

Impact

A regulatory impact analysis must accompany every economically significant federal rule or regulation. The Office of Policy Development and Research performs this analysis for all U.S. Department of Housing and Urban Development rules. An impact analysis is a forecast of the annual benefits and costs accruing to all parties, including the taxpayers, from a given regulation. Modeling these benefits and costs involves use of past research findings, application of economic principles, empirical investigation, and professional judgment.

The Impact of the Final Rule on Income and Rent Determination Requirements in Public and Assisted Housing

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Abstract

Applicant or tenant failure to correctly report income in U.S. Department of Housing and Urban Development (HUD)-assisted housing programs may result in overpayment or underpayment of housing assistance. To mitigate the issue, HUD issued a final rule on rent and income determination in assisted housing. Assuming the rule is 100-percent effective in eliminating earned-income-based rent errors, if no oversubsidized tenants left in response to rent increases based on correct determination of earned income, then the net transfer to new tenants would be about \$480 million a year, resulting in about 92,000 new tenants served. At the other extreme, if all households that were oversubsidized due to earned-income error left HUD-assisted housing in response to rent corrections under the rule, the transfer to new tenants would amount to about \$1.72 billion a year (a figure that includes the subsidies they are properly entitled to under the law), resulting in about 337,000 new tenants served. The rule is unlikely to be 100-percent effective, however. The corrective actions of income and rent discrepancies may not necessarily lead to a reduction in subsidy; they could, in fact, lead to an increase in program funding needed to maintain the number of households served by the program if formerly oversubsidized households withdraw from the programs and are replaced by households with incomes still lower than theirs.

Analytic Problem

In January 2009, the U.S. Department of Housing and Urban Development (HUD) published a final rule aimed at streamlining the process of upfront verification of the income of assisted families, including the use of the Enterprise Income Verification (EIV) System.¹ The rule's goal is to reduce errors and overpayment of subsidies caused by incorrect income determinations and rent calculations in HUD's public and assisted programs. Proper income determination and cost controls are key determinants of the level of federal assistance for operating subsidies, which is calculated in theory as the difference between operating costs and income-based rents charged to tenants.

HUD's Office of Policy Development and Research determined that a Regulatory Impact Analysis (RIA)² was required because the refinement of income and rent determination requirements in public and assisted housing programs could result in transfers of funding to and among stakeholders of more than \$100 million a year.

The conclusions in this article are based on an ongoing HUD research study, the Quality Control study (QC study).³ The findings in the 2005 report imply that the gross transfer resulting from eliminating all the underpayment and overpayment of rents is approximately \$925 million (\$584 million in rent subsidy overpayment and \$341 million in rent subsidy underpayment). Of the \$925 million, about \$138 million in rent subsidy overpayment and \$17 million in rent subsidy underpayment are attributed to errors in earned income reported to, or recorded by, program administrators as determined by QC study interviewers. In addition, data matching with the National Directory of New Hires (NDNH) indicate an additional \$359 million in rent underpayment due to tenants' failure to report income to both program administrators and QC study interviewers. The corrective actions of income and rent discrepancies found through EIV may not necessarily lead to a reduction in subsidy; they could, in fact, lead to an increase in program funding needed to maintain the number of households served by the program if formerly oversubsidized households withdraw from the programs and are replaced by households with incomes still lower than theirs.

Background

Third-party program administrators, including public housing agencies (PHAs), public and private project owners, and contracted management agents, administer HUD's rental housing assistance programs on HUD's behalf. Eligible tenants are generally required to pay up to 30 percent of their

¹ Published in the *Federal Register* as a final rule on January 27, 2009. 74 Fed. Reg. 4832.

² General requirements for assessing costs and benefits in an RIA were first introduced in Executive Order 12291, "Federal Regulation" (February 17, 1981). These requirements were revised and reissued as Executive Order 12866, "Regulatory Planning and Review" (October 4, 1993), where they continue to apply.

³ Under contract with HUD, ORC Macro of Calverton, Maryland, conducts an annual quality control study for rental assistance subsidy determinations. The study provides national estimates of the extent, severity, costs, and sources of rent errors for public housing and other assisted housing programs.

income toward shelter costs (rent plus utilities), with HUD providing the balance of the rental payment. New program applicants are required to provide certain information on household characteristics, income, assets, and expenses that are used to determine what rent they should pay. Existing tenants are required to recertify this information annually and sometimes more frequently, when significant changes in household income or composition have occurred.

Applicant or tenant failure to correctly report income may result in HUD's overpayment or underpayment of housing assistance. The failure of the responsible program administrator to correctly interview the tenant or to process, calculate, and bill the tenant's rental assistance may also result in HUD's overpayment or underpayment of housing assistance. After a household income discrepancy is discovered, a PHA may take action to recover the lost rent due to past-unreported income and to prevent further rent payment error. These actions include referral to the HUD Inspector General, termination of housing assistance, rent increases, and rent repayment. If a parallel policy is applied to tenants with overpayment of rent (subsidy underpayments), PHAs would take action to reimburse overpaid rents and adjust future rent payments. Although it is probable that program administrators would move to adjust future rent payments, it is less certain that they would act to cover subsidy underpayment by reimbursing overcharged tenants or to recover the lost rent payment due to past-unreported income. It is, therefore, not known how much of the past subsidy error can be corrected.

This analysis does not consider tenants' reactions to changes in individual subsidy levels caused by the rule. For example, in the case of a household's termination or departure from the housing program, we do not know whether the PHA can or will accept a new tenant in a timely manner. Also, when a new tenant is accepted, we do not know if the new tenant will pay a higher or lower rent. If most newly admitted tenants pay lower rents, this scenario could lead to an increase in subsidy needs. This article assumes that any oversubsidy eliminated by the rule is transferred from oversubsidized tenants to undersubsidized tenants and unsubsidized (new) tenants. If currently oversubsidized tenants whose rents are corrected by the rule subsequently quit the program and are replaced by different tenants, the amount of the subsidy transfer is larger, reducing the number of new tenants.

Using the 2005 QC study data for illustration, under the simplifying assumption that different households do not enter or leave the program because of better income verification, more than \$138 million would be redistributed among assisted households each year if the rule were 100-percent effective in reducing subsidy determination errors related to earned income as found in the 2005 QC study. In addition, \$359 million of rent underpayment associated with unreported or underreported income as detected in the NDNH income matching study would be corrected⁴ if the rule were 100-percent effective.

⁴ The NDNH data are used to identify sources of earned income or unemployment compensation not found during the QC study field data collection process. Adding the new sources of income to the incomes already identified during the QC field data collection and recalculating the household's rent determine the rent underpayment (subsidy overpayment) associated with these new sources of income.

The rule is unlikely to be 100-percent effective. Moreover, as stated previously, correct subsidy determination will change participant households' incentives, and thus the set of households served will remain the same. Although the findings of the yearly QC study are indicative of the source and magnitude of the payment errors, the QC study does not elaborate on the fiscal and economic impact of policies that would eliminate the errors. Various interpretations and conclusions have been drawn from the QC study findings.

Analysis

The final rule mandates the use of Upfront Income Verification (UIV). EIV is a tool of UIV. The mandate is the implementation of UIV, not the use of EIV.⁵ Other tools, such as computer matching agreements with a federal, state, or local government or private agencies or direct requests to federal, state, or local government agencies or private agencies, are suggested under UIV. Notwithstanding, the use of EIV is suggested whenever it is possible because it is free to PHAs. EIV is a sunk cost already supported by HUD.⁶

Successive QC studies report that incorrect income and deduction amounts were by far the most significant sources of errors in determining rents. These research findings reinforce the notion that the full implementation of the process of UVI, including the use of EIV provision of the final rule, would be the primary factor in reducing rent errors due to unreported and underreported household income. The rule is unlikely to achieve the complete elimination of income-related error found in the QC and income matching studies, however. This analysis focuses on earned-income error because it is the only QC income category that does not also include other income types not covered by the EIV System. The transfer amounts associated with 100-percent effectiveness in eliminating earned-income error stand as a proxy for the overall effectiveness of the rule. Although the rule is unlikely to result in 100-percent elimination of earned-income error, it will result in the correction of error from other types of income.

The following paragraphs address the potential effect on the distribution of subsidies among groups of tenants (transfers attributed to the rule) under the assumption that the rule is 100-percent effective in eliminating earned-income-related error.

Because undersubsidized tenants are more likely to stay in assisted housing programs when their rents are reduced by correct accounting of their earned income, the transfer to these tenants under the final rule is likely to amount to the error reduction of \$17 million a year. Because undersubsidy errors are on net smaller than oversubsidy errors, the source of this transfer can be considered oversubsidized tenants.

⁵ Although EIV has been available to Office of Public and Indian Housing program administrators for a number of years, its use has not been required, although it may have contributed to some of the reduction in earned-income-based subsidy errors since 2000.

⁶ HUD estimates that it would cost between \$1 and \$45 per verification if PHAs were to implement their own alternative methods of income verification.

Oversubsidized tenants, of course, are faced with a different incentive when their rents are increased due to correct detection of, and accounting for, their earned income. Many may choose to leave HUD subsidy programs if the (reduced) benefits are outweighed by the costs (of income reporting and other rule compliance). In this case, the \$497 million a year in oversubsidy error represents a minimum transfer (assuming 100-percent effectiveness of the rule in reducing this error) to undersubsidized and unsubsidized tenants who enter the programs (assuming no change in real funding levels), because those tenants leaving the programs would forfeit to new tenants any remaining subsidy they would receive under their corrected rents.

Assuming the rule is 100-percent effective in eliminating earned-income-based rent errors, if no oversubsidized tenants left in response to rent increases based on correct determination of earned income, then the net transfer to new tenants would be about \$480 million a year (\$497 million in underpaid rents from underreported income minus \$17 million in overpaid rents from overreported income), resulting in about 92,000 new tenants served (assuming an average total subsidy per tenant of \$5,091 a year) At the other extreme, if all 337,000⁷ households that were oversubsidized due to earned-income error left HUD-assisted housing in response to rent corrections under the rule, the transfer to new tenants would amount to approximately \$1.72 billion a year (a figure that includes the subsidies they are properly entitled to under the law), resulting in about 337,000⁸ new tenants served, again assuming \$5,091 average annual subsidy cost.

Caveats

A potential exists for improvement in the proper payment of HUD subsidies. Rent errors have been declining due to past HUD actions, but there is less consensus on the size of the potential fiscal or economic impact of corrective action measures available to program administrators. Although it is likely that a program administrator would act to correct future rent payments, it is not certain that PHAs would recover the lost rent payment due to past-unreported income, or how much overpaid subsidy can in fact be recovered from households with rent payment errors. The implementation of the final rule would improve the integrity of the programs and would result in some transfers. It will not necessarily lead to a reduction in subsidy needs, however, and could in fact lead to an increase in program funding to maintain the number of households served.

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⁷ This estimate does not account for any overlap between oversubsidized tenants with QC study earned-income error (212,000) that may also have had underreported income detected in the income match study (125,000). Therefore, it is an overestimate.

⁸ Again, this is likely an upper-bound estimate because new tenants may have incomes even lower than the misreported incomes of formerly oversubsidized tenants, so fewer would be served.

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Additional Reading

ORC Macro. 2006. *Quality Control for Rental Assistance Subsidies Determinations, Final Report for FY 2005*. Washington, DC: U.S. Department of Housing and Urban Development, Office of Policy Development and Research.