Foreword

This foreword is the same for three independent reports, discussed below.

The U.S. Department of Housing and Urban Development (HUD) calculates Fair Market Rents (FMRs) annually for the more than 2,600 distinct markets in the United States. HUD regulations define FMRs as the 40th percentile of gross rents paid for units occupied by "recent movers." FMRs are used to inform the "payment standard," or the maximum amount of rental assistance, available to low-income households in the Housing Choice Voucher program. HUD also relies on these FMRs in a variety of other programs, including the public housing and homelessness assistance grant programs.

Given the centrality of FMRs to the work of HUD, ensuring their accuracy is extremely important. If FMRs are too low, voucher holders may be unable to find adequate units to lease, especially in neighborhoods of opportunity. If FMRs are too high, public housing agencies (PHAs) will be unable to maximize the number of families who receive assistance.

On July 27, 2020, HUD published a Notice of Funding Availability (NOFA) for a series of Congressionally mandated studies of "Alternative Methods for Calculating Fair Market Rents (FMRs) in Rental Markets With Rapidly Rising Rents."[1] The notice solicited research proposals to define markets with rapidly rising rents and identify alternative calculation methods to generate FMRs that track market conditions more closely than current methods. HUD funded three grants through this NOFA and is now sharing the final reports.

The challenge that these reports are seeking to solve is the time lag between the American Community Survey (ACS) data, which has the best estimate of local rents, and the effective date of the FMRs. For example, data from the 2019 ACS were used as the base rents for calculating the fiscal year (FY) 2022

[1] FR-6400-N-60, "Alternative Methods For Calculating Fair Market Rents (FMRs) in Rental Markets With Rapidly Rising Rents," https://www.hud.gov/sites/dfiles/SPM/documents/FR-6400-N-60.pdf.

FMRs, a 3-year gap. Of particular concern are the markets that have rapid rent growth in this gap time period.

Prior to the FY 2023 calculations, HUD relied solely on public data sources to calculate the change between the ACS-based data and the FMR year. For FY 2022, those data were Bureau of Labor Statistics (BLS) rent inflation data for 22 metropolitan areas and 4 census regions—to fill that gap and bring the rents and utilities forward to the current year—followed by local and regional trend factors to bring the rents and utilities forward to the effective year. The BLS data, however, are not as geographically precise as the ACS data, and thus may underestimate or overestimate rent change within the geographies to which they are applied. These three reports support ongoing HUD policy conversations on the use of private-sector data in FMR calculations.

Study 1. "Alternative Methods for Calculating Fair Market Rents (FMRs) in Rental Markets with Rapidly Rising Rents" by Daniel McMillen of the University of Illinois at Chicago and Ruchi Singh of the University of Georgia.

- *Method.* This study examines two methods for altering FMR calculations. First, they identify a sample of areas that experienced high rent growth as measured by ACS. The authors then examine inflation factors calculated from measures of rent provided by Axiometrics (now RealPage), a private firm, finding that there was a positive correlation between changes in the Axiometrics rent and rents measured in the ACS. The authors also examined the use of price-to-rent ratios to predict rents, leveraging the fact that home purchase price data are often more widely available than rent data. They calculated two versions of those ratios, one using Zillow data, and one using public-sector data from the ACS and Federal Housing Finance Administration House Price Index Data.

- *Recommendation.* The researchers recommend that HUD consider using the Axiometrics (RealPage) data and the price-to-rent ratios in FMR calculations, but they recommend no changes in HUD's current trend factor forecast methodology.

Study 2. "Alternative Fair Market Rents for Local Housing Markets" by Daniel Teles, Alyse D. Oneto, Yipeng Su, and Ananya L. Hariharan of the Urban Institute and Hiren Nisar of 2M Research.

- *Method.* This study explores the use of time series models and alternative data sources to improve FMR trend factor estimation. The authors first define areas considered to have rapidly rising rents and then identify factors believed to be leading indicators of housing supply and demand. Alternative FMRs were estimated using two time series models along with local data. The research team then compared the results to FMR estimates produced by HUD in prior years.
- *Recommendation.* The team concludes that FMR trend factor estimates might be improved in counties with rapidly rising rents with a time series model using local county-level data, but further research is needed.

Study 3. "Fair Market Rents Trend Component Modeling Technical Report" from UrbanSim Inc. and the Terner Center.

- *Method.* As an alternative to HUD's current trend factor forecast methodology, the authors select multiple housing and demographic variables to include in the analysis with the rent and utilities Consumer Price Index components. They compare a vector error correction model (VECM) with a pure time series model and a second time series model that includes exogenous factors. They found that VECM outperformed the other models in a slight majority of cases for 2018–19, but a larger majority for 2019–20, suggesting that it is particularly well-suited to a volatile rental market.

- R*ecommendation.* The authors recommend a change to the trend factor forecast methodology using the VECM approach in volatile rental markets. They also recommend that HUD update FMRs in markets with extreme price movements on a more frequent basis using data from the private company Apartment List—which is comprehensive, updated frequently, and based on market data rather than surveys—with a band-pass filtering approach to identify markets with rapidly rising rents.

These reports were timely. For FY 2023 FMR calculations, HUD was faced with two challenges: (1) ACS 2020 1-year local data were unavailable due to census data collection issues, and (2) evidence from multiple sources that rents were rising quickly at the end of 2021 and beginning months of 2022. These reports and other analysis by HUD informed the July 13, 2022, HUD Notice of Proposed Changes in the Methodology Used for Calculating Fair Market Rents[2] to include the use of private-sector rent data to augment rent inflation measures from public sources.[3]

HUD adopted these changes only for FY 2023. Going forward, HUD intends to carefully consider these studies along with other research to determine if new methods should be used in the future to calculate FMRs in areas with rapidly rising rents as accurately as possible.

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[2] FR–6334–N–01, "Proposed Changes to the Methodology Used for Calculating Fair Market Rents," https://www.regulations.gov/docket/HUD-2022-0051/document.
[3] FR-6343-N-01 "Fair Market Rents for the Housing Choice Voucher Program, Moderate Rehabilitation Single Room Occupancy Program, and Other Programs, Fiscal Year 2023," https://www.federalregister.gov/documents/2022/09/01/2022-18905/fair-market-rents-for-the-housing-choice-voucher-program-moderate-rehabilitation-single-room.