NATIONAL AFFORDABLE HOUSING MANAGEMENT ASSOCIATION

400 North Columbus Street
Suite 203
Alexandria, VA 22314
(703) 683-8630
(703) 683-8634 FAX
www.nahma.org

Testimony of J. Kenneth Pagano
House Financial Services Subcommittee on Housing and Community Opportunity
The Impacts of Late Housing Assistance Payments on Tenants and Owners in the Project-Based Rental Assistance Program
October 17, 2007

Thank you, Chairwoman Waters for holding this important hearing to examine the impact of late Housing Assistance Payments (HAPs). Good morning, Ranking Member Capito and members of the Subcommittee.

My name is Ken Pagano, and I am honored to be here today to speak on behalf of the National Affordable Housing Management Association (NAHMA). NAHMA represents management agents and owners involved in federal rental assistance programs. Executives of property management companies, owners of affordable rental housing, public agencies and vendors that serve the affordable housing industry constitute NAHMA's membership. Our members have considerable experience both in developing the properties and in ensuring regulatory compliance. I am also President and CEO of Essex Plaza Management Company, of Newark, New Jersey and President of NAHMA's regional chapter, New Jersey Affordable Housing Management Association (JAHMA).

I would like to begin by commending you, Chairwoman Waters, for the leadership role you have taken on this issue. Today's hearing is a very important step toward reassuring concerned affordable housing professionals, owners and investors that Congress is interested in resolving the serious payment disruptions in the project-based Section 8 program. Thank you for your efforts.

Background

Before I discuss the specifics of how late HAP payments harm affordable properties and our tenants, there are a couple of key background points I would like to emphasize. First, making timely HAP payments to housing providers is a contractual obligation between the federal government and affordable housing providers. HAPs are the contractual rental subsidy payments made by HUD to the owner of a federally-assisted housing unit. These payments make up the difference between 30 percent of a tenant's income and the rent. The most common term for the HAP contract is one year, but there are also multi-year terms. Regardless of the contract length, all HAP renewal contacts are subject to annual appropriations. Secondly, late HAP payments are chronic problems which have plagued affordable housing managers for about the last ten years. The events of this summer, when payments nationwide were delayed for one to three months, were a dramatic and painful example of how badly the system is broken. Thirdly, late HAPs jeopardize the financial and physical health of apartment communities that serve low-income families with few housing options. Ironically, the more low-income tenants a property houses, the more burdened it is by late payments because tenants cannot afford to pay market rents and there are few other ways to increase cash flow. When HAP payments are late, owners and agents must use maintenance funds to make the mortgage payments, meet payroll, pay utilities or other expenses. The final background point I would raise is if owners begin to opt-out of this program and if nervous investors walk away from preservation deals because they've lost faith in the dependability of Section 8 funding, the low-income families who need this housing most will lose it; and the tragedy of this situation will be that it was entirely avoidable.

A Chronic Problem Documented by the Government Accountablity Office (GAO)

Late HAPs are not a new problem. They have presented management challenges for nearly ten years, since contract renewal process under the Mark-to-Market program was implemented.

Thanks to the bipartisan request of Housing and Community Subcommittee Chairwoman Waters, Financial Services Committee Chairman Frank, and the previous Republican leadership of the Financial Services Committee and Housing Subcommittee, the Government Accountability Office (GAO) provided independent, unbiased documentation of the late HAP payment problem. GAO's November 2005 report, "Project-Based Rental Assistance: HUD Should Streamline Its Processes to Ensure Timely Housing Assistance Payments (GAO-06-57)," corroborated much of what the affordable housing industry already knew about late HAP payments from membership surveys and anecdotes. Specifically, late HAPs occur quite frequently, are usually resolved within two weeks of the due date, and are more likely to occur during a contract renewal, mark-to-market, or mark-up-to-market process, and owners receive no advanced warning. It also corroborated our arguments about the damaging toll late subsidy payments have on the operations of affordable properties. GAO noted that some properties are in a better financial position to continue operations until the subsidy arrives; but they also spoke with owners who incurred thousands of dollars worth of penalties for late payments on their mortgages and utility bills which could have been avoided if they had received their subsidy payments on time.

Some of GAO's other key findings included:

- No statutory or regulatory standard exists for HUD's timeliness of subsidy payments to owners.
- "Although HUD has made changes to improve contract administration, it has not comprehensively addressed the factors that most affect the timeliness of payments--that is, its contract renewal and contract funding and monitoring processes."[1]
- HUD's failure to promptly allocate and obligate additional funds to contracts also results in late payments.
    - Some HUD field office staff do not have access to data systems, were not trained to use the systems, or were not trained to monitor funding levels.

[1] See page 31 of the 2005 report.

- o HUD frequently underestimates the amount of money a contract will need when it makes obligations at the beginning of a year.
- o HUD's existing monitoring has failed to prevent payment delays for HAPs that need more obligated funds.

- Local market factors primarily drive opt-out decisions.
- Continuing resolutions should not affect HAP timeliness. (In a GAO report released in April 2007, HUD reversed course and cited CRs as a major cause of late HAPs.)
- HUD has no system for alerting owners about late payments or expected time for resolution.

The report concentrated on HUD's payment processes, with only passing references to Congress' role in the appropriations process and no attention at all to OMB's part in releasing funds to HUD for distribution. This is an important point, because there are still procedural issues which must be addressed even after funding is stabilized. For example, NAHMA believes GAO missed an opportunity to examine the turn-around time for moving appropriated funds from OMB to HUD.

GAO made three recommendations to HUD for improving timeliness of HAP payments,[2] and HUD agreed with all of them.[3] The specific recommendations were that HUD should:

- "Streamline and automate the contract renewal process to prevent processing errors and delays and eliminate paper/hard copy requirements to the extent practicable;"
- "Develop systematic means to better estimate the amounts that should be allocated and obligated to project-based housing assistance payment contracts each year, monitor the ongoing funding needs of each contract, and ensure additional funds are promptly obligated to contracts when necessary to prevent payment delays;" and

[2] See page 32 of the 2005 report.
[3] See pages 37-38 of the 2005 report. The specific HUD comments are found on page 38.

- "Notify owners if their monthly housing assistance payments will be late and include in such notifications the date by which HUD expects to make the monthly payment to the owner."

Much of HUD's hopes for improving its HAP contract renewal process rested on its Business Process Reengineering (BPR) effort, a long-term project intended to improve "inefficient or redundant processes" and to integrate data systems.[4] Unfortunately, the BPR was abandoned due to cost concerns. At the time, however, GAO also pointed out that the BRP was a larger initiative not focused on the HAP payment process, and focusing on this strategy would cost HUD the opportunity to make immediate improvements. GAO proposed,

> "…HUD effectively could prevent many delayed payments by better estimating the amounts it needs to obligate to contracts each year, more systematically monitoring contract funding levels on an ongoing basis, and promptly allocating and obligating additional funding to contracts when necessary."[5]

In April 2007 GAO released another noteworthy report, "Project-Based Rental Assistance: HUD Should Update Its Policies and Procedures to Keep Pace with the Changing Housing Market (GAO-07-290)." This report analyzed contract activity from 2001 to 2005. It focused on the number of opt-outs, which properties were most at-risk, HUD's preservation tools and reasons for the decisions to continue or leave the program. Late HAPs were mentioned in this report, as a source of "HUD fatigue" for owners and management agents which could lead to fewer contract renewals.[6] It is important to note here that while GAO again cited local market conditions as the primary factor in the opt-out decision, they acknowledged that other factors could eventually outweigh purely economic factors.

[4] See page 21 of the 2005 report.
[5] See page 31 of the 2005 report.
[6] See page 28-29 of the 2007 report.

NAHMA agrees with GAO's assessment that market factors are the major factor in an owner's decision to opt out, but we would caution that each of these studies was released prior to the financial chaos project-based Section 8 properties experienced from July through September of 2007. Late HAPs and insufficient contract funding are now an economic consideration.

More importantly, the 2007 GAO report provided compelling documentation about the consequences of late HAP payments:

> "Owners told us that when they did not receive payments on time, they often had to use reserve funds to cover critical operating expenses, leading to cash flow problems. During these periods, some owners delayed needed maintenance to make up for the budget shortfall. For example, we found in our work for this current report that in Baltimore, a nonprofit owner of a project-based Section 8 property for elderly residents delayed critical repairs to the boiler system when the payments were delayed. The owner used reserve funds that should have been used for repairs to cover operating costs. This situation contributed to a lower physical REAC score for the owner because the boiler was in need of repair."[7]

This example is consistent with reports by many NAHMA members who have had to lay-off staff, cut services to residents, miss mortgage payments, make late utility payments or miss payments to site vendors because of late HAP payments.

A Difficult Summer: Late HAP Payments Harmed Affordable Properties and Tenants

The negative impact of late HAPs for properties and tenants were only worsened by the funding crisis of this summer. In one awful situation, a NAHMA member from Louisiana expressed frustration that her property could not take in Katrina evacuees because without the HAP payments, the property could not afford to prepare the vacant units for occupancy.

[7] See page 34 of the 2007 report.

In my own experience as a management agent, the problems with HAP payments this summer have caused a crisis in confidence for owners, investors, and the vendors who service my properties. The cost of operating project-based Section 8 properties has increased as a result of the late HAPs. Despite many years of timely payments, vendors are now asking for upfront deposits, and I've lost discounts because I was not able to pay them on time. Banks as well as vendors are charging late fees. Ironically, no such fee is imposed on HUD for making late HAP payments to the properties in the first place! My properties have paid between 12 to 18 percent late fees on water, sewer and tax payments in New Jersey because HUD did not pay us on time.

Maintenance and services to tenants have also been cut back on my properties due to the funding delays. For example, I've had to cut the hours of the Neighborhood Networks (community learning centers) on the properties. I've also had to defer scheduled work outlined in the mark-to-market process because I needed the money to make debt service payments. I've also had to defer general maintenance and cut back supportive services.

I am also feeling pressure to opt-out from the partners on some of the properties I manage. My owners and limited partners are looking at this situation where their costs are increasing, returns are diminishing and the uncertainty of HAP funding is putting the projects at risk of default on the mortgages. Risks to properties restructured under mark-to-market include default on the first mortgage, as well as inability to make interest payments on the HUD-held second mortgage. The partners are asking me, "Why am I still in this program?" At the same time, they are being approached by investors who would like to convert the properties to condominiums or market rate units.

Additional Lessons from the Summer of 2007

GAO's extensive commentary on HUD's lack of information about the funding needs for these contracts foreshadowed the major funding interruptions affordable housing providers experienced during the forth quarter of 2007. House Appropriations Committee Report (H. Rept. 110-238) to accompany the FY 08 Transportation- HUD bill (HR 3074) was more blunt about its lack of confidence in HUD's budget request for project-based Section 8. Under the heading, Project-Based Rental Assistance Committee Recommendation, the Committee wrote:

> "The Committee is deeply concerned about HUD's inability to calculate the actual funding needs of this program. Based on recent calculations on expiring contracts and the true annual voucher cost, the Department has put the Committee in the difficult position of correcting an undefined, seemingly unlimited shortfall. The Department is either unable or unwilling to report its recaptures in this account and seems to have lost track of its contracts. As this program is based on legal contracts, it seems reasonable that HUD should be able to calculate the true need of this program. The Committee understands that the Department has engaged a contractor to assess the needs of this program and anticipates getting accurate information from this report. The Department is instructed to provide the results of that report to the Committee and to discuss the results within one week of the issuance of the report…"

The report referenced by the House Appropriations Committee is a contract review study that has been underway for some time. It is NAHMA's understanding that this study was supposed to have been completed by the end of last year. Later, we were told this report would be released in the summer of 2007. We are concerned that if Congress waits until the report is finally released to correct the appropriations for project-based Section 8, it may be too late. We respectfully suggest that Congress could use other cost estimates, perhaps from the Congressional Budget Office.

NAHMA and other industry participants believe the funding crisis affordable housing providers experienced during the fourth quarter of FY 2007 was the result of insufficient FY 07 appropriations for project-based Section 8 contract renewals, and failure on the part of HUD and the Office of Management and Budget to submit adequate funding requests to Congress. Our members remain gravely concerned that the Administration has not revised its FY 08 request, which would cut appropriations for project-based Section 8 contract renewals, when the FY 07 appropriations have been clearly insufficient. We are even more puzzled by the fact that the Senate's FY 08 Transportation-HUD Appropriations bill adopted the President's request on the heels of this crisis.

Project-Based Section 8 Contract Renewals: Short-Term Funding Language

At the insistence of HUD's attorneys, the project-based Section 8 HAP contracts now include a new section 2, which allows HUD to obligate funding to owners for a period of time (expressed in months) less than the term of the contract (either one-year or multi-year). For example, the new contract language might state, "HUD is providing $350,000, which is sufficient to fund HAPs for approximately 4 months of the Renewal Contract term." HUD's lawyers believe the new language is necessary to continue providing short-term payments on contracts when funds for the whole term of the contract are insufficient.

Interestingly, HUD has cited the challenges in working out the new language as a cause of this summer's funding interruptions. I would note, however, that many of our members went weeks or months without payment on contracts that were not expired and therefore, would not have been using the new contracts.

The HAP contract forms are available as attachments to the Section 8 Renewal Guide and posted to HUD's website: http://www.hud.gov/offices/hsg/mfh/exp/guide/s8renewpgchg80907.pdf.

The new contracts have already been used to renew contracts that expired in the 4th quarter of FY 2007.

In the case of multi-year contracts, HUD is sending a letter to owners at every anniversary date which will notify owners when HUD does not have sufficient appropriations to make payments for the entirety of the next annual increment, and it is obligating a specified dollar amount to provide HAP payments for a specific number of months in the next annual increment. The letter is also stating HUD will obligate additional funding when appropriations are available and owners will receive written notification "of (i) the amount of such additional funding, and (ii) the approximate period of time within the remaining portion of the annual increment to which it will be applied."

According to HUD, the benefits of the new contract renewal language are two-fold. First, it allows the Department to keep some money flowing to owners when funding for the full contract term is not available. Second, it notifies owners about the status of funding for the contract.

A number of NAHMA members have expressed serious concerns that the new language legally binds them to provide housing under Section 8 rules and rent limitations for a year (or more) with no assurance of payment beyond the months to which HUD commits. While NAHMA agrees that partial funding is better than no funding, we believe the new short-term funding language in the HAP renewal contracts only underscores the importance of fully funding HAP renewals for the full 12 month term (or 12 month annual increments for multi-year contracts). Please put yourself in the position of the management agent who has to explain this new contract language to the property owner—who may already have doubts about whether to continue participating in the project-based Section 8 program.

Requested Congressional Action

Not surprisingly, NAHMA is unequivocal in our position that HAPs must be made to owners on time and in full. NAHMA believes the project based Section 8 program is at a crossroads. The severe payment problems of this summer, combined with HUD's new short-term funding language in Section 8 contracts, the Administration's requested cut for project-based Section 8 contract renewals, and the adoption of this cut in the Senate's FY 2008 Transportation-HUD Appropriations Act are raising questions throughout the affordable housing industry about whether the federal government is truly committed to the project-based Section 8 program--and whether it is worth the risk of participating in the program.

We call on Congress and the Administration to take immediate decisive steps that will restore confidence in this important program and protect the low-income tenants. We respectfully suggest these steps would include:

1. **Stabilizing funding by providing the necessary appropriations to pay the full 12 month increments of HAP contracts;**

   Regardless of whether the Administration submits a revised budget request, we urge Congress to use its own best judgment and increase the funding for project based Section 8 contract renewals to roughly $8 billion. We believe a minimum of $2.2 billion above the Administration's request is necessary to fully fund 12 month contracts in FY 08. Cutting this program--when FY 07 has been proven inadequate--will be disastrous for housing providers and residents.

2. **Addressing any regulatory issues that affect the timeliness of HAP payments;**

   This includes requiring the Administration to submit accurate budgetary information and improving the turn around time on inter-agency and intra-agency processing of these funds.

3. **Increasing protections for vulnerable tenants;**

   We urge Congress to amend the enhanced voucher statute to make these tenant protections available when HAP payments stop for any reason (especially due to the government's failure to pay owners) and also to provide these vouchers to tenants even before the end of a one year notice period.

4. **Requiring HUD to pay owners interest on late HAP payments.**

   Ideally, we believe HUD should pay interest on late HAPs, just as owners must pay late fees on missed mortgage and / or utility payments which result from the late HAP. A precedent exists in the U.S. Treasury Department's prompt payment rule, which assesses late interest charges against federal agencies that pay vendors after a payment due date.

   NAHMA supports a legislative change which would:

   - Require HUD to notify owners when payments will be late;
   - Require HUD to automatically approve releases from reserves when the HAP is 10 days late; and
   - Require HUD to pay interest on late HAP payments to owners after 10 days.

   A copy of this draft legislation follows my testimony.

   I would like to emphasize our preference is to receive HAP payments on time and in full rather than late payments with interest. Unfortunately, NAHMA has come to believe this measure is necessary to create disincentives against chronically late subsidy payments.

<u>Conclusion</u>

Once again, I would like to thank Chairwoman Waters for allowing me to testify this morning. I would be happy to answer any questions from the Subcommittee members.

SEC. ____. CORRECTING HARM CAUSED BY LATE SUBSIDY PAYMENTS.

Section 8 of the United States Housing Act of 1937 (42 U.S.C. 1437f) is amended by adding at the end the following new subsection:

“(ff) LATE PAYMENTS. –

“(1) GENERAL. – The Secretary, or the Secretary’s designee, shall make project-based housing assistance payments under this section each month on or before the due date.

“(2) DUE DATE. – The due date for a monthly payment shall be the first business day of the month.

“(3) NOTIFICATION OF LATE PAYMENT. – The Secretary, or the Secretary’s designee, shall notify a project owner at least 10 days prior to the due date if payment of a housing assistance payment will be late and shall inform the project owner of the approximate date the payment will be made.

“(4) USE OF RESERVES. – If a payment has not been received 10 or more days after the due date, a project owner shall be entitled to obtain funds from a project replacement reserve, residual receipts reserve or other project reserve in order to pay operating and debt service costs.

“(5) INTEREST PAYMENT. – If a monthly payment is not made within 10 days after the due date, the Secretary shall pay simple interest computed from the due date until the date of payment at a rate determined by the Secretary of Treasury in accordance with section 12 of the Contract Disputes Act of 1978 (41 U.S.C. 611).”