference call, PIH stated that:

Comment 1

1. As a general comment, OPHVP thanks OIG for validating its current efforts to proactively update guidance on flat rent requirements and identify compliance monitoring metrics with HUD's Policy Development and Research Office.

Comment 2

Our comments on the Draft Report are:

Comment 3

2. On page 3 of the report, OPHVP notes that OIG omits the ability of PHAs to request a flat rent exception amount as an alternative flat rent setting option and that it should be added to this process overview.
3. From our reading of the draft report, OIG's process for determining residents' "minimum rent" was not clear. However, per our exit conference conversation, it is our understanding that OIG incorporated the minimum available Fair Market Rent product (Fair Market Rent, Small Area Fair Market Rent, or unadjusted rent), less a utility allowance when applicable. PIH recommends that OIG clarify the methodology used to determine compliance for the sample.

Comment 4

4. On page 16 of the report, we request that OIG change references to "eviction" for families that are above the income limits. The correct programmatic term for this action would be "termination."

OIG Evaluation of Auditee Comments

- Comment 1 We appreciate HUD’s ongoing efforts to update guidance on flat rent requirements and design compliance monitoring procedures. When HUD finalizes and implements the monitoring procedures and new guidance we will be able to close recommendations 1A and 1C.
- Comment 2 We included background information on flat rent exceptions in our final report as requested.
- Comment 3 We modified the report to better clarify that we reviewed fair market rents, small area fair market rents, and unadjusted rents in our determination of the minimum flat rent amount required.
- Comment 4 We adjusted the language in the report to read “termination” instead of “eviction.”

Appendix C

Flat Rent Errors

Projectable errors

Sample number	Public housing agency code	Tenant rent	Minimum rent*	Underpayment
1	AL105	\$223	\$236	\$13
2	AR021	235	290	55
5	TX081	282	344	62
6	TN032	295	323	28
7	GA109	301	328	27
11	KY012	337	400	63
14	KY070	355	653**	298
19	GA213	382	425**	43
21	OH004	395	432	37
24	MS077	411	432**	21
29	OH003	441	442	1
33	SC020	467	511	44
37	PA014	499	611	112
44	NC034	571	632**	61
47	FL008	615	623	8
50	CA008	671	775	104
53	NC022	747	827	80
56	NV018	884	974	90

*Minimum rent is the lower of the minimum required flat rent (fair market rent, small area fair market rent, or unadjusted rent, less any applicable utility allowance) or the rent amount based on the tenant's income.

**In these cases we used the tenant's income based rent amount to calculate the underpayment because the minimum required flat rent amount was in excess of what the tenant would have paid if they chose an income based rent.

Incorrect methodology and nonprojectable errors

Sample number	Public housing agency code	Incorrect methodology	Nonprojectable errors	Description of error
12	TN009	X		Used outdated fair market rents to calculate flat rents.
20	MN048	X		Used proposed fair market rents instead of final fair market rents to calculate flat rents.
23	KS059		X	Tenant was an income-based tenant during the month projected, but the flat rent schedule had not been updated.
28	WI052		X	Flat rent was correct for the sampled tenant-unit; however, the flat rent schedule was based on unit square footage rather than number of bedrooms.
31	PA006	X		Improperly phased in flat rents for the sampled tenant.
32	MN026		X	Flat rent was correct for the sampled tenant-unit; however, the flat rent schedule showed that all units larger than a one bedroom paid the same flat rent.
41	MD006	X		Housing authority set its flat rents at low-income housing tax credit maximums and believed it was charging less than required according to flat rent requirements.
42	NE117	X		Used proposed fair market rents instead of final fair market rents to calculate flat rents.
43	KY074	X		Used proposed fair market rents instead of final fair market rents to calculate flat rents.
45	PA010	X		Relied on market study completed before HUD published fair market rents to set flat rents.
49	NC065	X		Used outdated fair market rents to calculate flat rents.
52	VA007	X		Used outdated fair market rents to calculate flat rents.
54	WV009	X		Housing authority had a written policy to calculate flat rents by subtracting \$100 from the fair market rents.
55	TX327		X	Housing authority was updating rent amounts at interim reexaminations instead of annual reexaminations, but the tenant was paying the correct rent by December 2016.
Totals		10	4	

Appendix D

Criteria

Notice PIH 2015-13 (HA)

Issued September 8, 2015

1. PURPOSE

This notice implements Section 238 of Title II of P.L. [Public Law] 113-235, the Department of Housing and Urban Development Appropriations Act of 2015 (FY [Fiscal Year] 2015 Appropriations Act). The FY 2015 Appropriations Act amended Section 210 of Title II of P.L. 113-76, the Department of Housing and Urban Development Appropriations Act of 2014. This Notice supersedes and replaces the guidance provided in Notice PIH 2014-12 and clarifies HUD's interpretation of the statutory amendment related to flat rents. This notice also serves as supplemental guidance to the interim rule published on September 8, 2015 with an effective date of October 8, 2015.

2. APPLICABILITY, BACKGROUND, AND HUD INTERPRETATION OF NEW STATUTORY REQUIREMENTS

The FY 2014 Appropriations Act required PHAs [public housing agencies] to establish flat rents at no less than 80 percent of the applicable Fair Market Rent (FMR). However, if a new flat rent amount for a unit increased a family's existing rental payment by more than 35 percent, then the new flat rent amount was required to be phased in as necessary to ensure that the family's existing rental payment did not increase by more than 35 percent annually. HUD implemented these requirements through Notice PIH 2014-12, which outlined the changes in the FY 2014 Appropriations Act and provided guidance to PHAs on how to implement the new changes. Through FAQs [frequently asked questions] accompanying Notice PIH 2014-12, HUD provided flexibility to PHAs to phase in all flat rent increases over a three year period, including those increases that were 35 percent or less.

The FY 2015 Appropriations Act further amended the public housing rent requirements for flat rents. Specifically, the statute was amended to require that flat rents must be set at no less than the lower of 80 percent of:

1. the applicable fair market rental established under section 8(c) of this Act; or
2. at the discretion of the [HUD] Secretary, such other applicable fair market rental established by the Secretary that the Secretary determines more accurately reflects local market conditions and is based on an applicable market area that is geographically smaller than the applicable market area used for purposes of the applicable fair market rental under section 8(c).

A PHA may apply for an exception allowing for a flat rental amount for a property that is lower than the amount outlined in the options above. The Secretary may grant such an exception if

HUD determines that the fair market rent for the applicable market area does not reflect the market value of the property and the proposed lower flat rental amount is based on a market analysis of the applicable market.

The FY 2015 Appropriations Act maintained the protection that any rent increase of more than 35 percent due to the flat rent changes must be phased in as necessary.

As flat rents are fully implemented, the higher rent levels will ensure that families with higher incomes pay an appropriate market-based rent. It is an important policy goal to provide scarce public resources to those most in need of deeply affordable housing. PHAs are therefore reminded that they have the discretion, in accordance with federal law and regulations (24 CFR [Code of Federal Regulations] 960.261; [Federal Register] FR-4824-F-02), to establish occupancy policies that include the termination of public housing tenants who are above the income limits for eligibility to participate in public housing programs. HUD encourages PHAs to provide a balance between the important goals of supporting the sustained self-sufficiency of families with the ever increasing demand for affordable housing units among families on their waiting lists.

3. SMALLER GEOGRAPHICAL AREA FMRs

PHAs may use a HUD-established FMR that is based on an area geographically smaller than the effective FMR published in the Federal Register. To satisfy this option, PHAs may use the applicable Small Area Fair Market Rent (SAFMR), which HUD will publish annually on its website (available at: <http://www.huduser.org/portal/datasets/fmr/smallarea/index.html>). For some areas for which HUD does not publish a SAFMR, HUD will permit PHAs to use the unadjusted rent¹, which HUD will publish annually on its website. PHAs are not permitted to establish smaller geographical FMRs, different from these options. For areas where HUD has not determined a SAFMR or an unadjusted rent, PHAs must set rents at no less than 80 percent of the FMR, or apply for an exception flat rent pursuant to the requirements of Section 4 of this notice.

4. EXCEPTION FLAT RENTS

The FY 2015 Appropriations Act permits PHAs to request an exception flat rent that is lower than either 80 percent of the lower of the FMR or SAFMR/unadjusted rent if the PHA can demonstrate that these FMRs do not reflect the market value of a particular property or unit.

In order to demonstrate the need for an exception flat rent, PHAs are required to submit a market analysis methodology that demonstrates the value for the unit. While HUD does not prescribe a particular formula for determining the market analysis, PHAs must compare the public housing unit to unassisted units in the area using the following factors:

- Location, quality, size, unit type, age of the unit, and
- Amenities, housing services, maintenance, and utilities the PHA will provide under the lease.

PHAs must receive written HUD approval to utilize an exception flat rent prior to implementing the exception flat rent. PHAs that utilize exception flat rents must conduct a new market analysis, and obtain HUD approval, annually.

5. FMRs AND UTILITY PAYMENTS

Fair Market Rents (FMRs) are gross rent estimates that cover the rent plus the cost of all necessary utilities regardless of who actually pays the utilities. Although the inclusion of utilities in the FMR is an accurate estimate of the cost of renting a unit in a particular area, their inclusion for purposes of setting Public Housing flat rents may lead to families paying more in gross rent if the rent is not adjusted to reflect utility payments. Specifically, families that pay a flat rent for public housing units and that pay their own utilities would pay more in gross rent (i.e., rent plus utilities) than a family in a similarly situated unit where the PHA pays the utilities.

6. FLAT RENT POLICIES – HOW TO COMPLY ON AN ANNUAL BASIS

In order to comply with the flat rent requirements annually, no later than 90 days after issuance of new FMRs or SAFMRs by HUD, the PHA must:

- 1) Compare the current flat rent amount to the applicable FMR and SAFMR/unadjusted rent:
 - a) If the flat rent is at least 80 percent of the lower of the FMR or SAFMR/unadjusted rent, the PHA is in compliance with the law, and no further steps are necessary;
 - b) If the flat rent is less than 80 percent of the lower of the FMR and SAFMR, the PHA must set flat rents at no less than 80 percent of the lower of the FMR or SAFMR/unadjusted rent, subject to the utilities adjustment in section 5 of this notice, or the PHA may request an exception flat rent pursuant to the requirements of Section 4 of this notice;
- 2) Update the flat rent policies in the Admissions and Continued Occupancy Policies (ACOP) as necessary;
- 3) At all new admissions, permit the family to choose between the flat rent amount and the income-based rent; and
- 4) For families that are current public housing residents, offer the updated flat rent amount at the next annual rent option, and permit the family to choose between the flat rent amount and the income-based rent, subject to the requirements of Section 7 of this notice.

7. FLAT RENT INCREASE PHASE-IN REQUIREMENTS

In compliance with the FY 2014 Appropriations Act, Notice PIH 2014-12 required that if an existing tenant's rental payment would be increased by more than 35 percent as a result of changes to the flat rent amount, the increase must be phased-in such that a family would not experience an increase in their rental payment of more than 35 percent in any one year. Through Notice PIH 2014-12, HUD provided additional flexibility that would permit PHAs to phase in all rent increases resulting from the new flat rent requirements over a three year period. However, the FY 2015 Appropriations Act provides PHAs additional flexibility to establish flat rents at

lower amounts, thereby eliminating the need for the three-year phase-in of all flat rent increases. Therefore, pursuant to this Notice, the only flat rent increases that may be phased-in are those where a family's rent will increase by more than 35 percent. PHAs that began phase-ins for families with rent increases at 35 percent or less do not need to take any immediate action to update the flat rents for such families, but at the family's next annual rent option, the requirements outlined below shall apply.

8. CONDUCTING ANNUAL RENT OPTIONS

HUD regulations at 24 CFR 960.253(a) requires PHAs to annually give families the option to choose between paying the flat rent or the income-based rent, and stipulates that PHAs may not give families the option more than once per year, except in the case that the family has chosen the flat rent and experiences a financial hardship. Further, 24 CFR 960.253(e) stipulates that PHAs provide sufficient information to allow a family to make an informed choice regarding rent options. PHAs must provide at least the following information:

- The PHA's policies on switching the type of rent due to financial hardship;
- The dollar amount of the flat rent and the income-based rent.

For families who choose to pay flat rents, PHAs are provided the flexibility not to conduct income re-examinations annually. HUD regulations at 24 CFR §960.253(e)(2) and §960.257(a)(2) provide that for families that chose to pay flat rents PHAs must conduct re-examinations of family income at least once every three years, not annually. In years when a PHA does not conduct a full re-examination of family income, PHAs are not released from the requirement to give the family the option of paying the flat rent or the income-based rent as calculated from the most recent examination of family income and composition.

24 CFR 960.253

(a) Rent options. (1) Annual choice by family. Once a year, the PHA must give each family the opportunity to choose between the two methods for determining the amount of tenant rent payable monthly by the family. The family may choose to pay as tenant rent either a flat rent as determined in accordance with paragraph (b) of this section, or an income-based rent as determined in accordance with paragraph (c) of this section. Except for financial hardship cases as provided in paragraph (d) of this section, the family may not be offered this choice more than once a year.

(2) Relation to minimum rent. Regardless of whether the family chooses to pay a flat rent or income-based rent, the family must pay at least the minimum rent as determined in accordance with §5.630 of this title.

(b) Flat rent. The flat rent is determined annually, based on the market rental value of the unit as determined by this paragraph (b).

(1) The PHA must establish a flat rent for each public housing unit that is no less than 80 percent of the applicable Fair Market Rent (FMR) as determined under 24 CFR part 888, subpart A; or

(2) HUD may permit a flat rent of no less than 80 percent of an applicable small area FMR (SAFMR) or unadjusted rent, if applicable, as determined by HUD, or any successor determination, that more accurately reflects local market conditions and is based on an applicable market area that is geographically smaller than the applicable market area used in paragraph (b)(1) of this section. If HUD has not determined an applicable SAFMR or unadjusted rent, the PHA must rely on the applicable FMR under paragraph (b)(1) or may apply for an exception flat rent under paragraph (b)(3).

(3) The PHA may request, and HUD may approve, on a case-by-case basis, a flat rent that is lower than the amounts in paragraphs (b)(1) and (2) of this section, subject to the following requirements:

(i) The PHA must submit a market analysis of the applicable market.

(ii) The PHA must demonstrate, based on the market analysis, that the proposed flat rent is a reasonable rent in comparison to rent for other comparable unassisted units, based on the location, quality, size, unit type, and age of the public housing unit and any amenities, housing services, maintenance, and utilities to be provided by the PHA in accordance with the lease.

(iii) All requests for exception flat rents under this paragraph (b)(3) must be submitted to HUD.

(4) For units where utilities are tenant-paid, the PHA must adjust the flat rent downward by the amount of a utility allowance for which the family might otherwise be eligible under 24 CFR part 965, subpart E.

(5) The PHA must revise, if necessary, the flat rent amount for a unit no later than 90 days after HUD issues new FMRs.

(6) If a new flat rent would cause a family's rent to increase by more than 35 percent, the family's rent increase must be phased in at 35 percent annually until such time that the family chooses to pay the income-based rent or the family is paying the flat rent established pursuant to this paragraph.

(f) Choice between flat and income-based rents. Families must be offered the choice between a flat rental amount and a previously calculated income-based rent according to the following:

(1) For a family that chooses the flat rent option, the PHA must conduct a reexamination of family income and composition at least once every three years.

(2) At initial occupancy, or in any year in which a participating family is paying the income-based rent, the PHA must:

(i) Conduct a full examination of family income and composition, following the provisions in §960.257;

(ii) Inform the family of the flat rental amount and the income-based rental amount determined by the examination of family income and composition;

(iii) Inform the family of the PHA's policies on switching rent types in circumstances of financial hardship; and

(iv) Apply the family's rent decision at the next lease renewal.

- (3) In any year in which a family chooses the flat rent option but the PHA chooses not to conduct a full examination of family income and composition for the annual rent option under the authority of paragraph (f)(1) of this section, the PHA must:
- (i) Use income information from the examination of family income and composition from the first annual rent option;
 - (ii) Inform the family of the updated flat rental amount and the rental amount determined by the most recent examination of family income and composition;
 - (iii) Inform the family of the PHA's policies on switching rent types in circumstances of financial hardship; and
 - (iv) Apply the family's rent decision at the next lease renewal.

Appendix E

Sampling and Projections

Audit Universe

The audit universe consisted of 50,597 units. Each unit had a monthly flat rent payment effective through December 2016. This number included 3,277 units with monthly flat rent payment effective 2017, which we included in testing compliance for December 2016. The total of flat rent payments in this audit universe was \$25,581,747.

Sample Frame

The audit universe.

Sampling Unit

Monthly flat rent payment for each rental unit.

Sampling Unit Valuation

The total dollar amount paid by flat rent tenants was our sampling unit valuation and was used in our sample selection. We reviewed the sampled tenants to determine the amount of underpayment for the sampled units.

Sample Selection Method

We used Systematic Random Sampling to select our sample. We ordered sampling units by monthly flat rent amount and selected a systematic random sample of 60 records for auditing using the SAS Proc Surveyselect procedure with a random-number seed value of 2017.

Bootstrapping and Projection

In this audit, we were interested in determining the portion in dollar amount that was underpaid, not the total dollar amount of the sample item. Underpayment (instead of total payment) is a common interest in noncompliance audits.

When a sampling unit contains multiple items, some of them might be accurate, while others might not. In other words, only some (not all) of the items in a sampling unit, which meet certain criteria (for example, material value), merit detailed review or audit. This creates additional complexity to our projection for universe error rate and especially for universe error amount. To accommodate such situations, we applied a bootstrapping approach – a nonparametric statistical method that applies the procedure of resampling with replacement from the selected audit sample (with the same sample size) to construct an empirical distribution for the universe of interest.ⁱ This bootstrap approach produces more accurate statistical intervals than those obtained using the sample variance and assumptions of normality.ⁱⁱ

To determine how many tenants did not meet HUD's flat rent requirements and how much they were they undercharged, we took 100,000 samples (with 60 records in each sample),ⁱⁱⁱ with

replacement, from the selected audit sample, which contained 60 records with known error status (yes-no) and exact error amount (underpayment) for each single record that was audited.

We ordered these 100,000 bootstrapped error rates and error amounts, respectively, to empirically approximate the unknown distributions of the universe error rates and error amounts in this audit. Once we obtained the selected audit sample results, we relied on them to perform bootstrapping and thus to make reliable statistical inference on the universe error amount. To be conservative, we reported values at one-sided 95 percent confidence level as the final projected dollar amount and percentage (and number) for the universe.

Projected Results

We applied the bootstrapping and projection method (described above) using SAS, based on audit review results of 60 records with known error status and error amount. The table below shows the projected distribution of underpayment – the 5th, 50th (median), and 95th percentiles of projected error rate (in percentage), error count and error amount during December 2016, and error amount for 2017. The 5th percentile corresponds to the one-sided 95 percent confidence level. From the table, we conclude that (1) public housing agencies did not properly implement HUD’s flat rent requirements for an estimated 10,119 tenants (20 percent) during December 2016 and (2) public housing agencies undercharged flat rent tenants by \$527,052 during December 2016 and could undercharge flat rent tenants by \$6,324,625 during the next year.

The projected distribution of underpayment

Measure	5th percentile	50th percentile	95th percentile
Error rate (%)	20.0	30.0	40.0
Error count (monthly)	10,119	15,179	20,239
Error amount (monthly)	\$527,052	\$940,261	\$1,502,731
Error amount (yearly)*	\$6,324,625	\$11,283,131	\$18,032,771

*We multiplied the monthly amount by 12 to obtain the annual figure.

ⁱ Efron, B. (1979). Bootstrap methods: another look at the jackknife. *Annals of Statistics*, 7, 1-26

ⁱⁱ DiCiccio T.J.; Efron B. (1996). Bootstrap confidence intervals (with Discussion). *Statistical Science* 11: 189-228

ⁱⁱⁱ Andrews, D.W.K.; Buchinsky, M. (2001). Evaluation of a three-step method for choosing the number of bootstrap repetitions. *Journal of Econometrics*, 103, 345-386