
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR-5323-N-03]

Final Notice on Ending the “Hold-Harmless” Policy in Calculating Section 8 Income Limits Under the United States Housing Act of 1937

AGENCY: Office of the Assistant Secretary for Policy Development and Research, HUD.

ACTION: Final notice.

SUMMARY: Today’s notice announces that HUD will allow Section 8 income limits to decrease beginning with the Fiscal Year (FY) 2010 income limits, but will limit all annual decreases to no more than 5 percent and limit all annual increases to 5 percent or twice the change in national median family income, whichever is greater. This notice follows notices of September 14, 2009, and October 7, 2009, that solicited public comment on HUD’s proposal to discontinue its “hold-harmless” policy. HUD’s hold-harmless policy maintained Section 8 income limits for certain areas at previously published levels when reductions would otherwise have resulted from changes in median family income estimates, housing cost adjustment data, median family income update methodology, income limit methodology, or metropolitan area definitions. HUD has also decided that rents used in its HOME Investment Partnerships program (HOME) will continue to be held harmless and that income limits for rural housing programs will continue their current hold-harmless policy, based on different area definitions.

DATES: *Effective Date:* May 17, 2010.

FOR FURTHER INFORMATION CONTACT: For technical information on the methodology used to develop income limits and median family income

estimates, please call the HUD USER information line at 800-245-2691 or access the information on the HUD Web site, <http://www.huduser.org/portal/datasets/il.html>. That Web site lists current and historical income limits. Furthermore, HUD maintains an interactive on-line documentation system for income limits and median family income estimates. The documentation system provides interested users with their income limits prior to the application of the hold-harmless policy in areas currently being held harmless. The FY 2009 documentation system may be accessed at http://www.huduser.org/portal/datasets/il/index_il2009.html.

Questions may be addressed to Mark Stanton or Marie Lihn, Economic and Market Analysis Division, Office of Economic Affairs, Office of Policy Development and Research, telephone number 202-708-0590. Persons with hearing or speech impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at 800-877-8339.

Electronic Data Availability: This **Federal Register** notice is available electronically from the HUD news page: <http://www.hud.gov/offices/adm/hudclips/index.cfm>. **Federal Register** notices also are available electronically from the U.S. Government Printing Office Web site: <http://www.gpoaccess.gov/fr/index.html>. This **Federal Register** notice also will be posted on the following HUD Web site: <http://www.huduser.org/portal/datasets/il.html>.

SUPPLEMENTARY INFORMATION:

I. Background: The September 14, 2009, Notice

On September 14, 2009, HUD published a notice in the **Federal Register** (74 FR 47016) seeking public comment on the impact of eliminating the hold-harmless policy for Section 8 income limits while continuing this policy for rents in the HOME program.¹

¹ Section 3(b)(2) of the United States Housing Act of 1937 (42 U.S.C. 1437a(b)(2)) (1937 Act) provides for assisted housing for “low-income families” and “very low-income families,” and defines these terms as families whose incomes are below 80 percent and 50 percent, respectively, of the median family income for the area with adjustments for family size. These income limits are referred to as “Section 8 income limits” because of the historical and statutory links with that program, although the same income limits are also used as eligibility criteria by several other Federal programs. The 1937 Act specifies conditions under which Section 8 income limits are to be adjusted either on a designated area basis or because of unusually high or low family incomes or housing-cost-to-income relationships. Section 8 income limits are calculated using Section 8 Fair Market Rent (FMR) area definitions, which in turn are based on Office

In the September 14, 2009, notice, HUD stated that through FY 2009, it would continue its policy of maintaining Section 8 income limits for HUD rental subsidy programs at the previously published level in cases where HUD’s estimate of area median family income or housing cost adjustment data, or changes in calculation methodology, would lead to a lower income limit than was previously published. This hold-harmless policy was implemented to avoid jeopardizing the financial feasibility of existing housing projects in instances where program rents were tied to Section 8 income limits. Under the hold-harmless policy, Section 8 income limits would be maintained until such a time as income limit calculations produced increases.

The primary Federal housing programs that rely on Section 8 income limits other than the Section 8 Voucher program are multifamily tax subsidy projects (MTSPs) financed with low-income housing tax credits (LIHTCs) under section 42 of the Internal Revenue Code of 1986 (IRC) and tax-exempt private activity bonds under section 142 of the IRC. Under these programs, maximum rents for units in MTSPs are generally 30 percent of the HUD-published Section 8 income limit for a four-person household, adjusted by the number of bedrooms in a unit. MTSPs use of Section 8 income limits to determine rents was HUD’s principal reason for establishing the hold-harmless policy; otherwise, when Section 8 income limits fall, the maximum rent that private owners can charge low-income tenants in the MTSPs falls, which may place a financial strain on existing MTSPs. MTSP rents, however, are now protected from falling under the Housing and Economic Recovery Act of 2008 (Pub. L. 110-289, approved July 30, 2008) (HERA).

HERA eliminates the need for HUD to continue its hold-harmless policy for the benefit of MTSPs. Specifically, Section 3009 of HERA amended IRC section 142(d) (26 U.S.C. 142 (note)) by implementing a statutory project-level hold-harmless provision for existing MTSPs. The provision applies to all MTSP projects and is not limited to projects benefiting from the HUD hold-harmless policy. As a result of this provision, determinations of area median gross income with respect to the project may not be less than the determination with respect to the project made for the preceding year. Section 3009 also provides additional

of Management and Budget metropolitan statistical area definitions.

relief for MTSPs in areas where HUD modified its methodology to include additional data in its calculation of area median gross income. For these “HUD hold-harmless impacted projects,” the area median gross income will be the greater of the amount determined without regard to this provision or the 2008 determination, plus any increase after 2008. MTSP income limits as specified by Section 3009 are available at <http://www.huduser.org/portal/datasets/mtsp.html>.

Since other Federal programs use Section 8 income levels to determine program eligibility, the September 14, 2009, notice requested public comment on whether HUD should discontinue its hold-harmless policy. Other Federal programs that use the Section 8 income levels include, but may not be limited to, the Department of Treasury’s tax-exempt Mortgage Revenue Bond program for Homeownership Financing; the Department of Agriculture’s Rental and Ownership Assistance programs; the Federal Deposit Insurance Corporation’s Disposition of Multifamily Housing to Non-profit and Public Agencies and the Disposition of Single Family Housing; the Federal Housing Finance Agency’s Rental Program Funding Priorities and Homeownership Funding Priorities; the Veterans Administration’s Eligibility for Disability Income Support Payments; and the HUD-administered, governmentwide Uniform Relocation Act (42 U.S.C. 4601, *et seq.*) to determine the extent of replacement housing assistance. Applicable income limits are modified to meet the requirements of each of these programs, but each starts with the Section 8 very low-income limit that incorporates high and low housing cost adjustments and the State nonmetropolitan median as the basis for a minimum.

Finally, the September 14, 2009, notice stated that determinations of Difficult Development Areas (DDAs) under section 42 of the IRC would be affected by the decision to discontinue the hold-harmless policy. HUD also requested public comment on whether the hold-harmless policy should be maintained with respect to Section 8 income limits used for calculating HOME program rents. HUD noted that maintaining the hold-harmless policy for HOME program rents would prevent such rents from falling in areas where incomes may be falling, while discontinuing the hold-harmless policy with respect to eligibility requirements would help target HOME funds for use by families with lower incomes and greater need.

The September 14, 2009, notice was corrected by a notice published on October 7, 2009, (74 FR 51615), which also extended the public comment deadline to November 6, 2009. As discussed later in today’s notice, HUD has considered the comments filed in response to these **Federal Register** publications.

II. Discussions With Federal Programs

HUD’s Office of Policy Development and Research discussed whether to eliminate its hold-harmless policy for Section 8 income limits with each HUD program director and all other Federal agencies that use Section 8 income limits for rent and income eligibility. For its HOME program, which is not included within the statutory hold-harmless provision provided by HERA, HUD determined that rents will be held harmless, but that income limits will be allowed to fluctuate with the market. In discussions with the Internal Revenue Service, it was clarified that existing MTSPs would be protected from future rent declines and that it was appropriate to allow declines in income eligibility for both multi-family and single family tax credits. The Department of Agriculture’s Rural Housing Service requested that HUD continue its hold-harmless policy, which is based on some unique area definitions. No other Federal agency provided HUD with substantive comment regarding its plans to modify the hold-harmless policy. Additional details about the specific income limits used by each of these programs can be found at: http://www.huduser.org/portal/datasets/il/il09/IncomeLimit_sBriefingMaterial_FY09.pdf.

III. Overview of Key Public Comment Concerns

By the close of the public comment period on November 6, 2009, HUD received a total of 32 public comments. Most were opposed to the elimination of hold harmless for Section 8 income limits. The most common reason expressed for the opposition to the elimination of the hold-harmless policy was that many affordable housing developments use Section 8 income limits to set rents and the possibility of lower rents for these projects would be detrimental to existing and future project development; existing projects would be at risk for financial default, while future projects would have difficulty securing financing. One commenter noted that few tenants would benefit from discontinuing the hold-harmless policy, based on the impact to Section 8 tenants as cited by HUD in its notice. Many commenters,

while preferring that HUD publish only one hold-harmless income limit per area, recognized the need for income limits that are not held harmless in programs where HUD provides direct rental assistance. As a result, these commenters recommended that HUD issue two sets of income limits; one for direct rental subsidies, and one for all affordable housing programs, regardless of the “placed-in-service” date. HUD considered these comments, but finds that it has no authority to establish income limits for all affordable housing programs such as those funded with city/county levy, State housing trust funds, or other sources that may be contractually tied to Section 8 income limits. HUD’s authority to produce individual program income limits covers: Section 8 programs; MTSP income limits for HUD Hold-Harmless Impacted Projects as defined in HERA; the HOME and Community Development Block Grant (CDBG) programs, which use parallel language in establishing income limit methodology, rather than incorporating Section 8 income limits by reference; and, through statutory consultation requirements, the Department of Agriculture’s Rural Housing Service programs. To ensure clarity in future estimates, HUD will reference the specific programs for which the different published income limits will apply.

Some commenters noted the impact of HUD’s proposed policy on the purchase of single-family homes using tax-exempt mortgage revenue bonds. This program is governed by Section 143 of the IRC and was not amended by HERA. Section 8 income limits are used to determine income eligibility for this program. One commenter noted that this is not the time to limit the pool of eligible families who can take on the rigors of homeownership, which elimination of the hold-harmless policy may do. Commenters from a rural State questioned HUD’s reliance on American Community Survey (ACS) income data, noting instances where some counties are not covered by the 3-year ACS data. These commenters assert that small rural states are disproportionately impacted by data changes. To address these concerns, HUD has decided to impose a cap on the annual decreases in income limits of a maximum of 5 percent or, in the case of increases, 5 percent or twice the change in national median family income, whichever is greater. Additionally, beginning with income data used to develop FY 2011 income limits, HUD will use 5-year

ACS, data which will cover even the smallest areas.

Nine of the 24 comments filed by State or regional agencies or developers or their representatives were from the Northwest/Alaska region (HUD Region 10). Commenters included State housing finance commissions, housing and community service organizations, and legal service agencies. The commenters did not identify unique regional, State, or local programs that would be affected more than other states or regions. They claimed, however, that properties funded with HOME, CDBG, city/county levy, or State housing trust funds will face serious cash flow issues if the hold-harmless policy is eliminated. These commenters requested that HUD do whatever necessary, including seeking legislation, to give all these programs the same hold-harmless income limit, irrespective of the "placed-in-service" date. As noted, however, HUD is required to implement Section 3009 of HERA, which gives MTSPs different income limits based on the placed-in-service date. Projects that were held harmless in 2007 or 2008 are eligible for increases in income limits based on increases in the median family income. Projects that were not held harmless in 2007 or 2008 or were placed-in-service after that date do not qualify for this increase. HUD's authority to produce individual program income limits covers: Section 8 programs; MTSP income limits in HUD Hold-Harmless Impacted Projects as defined in HERA; the HOME and CDBG programs, which use parallel language in establishing income limit methodology rather than incorporating Section 8 income limits by reference; and, through statutory consultation requirements, the Department of Agriculture's Rural Housing Service programs.

A joint comment was filed by several public interest and trade groups recommending that HUD delay eliminating hold harmless for the Section 8 income limits, because legislative and regulatory changes are required for programs not protected by HERA to mitigate the impact on the financial stability of new projects and protect those in planning phases. The commenters asserted that HUD must amend its regulations to allow rent stabilization in the HOME program. The commenters also stated that eliminating the hold-harmless policy would, for the Mortgage Revenue Bond program, which provides below-market interest rate mortgages to moderate-income first-time homebuyers, and the Neighborhood Stabilization Program (NSP), which assists households within a range of incomes, place grantees in

violation of the respective programs' requirements if income limits decline. Moreover, the commenters noted that the elimination of hold harmless would be exacerbated by applying it when incomes are declining and recommended that HUD delay any policy change until the income data no longer reflect declines from the recession, which the commenters estimated will be by the FY 2012 income limits. As noted in this notice, however, HUD has determined that rents used in the HOME program will continue to be held harmless, precluding a need for regulatory change. The NSP program relies on elements of both the HOME and CDBG program for continued affordability. To the extent that an NSP grantee chooses to apply HOME rents, they will be held harmless under the HOME program. HUD will review issuing appropriate transition guidance for CDBG grantees, including NSP grantees that choose to develop their own continued affordability policies. The possible destabilization of neighborhoods that fall out of compliance when income limits fall will be limited by the cap of the maximum of 5 percent, and by changes in program implementation that limit the eligibility determination to a specific date, thereby preventing areas from falling out of compliance.

Another commenter opposed the elimination of the hold-harmless policy because there will not be a minimal impact from the elimination for the Section 8 rental assistance program, as stated in the original and revised **Federal Register** notices on this policy. The commenter noted that changes in the boundaries of its metropolitan area magnify the impact of change in this change of policy. HUD will address this issue by the implementation of caps and floors on the annual percentage change in income limits.

Several other commenters strongly supported the elimination of the income limits hold-harmless policy. One commenter noted that it has worked hard to formally decouple the LIHTC program from the HUD Section 8 income limits. A second stated that the core users of income limits are Housing Choice Voucher, Section 8 project-based, and Public Housing programs and that this change will have little impact on these programs. Both commenters stated that the current hold-harmless policy does not protect tenants from artificially high rents and stressed that renters' interests also should be considered. The commenter also stated that income limits should be relatively stable because the ACS is capable of producing frequent updates.

In the past, most major changes occurred from rebenchmarking income data from the decennial census. With income data collected annually by the ACS, this should not occur. Both commenters suggest mediating the impact of eliminating the hold-harmless policy by limiting annual changes; one proposed a cap in changes of up to plus or minus 5 percent, while the second recommended an amount equal to double the change in the median family income.

IV. Discussion of Public Comments

Comment: The hold-harmless policy should be eliminated because doing so will have little to no impact on existing program participants or housing providers. One commenter stated that the Housing Choice Voucher, Section 8 project-based, and Public Housing programs are the core users of the income limits, and that the only impact of the elimination of the hold-harmless policy on those programs will be to lower the eligible income eligibility for applicants being admitted to the program in a given year and only in those jurisdictions that experience a measured decline in income. It will have little to no impact on existing program participants or housing providers.

HUD Response: HUD agrees that the hold-harmless policy should be eliminated in order to provide better income targeting for affordable housing.

Comment: Eliminating the hold-harmless policy will allow target thresholds to be set more accurately. According to one commenter, the hold-harmless policy has inflated income limits making eligibility and targeting levels artificially high. Elimination of the policy would allow voucher, project-based Section 8 and public housing eligibility and targeting thresholds to be established more accurately, thereby better directing assistance to families with the income level that Congress intended to help.

HUD Response: HUD agrees that elimination of the hold-harmless policy will allow a more accurate targeting of assistance to the families that Congress intends to help.

Comment: The hold-harmless policy should be eliminated because it is no longer needed due to the enactment of HERA. The commenter stated that, given HERA, HUD's policy of maintaining artificially high income limits can no longer be justified. The hold-harmless policy increases the number of households eligible for Public Housing and Section 8 Voucher programs, and more importantly, undercuts the statutory mandate that

these programs be targeted to those households with the lowest incomes, which are most in need of housing assistance. Discontinuing the hold-harmless policy will make it more likely that Federal housing programs will target persons and communities with the most need as Congress has intended, the commenter stated.

HUD Response: HUD agrees that HERA eliminated the principal basis for the income limits hold-harmless policy. It is HUD's intent to target affordable housing resources using the most accurate information. Eliminating the hold-harmless policy will prevent income limits in certain areas from being established at artificially high levels and, as a result, ensure that HUD can better target affordable housing resources.

Comment: The hold-harmless policy should be eliminated because manipulating calculations of Area Median Income (AMI) is ill advised. One commenter stated that the hold-harmless policy used in calculating income limits under Section 8 should be eliminated because the efforts to mitigate the negative impacts of the use of AMI, by manipulating data, only serve to complicate operations unnecessarily. When the impact of the mitigations result in calculations of AMI that are higher than what is derived from the data from the Census and the ACS, low-income tenants wind up bearing a heavier rent burden without the benefit of any of the artificially inflated income. These side effects raise serious questions about the appropriateness of the hold-harmless policy as a remedy, the commenter stated.

HUD Response: HUD agrees that the hold-harmless policy can be detrimental to low-income renters in MTSPs where tenant rents are based on income limits rather than individual tenant incomes and who must pay rents based on artificially inflated income limits.

Comment: The hold-harmless policy should be maintained in order to avoid an increased administrative burden. Several commenters stated that the hold-harmless policy should be maintained in order to avoid increased administrative burden for owners, property managers, and State and local agencies. If HUD discontinued the hold-harmless policy, projects funded from multiple sources will have two sets of income and rent limits. Some commenters stated that implementation of MTSP and HERA special income limits for tax-credit and bond-financed properties, and a separation from Section 8 income limits, while well intentioned, would create a massive

administrative problem affecting public funders, owners, property managers, and residents of affordable housing. Another commenter stated that for years, housing advocates have worked to make other HUD programs compatible with the IRS Section 42 Tax Credit Program and that requiring alternative income limits would impede these efforts.

HUD Response: HUD does not agree that the removal of the hold-harmless policy would create substantially more administrative burden for MTSPs. Project managers and MTSP compliance monitors would still need to observe HUD's annual releases of new income limits to determine if they are eligible for income limit and rent increases. The comparison point will be different. Rather than looking at HUD's previous year's income limits for their area, project managers and MTSP compliance monitors will need to compare the new income limits to the income limits projects are operating under currently to see if they are eligible for an increase in income limits and rents. This information should be readily available. The statutory hold-harmless provision in HERA prevents income limits and rents from ever falling below the highest levels the project ever operated under. Eliminating the Section 8 income limit hold-harmless policy does not mean that rents for MTSPs will decline over the life of a project.

Comment: If the hold-harmless provision is eliminated, fewer affordable housing projects will be built. Several commenters stated that without hold-harmless protection, the result will be fewer overall projects being built, and an underwriting volatility that is counterproductive to HUD's overall mission to build affordable housing. Reducing the rent-supported underwriting structure of these developments would make it virtually impossible to finance many new projects. These commenters stressed that eliminating the provision will make it more difficult for lenders to underwrite affordable housing, which will reduce the amount of affordable housing, and that the hold-harmless policy has enabled banks and investors to finance the development of mixed-income communities that include units to serve the very low-income.

HUD Response: Maintaining Section 8 Income Limits at artificially high levels is not a sustainable way to encourage development of affordable housing. Furthermore, rents for the HOME program and rents for MTSPs will not be allowed to decline once the projects are placed-in-service, so underwriters need not worry about rents decreasing

in operating projects. Other programs with rents tied to the Section 8 income limits will have to institute their own regulatory changes to prevent rent decreases over the life of a project, or will have to allow declines commensurate with the market. HUD will limit any decline in income limits to the maximum of 5 percent or, in the case of increase, 5 percent or twice the change in national median family income, whichever is greater, to reduce the potential administrative impact in determining income eligibility and to further provide greater certainty regarding revenue stream concerns.

Comment: Eliminating the hold-harmless policy would threaten the economic viability of thousands of properties nationwide that have rent limits contractually tied to Section 8 income limits. According to several commenters, suspension of the hold-harmless policy for Section 8 income limits would create unintended negative consequences for low-income housing tax-credit, bond, and other affordable housing projects that mix Federal, State, and/or local funding to create affordable rental housing serving the lowest incomes. Several commenters stated that they understood HUD's reasons for changing its hold-harmless policy for the Section 8 program and its desire to have a separate set of limits for Section 8 that accurately reflect area incomes. However, properties funded with HOME, city and county funds, and State Housing Trust Funds have rent limits contractually tied to Section 8 income limits. CDBG affordable rent policies are set at the local level, by each grantee, and are likely to be tied to the Section 8 income limits. If HUD changes the hold-harmless policy, these commenters stated, the result would be decreased rental income for properties that remain tied to Section 8 program limits and properties using Section 8 income limits would face serious cash flow problems. Such a decrease in rental income would result in insufficient cash flow so owners will defer maintenance on buildings, causing the rate of foreclosure to increase.

HUD Response: HUD has decided to hold-harmless the rents for properties funded with HOME, but not the income limits to determine eligibility. HUD will consider issuing transition guidance for CDBG grantees that have linked rents to Section 8 income limits. HUD's authority to produce individual program income limits covers Section 8 programs; MTSP income limits in "HUD Hold-Harmless Impacted Projects," as defined in HERA; the HOME and CDBG programs, which use parallel language in establishing income limit

methodology rather than incorporating Section 8 income limits by reference; and, through statutory consultation requirements, the Department of Agriculture's Rural Housing Service programs. Administrators of city, county, or State housing subsidy programs using Section 8 income limits to establish eligibility and/or rents should establish their own hold-harmless policies, if needed and desired. HUD wants to serve more low-income residents and target its funds appropriately, while serving the affordable housing market.

Comment: Eliminating the hold-harmless policy will put many affordable multifamily properties that receive HOME and CDBG funds at risk. One commenter stated that many of the assets in the current housing stock of affordable multifamily properties could be put at risk as a result of the proposed policy change because the change would affect the level of income used to qualify tenants and the maximum rents charged in both tax-credit and other projects that receive HOME and CDBG funds. These projects are required to adhere to the more restrictive income guidelines and rent levels issued by HUD's Office of Community Planning and Development.

HUD Response: HUD has evaluated the impact of this policy on its programs and for projects funded by HOME and CDBG funds. HUD believes that holding the HOME rents harmless and issuing appropriate transition guidance, if necessary, for CDBG projects will sufficiently protect these projects.

Comment: This notice disregards the negative impact this proposal will have on the future development of MTSPs. Despite the fact that existing MTSPs are protected by HERA, the ability to develop and rehabilitate new housing through MTSPs will be negatively impacted by HUD discontinuing its hold-harmless policy, stated one commenter. According to the commenter, MTSP underwriting is based on the maximum rent potential, which is derived from the HUD very-low (50 percent) income limits. Currently, developers are assured that their rent potential will not decrease arbitrarily. Rents are also affected by increased utility costs. Removing the hold-harmless policy would impact future development and add more risk to a development scenario where rents often do decrease as utility costs increase.

HUD Response: An MTSP unit determines maximum rents based on income limits, irrespective of the market rate for rent or utilities or the tenant's actual income. Currently, the rent

potential is based on the determination of what people can afford. Incomes do go up and down and rents do go up and down. This is not arbitrary, but is driven by market forces. Utilities rates go up and down as well, though these costs may or may not be included in all project rents. The decrease of rents when utilities increase is not a certainty and is of no concern for the MTSPs since the rents are not based on either factor; they are based on incomes.

HUD acknowledges that the uncertainty in the projected revenue stream is increased in the planning phase by eliminating the hold-harmless policy. Developers will have to manage this risk. HUD will limit the uncertainty in the projected revenue stream by imposing a cap on annual decreases to the maximum of 5 percent or, in the case of increases, 5 percent or twice the change in national median family income, whichever is greater. This cap, along with the use of the 5-year ACS data beginning with the FY 2011 Section 8 income limits, will dampen the annual changes and should reduce risk. Once the project is placed-in-service, HERA eliminates the risk of declining income limits.

Comment: MTSP projects should be held to the same hold-harmless standard for both incomes and rents. New development projects are underwritten to the lowest rents among all proposed funding sources, thus no one program will benefit from having a higher hold-harmless rent if other program rents are not held to that same standard, stated two commenters. Having different income and rent standards also makes it more difficult for project owners and agency staff to do long-term compliance monitoring. For new development projects, both incomes and rents should be held harmless according to the limits in place when the reservation of tax credits or the award of Federal funds is made for the project, whichever is later in time, stated one commenter. Both commenters stated that maintaining income limits at levels in place the year the project is underwritten prevents projects from becoming infeasible, due to declines in rents that may occur between the time the funds are reserved for a project and the project's loan closing or placed-in-service date.

HUD Response: Different income and rent standards were created by HERA. The hold-harmless policy HUD is instituting for HOME rents is comparable to MTSPs that are not HUD Hold-Harmless Impacted Projects as defined in HERA. These HERA-defined rents are higher, and HUD has no authority to go back and grant these

rents to projects funded under HOME. HUD's authority to produce individual program income limits covers: Section 8 programs; MTSP income limits in HUD Hold-Harmless Impacted Projects as defined in HERA; the HOME and CDBG programs, which use parallel language in establishing income limit methodology rather than incorporating Section 8 income limits by reference; and, through statutory consultation requirements, the Department of Agriculture's Rural Housing Service programs. For rental housing subsidy programs that rely on Section 8 income limits for establishing eligibility and/or unit rents that are administered by State and local governments, administrators should establish a hold-harmless policy if desirable to do so. While HUD agrees that it makes sense for the income/rent level of a new MTSP to be established at the time of the loan's closing and not subject to the risk of changes between the loan closing and the placed-in-service date, HUD has no authority over this policy. HUD advises developers to underwrite MTSPs under a "worst-case scenario" of a 5 percent decline from current income limits and maximum rents to ensure that if such a change occurs, the project will be able to go forward. Such an approach has the added benefit of widening the pool of eligible low-income renters, should the income limits either not decline, or decline by an amount smaller than 5 percent.

Comment: The term "existing MTSPs" is unclear, and it is unclear if future MTSP developments will be protected by HERA. According to the commenter, it is not clear if the term "existing MTSPs" refers only to current developments, or if once a new MTSP is developed or rehabilitated, such developments are then considered "existing" and will have their income limits held harmless and not have to be concerned with future rent cap reductions. A second commenter asked if future MTSPs will be protected by HERA. The commenter saw no indication that future developments would be similarly protected.

HUD Response: As new MTSPs come online, their unit rents and income limits are based on the currently applicable Section 8 income limits. For a given area, these income limits and rents may be lower than they were the previous year, but, going forward, a project's individual income limits will never decline; they will be held harmless for the life of the project at the highest level ever attained by the project. HUD views this as the clear intent of Congress in enacting the HERA hold-harmless provision.

Comment: HUD's hold-harmless policy has provided certainty and predictability to housing finance agencies and programs. According to one commenter, an income limit decrease from one year to the next for single-family, first-time homebuyers served by housing finance agencies would be disruptive and result in confusion and misunderstanding on the part of homebuyers, Realtors, and originating lenders. The hold-harmless policy has provided certainty and predictability to housing finance agencies and programs, stated the commenter.

HUD Response: HUD is limiting the impact of any decrease in income limits to the maximum of 5 percent, to make such fluctuations less problematic. However, HUD is committed to removing the hold-harmless policy to improve targeting of all funds for affordable housing to those that are intended for it by Congress. Should median incomes continue to decline, AMIs will ultimately reach their natural level; HUD's current plan to cap decreases at the maximum of 5 percent only slows this process, it does not stop it. Housing finance agencies should explore their options with respect to implementing their own hold-harmless rent policies.

Comment: Neither the intent nor the effect of the hold-harmless policy has been to maintain artificially high income limits. The hold-harmless policy smoothes a generally upward trend of successive median family income estimates, preventing a pattern of temporary declines followed by large increases, stated a commenter. In turn, for some programs, this ensures that rent levels do not fluctuate significantly, either up or down, on a year-to-year basis, which is desirable and a reason to maintain the hold-harmless policy, stated the commenter.

HUD Response: HUD agrees that the intent of its hold-harmless policy was not to maintain artificially high income limits, but that the effect, in some cases, has been just that. HUD will limit annual decreases to 5 percent and limit annual increases to 5 percent or twice the change in national median family income, whichever is greater, to limit changes up or down in Section 8 income limits. The current hold-harmless policy allows for any increase, and there have been increases over 5 percent from time to time. Large increases are no better for the affordable housing program than large decreases. The use of 5-year ACS data beginning in FY 2011 will further smooth the trend in income limit changes.

Comment: Investment in affordable housing properties will decline. According to some commenters, banks and investors will not invest in affordable housing properties where rental income may decline after their initial investment. Predictability and stability in income and expense projections are key underwriting considerations. Investors and lenders will not underwrite ventures where rental income may decline unpredictably, stated the commenters. Another commenter stated that without the assurance of stable rental income, banks and investors will no longer be willing to invest in the affordable housing industry, which will result in far fewer units being developed.

HUD Response: Rental income will not decline over time; HOME and MTSP rents will not decline over the life of the project. HUD does not want to limit the production of affordable housing. HUD's goal with this change is to provide more manageable rent increases (by capping increases to the maximum of 5 percent, or twice the change in national median family income) and to allow decreases in income limits used to determine eligibility for programs (also of no more than the maximum of 5 percent).

Comment: Eliminating the hold-harmless policy would detrimentally affect the extremely poor. One commenter wrote that eliminating the hold-harmless policy would harm the extremely poor by causing them to live in a financially more tenuous and volatile project. Because eliminating the hold-harmless policy would put the financial stability of MTSPs at risk, the commenter stated, discontinuing the hold-harmless policy for future MTSPs would likely be disastrous for high-cost, high-poverty cities. Another commenter stated that HUD's approach supports only projects that receive direct governmental rental subsidies, where lower incomes lead to lower tenant-share rents. In those cases, HUD will have to offset lower tenant share rents by larger Federal rental subsidies to preserve the fiscal operations and quality maintenance of the properties. The MTSP programs do not have such a rental subsidy fallback option.

HUD Response: HUD disagrees that extremely low-income tenants (defined as those at 30 percent of the median family income) will be required to take up tenancy in financially more tenuous and volatile projects because extremely low-income tenants are already priced out of MTSPs and, for the most part, require Section 8 vouchers for assistance. Additionally, as already stated, MTSPs will not be made more

tenuous or volatile by HUD's proposed policy.

Comment: HUD cannot impose independent hold-harmless policies on the HOME program. Commenters stated that HUD cannot impose independent hold-harmless policies on rent income limitations or maximum rents in the HOME program without going through the official rule-making process. The regulations governing income targeting and maximum rent in rental programs for the HOME program at 24 CFR part 92 provide specific formulae and specific conditions under which the formulae may be altered, and a hold-harmless policy is not listed as legitimate grounds for alteration, stated a commenter.

HUD Response: HUD does not believe that a regulatory change is required in order to institute a hold-harmless policy for HOME rents.

Comment: A hold-harmless policy that is independent of the Section 8 income limits cannot be applied to the Treasury Department's Tax-Exempt Mortgage Revenue Bond Program without a legislative change. According to one commenter, allowing income limits to decline from one year to the next would cause problems in particular states, including confusion and resentment among potential buyers and administrative burdens for State agencies. Moreover, the commenter stated, section 143(f) of the IRC specifies that the 115 percent limitation on incomes of mortgagors under the MRB program be based on area median gross income, taking into account the regulations prescribed under Section 8 of the United States Housing Act of 1937. Therefore, a hold-harmless policy that is independent of the Section 8 income limits cannot be applied to the MRB program without a legislative change.

HUD Response: This issue was discussed with the IRS, and HUD was advised that the intent of Congress is better followed by allowing Section 8 income limits to decline. Once a borrower closes a loan financed with bonds issued under section 143 of the IRC, the borrower is not subject to eligibility reconsideration, because the borrower's income has increased or the applicable income limit has decreased. The intent of this program is to target a certain income category, and the hold-harmless policy obfuscates this income category.

Comment: It would be premature to remove a general hold-harmless policy from the income limits for the NSP. The commenter stated that after foreclosed properties have been purchased and repaired using NSP grants, these

properties must be used to assist households with incomes at or below 120 percent of the area median income. There is an additional requirement that 25 percent of the funds be used for households with incomes at or below 50 percent of area median income. If income limits decline after the 120 percent and 50 percent criteria for the NSP program have been properly documented, as could happen in the absence of a hold-harmless policy, NSP grantees in certain areas would be in violation of the NSP requirements. None of the issues that a temporary decline in income limits would cause in the NSP have been addressed in **Federal Register** notices or materials posted on the HUD Web site, stated the commenter.

HUD Response: As the commenter noted, most of this money has been allocated and the rest will be shortly. HUD will review issuing transition guidance for CDBG programs, including NSP, which will appropriately ensure eligibility over the life of a project to which assistance has already been provided.

Comment: *Small states are impacted disproportionately by data changes.* One commenter stated that the proposed change to the hold-harmless policy will create some unintended consequences. The commenter noted that the slightest change in sample sizes, counts, and methodological updates have a greater impact on small states, like her own. HUD changes its methodologies for calculating income limits with regularity. These changes can turn a steady stream of income levels into a dramatic shift, thereby lowering eligible income levels for housing programs from year to year, stated the commenter.

HUD Response: A careful reading of HUD's methodology documentation will show that HUD is doing everything justifiable to smooth out survey error fluctuations in its estimation and update processes. For example, the ACS data used in the income limit process is generally an update factor. As such, large changes are already limited. A survey estimate must pass stringent statistical tests before it is used. In addition, beginning with FY 2009 income limits, 3-year ACS data is used in this update process, so the sample size is not that small (estimates are available for areas as small as 20,000 persons). For the FY 2011 income limits, 5-year data will be used, which will further limit any fluctuations and will be the most comprehensive survey covering all geography for which income limits are set. Also, HUD will limit annual decreases to the maximum of 5 percent or, in the case of increases, 5 percent or twice the change in

national median family income, whichever is greater, so that large changes from year to year will be extremely rare.

Comment: *Many State and local governments have already incorporated HUD's AMIs into their own programs.* A commenter stated that the existing hold-harmless policy with respect to AMI should be maintained because many State and local governments have incorporated HUD's AMIs into their own programs. Owners sign long-term contracts to limit rents to specified percentages of the established AMI. According to the commenter, such programs were designed by cities with the understanding that owners would not be faced with rent rollbacks when AMI estimates decreased. It is not clear how such provisions, which rely on HUD AMI, can be adjusted for rent reductions. The simplest way to maintain governmentally assisted rental properties is to maintain the existing hold-harmless policy with respect to changes in AMI, concluded the commenter.

HUD Response: State and local government program rents are calculated by the city or State agency that is administering the program. These rents can and should be held harmless for the life of a project, just as HUD is doing for the HOME program and HERA does for the MTSP program. The city or State agencies may impose their own hold-harmless rules when calculating rents.

Comment: *HUD should ask Congress to enact legislation.* Several commenters recommended that HUD ask Congress to enact legislation that would allow HUD to publish income limits that extend the hold-harmless provisions just granted to LIHTC projects under HERA, to all multifamily affordable housing units that utilize Federal funding, except units that receive direct HUD Section 8 rental subsidy.

HUD Response: HUD believes that all Federal rental subsidy programs that set rents according to some version of the Section 8 income limits are covered by an appropriate hold-harmless arrangement, so that such legislation is not necessary. MTSP programs are covered by the hold-harmless provisions of HERA; HUD will hold rents in HOME projects harmless and review issuing appropriate transition guidance for the CDBG program. HUD has a hold-harmless agreement with the Department of Agriculture's Rural Housing Service program that will continue.

Comment: *HUD should consider a policy that slows adjustments.* One commenter stated that changes in

Census geography or HUD methodology may still lead to significant swings in HUD's estimates of area median income from year to year. If HUD chooses to implement a policy to mediate the impact of any potential swings in income limits, the commenter encouraged HUD to consider a policy that slows adjustments. Such a policy, if properly designed, would provide owners, program administrators, and tenants with a measure of security. A second commenter stated that there is a reasonable case for special protections against volatility in the income limits used for certain purposes, such as setting HOME rent caps. The commenter encouraged HUD to establish balanced protections that prevent both rent declines, which would harm owners in the HOME program, and sharp increases, which would harm tenants.

HUD Response: HUD agrees that large increases or decreases in Section 8 income limits should be avoided and, therefore, it will impose a cap on annual decreases to the maximum of 5 percent or, in the case of increases, 5 percent or twice the change in national median family income, whichever is greater. The hold-harmless policy did not limit large increases and this did prove harmful to tenants.

Comment: *HUD should impose only two sets of income limits.* Several commenters suggested that if HUD will not continue to use the hold-harmless provision, it should consider imposing two sets of income limits: Section 8 Rental Subsidy limits that apply only to units with direct rental subsidy and Multifamily Subsidy Program Limits that apply to all other affordable housing programs that employ the hold-harmless provision. Imposing two sets of limits would simplify income limits for residents, property managers, and developers and fulfill the purpose of the HERA legislation.

HUD Response: HUD believes that the elimination of the hold-harmless policy for Section 8 income limits does fulfill the intent of HERA. In HERA, it was the intent of Congress to grant MTSPs project-level hold-harmless income limits to determine income eligibility and maximum rents, and it was the intent of Congress to eliminate the Section 8 income limit hold-harmless policy so that MTSPs that go into service in the future can be based on higher or lower income limits, as warranted by data.

Comment: *HUD should publish income limits and apply them to all affordable housing programs with the exception of units with Section 8 rental subsidy.* Several commenters, in connection with the previous comment,

stated that HUD should publish Multifamily Subsidy Income Limits or HERA HUD Hold-Harmless Impacted Projects Income Limits for any given county or metropolitan area and apply such limits to all affordable housing programs, with the exception of units with Section 8 rental subsidy. The commenters stated that this proposal would prevent properties funded with HOME, CDBG, city/county levy, State Housing Trust funds, and other sources contractually tied to Section 8 limits from facing the serious cash flow issues that will occur if HUD eliminates the hold-harmless policy, as currently proposed.

HUD Response: Congress did not grant all existing and future MTSPs the ability to use the HERA HUD Hold-Harmless Impacted Projects income limits, and it is outside HUD's authority to do so. HUD has no authority to establish income limits specifically for use by State or local government rental subsidy programs. For rental housing subsidy programs that rely on Section 8 income limits for establishing eligibility and/or unit rents that are administered by State and local governments, administrators should establish a hold-harmless policy if it is desirable to do so.

Comment: HUD should create a streamlined waiver process. One commenter stated that HUD should create a streamlined waiver process to permit HOME-participating jurisdictions to quickly re-assist projects in cases where lower rents necessitate that projects receive more subsidy to remain financially stable. Increases in operating expenses over time, coupled with lower rent revenues resulting from loss of establishing hold-harmless income limits to current and lower levels, may result in new projects needing more subsidies to avoid becoming a troubled project.

HUD Response: The HOME rents will not decline over the life of the project, so this action is not necessary.

Comment: HUD should adopt a hold-harmless policy geared to HOME projects, which will be harmed if the hold-harmless policy is eliminated. The commenter wrote that HUD should adopt a hold-harmless policy to ensure that HOME rental projects have adequate rental revenues, but still require the sponsors of these projects to target vacant units to those households that fall within the Section 8 income limits. Another commenter stated that thousands of affordable housing developments assisted through the HOME program would be immediately placed in financial jeopardy. HOME projects are contractually bound by

long-term commitments to maintain rent at levels tied to the AMI. Nearly all HOME developments use the 65 percent of AMI standard to set maximum rents. Without the hold-harmless provision, stated the commenter, HOME properties face the prospect of shrinking rental income revenue whenever area median income estimates are reduced. Owners of HOME projects will find it impractical to operate such critical development projects with reduced rental income. This change will have a chilling effect on future participation in the program.

HUD Response: Rental income for HOME projects will not decline. HOME rents will be held harmless over the life of the project.

Comment: Because the impact of removing the hold-harmless policy is so broad, the policy should not be changed until potential problems for specific programs have been resolved. The programs affected by removing the hold-harmless policy include HOME, the Treasury Department's Tax-exempt Mortgage Revenue Bond program, the MTSPs not covered by the HERA-defined "HUD Hold-Harmless Impacted Projects" provisions, and the NSP established under both HERA and the American Recovery and Reinvestment Act of 2009. For the potential magnitude of the impact on various programs, the hold-harmless policy should not be changed until potential problems have been fully examined and resolved, one commenter stated. One commenter urged HUD to eliminate the hold-harmless policy only for Section 8 assistance and other direct rental subsidy programs or to postpone any decision to eliminate the hold-harmless policy until there has been more opportunity to consider and address its potentially negative consequences. Another commenter stated that HUD should have published how the proposed changes would affect actual jurisdictions, as it did on December 16, 2005, so that a more informed comment could be made. A 30 percent reduction in the AMI is not a modest decrease that will have a minimum impact on families. The commenter urged HUD to continue the hold-harmless provision for areas greatly impacted.

HUD Response: HUD has analyzed the impact of this change on the HOME program, the NSP program, the single-family mortgage credit program (Section 143 of the IRC), and the MTSPs not covered by HERA-defined "HUD Hold-Harmless Impacted Projects" provisions (and this includes the Tax Credit Program under Section 42 and Tax-Exempt Bonds program for multifamily units under Section 142), and discussed

the impact throughout this notice. In short, project rents are protected from declines for the life of the project. Income eligibility for these programs can go down each year, but by no more than the maximum of 5 percent, or up by no more than 5 percent or twice the change in national median family income, whichever is greater. HUD provided a State-by-State listing of areas that are currently held harmless.

Comment: There are concerns about removing the hold-harmless policy at this particular time. The unusual macroeconomic conditions that currently prevail are likely to exacerbate problems for many housing programs in 2011, one commenter stated. If HUD continues to apply its current methodology, 2010 income limits will be based on the 2006–2008 ACS estimates, and the 2011 estimates will be based on the 2007–2009 ACS estimates. FY 2009 was an atypical year, combining a severe recession with a general deflationary trend. A weak Consumer Price Index (CPI) adjustment, combined with new income data from a recession year, will likely produce widespread declines in the next release of 3-year ACS estimates and, therefore, in 2011 income limits. As a result, removing the hold-harmless policy will produce large declines in 2011 income limits that will find many industry stakeholders unprepared, the commenter concluded.

HUD Response: For clarification, it should be noted that the CPI is only used to adjust the timing of the ACS data; update factors are not generated using CPI. The Census Bureau adjusts the 3-year data used in the FY 2010 income limits to 2008. It is assumed this is a midpoint of the year, so HUD adjusts the data using the CPI to make the income limit data represent the end of the year. The 3-year ACS data released in 2011 will likely show declines, since the impact of the recession in 2009 would be an important component of that data; however, HUD will be using 5-year data (2005–2009) for the FY 2011 income limits, so that the declines from 2009 will be mitigated. In addition, HUD will impose a cap of the maximum of 5 percent to limit reductions from year to year.

Comment: HOME Program income limits should be held harmless in order to maintain compatibility with MTSP program limits. On the issue of whether the hold-harmless policy should be maintained for HOME rents but discontinued for HOME eligibility requirements, HOME is often combined with MTSPs. Conflicting eligibility requirements between HOME and

MTSPs have a strong tendency to create confusion. HOME income limits, should be held harmless in order to maintain compatibility with MTSP income limits, stated a commenter.

HUD Response: Because of the special provisions in HERA for HUD Hold-Harmless Impacted Projects, HOME income limits will not be able to mimic the HERA Special MTSP income limits. For new projects, income limits will not be held harmless for either of these programs, so initially, they will be the same. Going forward, projects containing both HOME funds and MTSP financing will have to make a determination about how to evaluate eligibility for both incoming families and ongoing eligibility. These projects should consider specifying eligibility rules at the outset of the project.

V. Policy Decision

Accordingly, HUD will eliminate the hold-harmless policy in estimating Section 8 income limits. Decreases to the Section 8 income limits from FY 2010 forward will be limited to the maximum of 5 percent; increases will be limited to 5 percent or twice the change in national median family income increase or decrease, whichever is greater. This means, for example, that if the national estimate of median family income increased by 3 percent from the previous year, local income limits could change by up to 6 percent. The income limits for MTSPs will continue to follow the formulas set out in HERA. Specifically, HERA provides that area median gross income with respect to any project will be held harmless and not be less than the area median income for the preceding calendar year for which such determination is made. In addition, a different income limit determination formula specified by HERA for projects in areas held harmless in calendar years 2007 or 2008 applies if these limits would be higher than the limits calculated for MTSPs using HUD's regular methodology.² Rents used in the HOME program will continue to be held harmless, although the income limits used to determine eligibility for HOME projects may decrease up to the maximum of 5 percent or increase up to 5 percent or twice the change in national median family income, per year, whichever is greater. The income limits for Rural Housing Service programs will continue their current hold-harmless policy, based on different area definitions; these

income limits are provided directly to the Department of Agriculture.

VI. Findings and Certifications

Environmental Review

This notice involves a discretionary establishment of income limits and exclusions with regard to eligibility for or calculation of HUD housing assistance or rental assistance which does not constitute a development decision affecting the physical condition of specific project areas or building sites. Accordingly, under 24 CFR 5019(c)(6), this notice is categorically excluded from environmental review under the National Environmental Policy Act of 1969 (42 U.S.C. 4321).

Dated: May 10, 2010.

Raphael W. Bostic,

Assistant Secretary for Policy Development and Research.

[FR Doc. 2010-11638 Filed 5-14-10; 8:45 am]

BILLING CODE 4210-67-P

² For a discussion of the special methodology, please see the FY 2009 MTSP Briefing Materials document available at http://www.huduser.org/portal/datasets/mtsp/mtsp09/MTSP_Briefing.pdf.