



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

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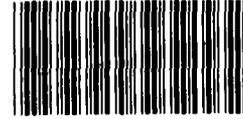
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COMMUNITY AND ECONOMIC  
DEVELOPMENT DIVISION

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JUN 11 1982

Mr. E. S. Savas  
Assistant Secretary for Policy  
Development and Research  
Department of Housing and  
Urban Development



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Dear Mr. Savas:

Subject: Procedures for Adjusting Rents in the Section 8  
Program Need Reexamination

We have made a preliminary review of the procedures the Department of Housing and Urban Development (HUD) follows in making annual rent adjustments under its section 8 program. Our review indicated that present procedures are not sound and could be resulting in greater or lesser amounts being paid in rental subsidies than is justified. The problem stems from the way HUD uses data supplied by the Department of Labor's Bureau of Labor Statistics (BLS). The BLS data represents a nationwide sample of the rental costs used in developing the Consumer Price Index (CPI). Some of this data is not appropriate for HUD purposes without further refinement. We are recommending that HUD reexamine its procedures in cooperation with BLS and develop a more sound and supportable methodology for making rent adjustments.

BACKGROUND

Section 201 of the Housing and Community Development Act of 1974 (Public Law 93-383) authorizing the section 8 program states that section 8 rental assistance contracts shall provide for adjustments annually, or more frequently, of the rents for units covered by the contracts. Such adjustments are to reflect changes in the fair market rentals in the housing area for similar types and sizes of dwelling units. The act allows the Secretary of HUD to make necessary adjustments on the basis of a reasonable formula.

HUD developed a formula approach to adjust section 8 rents and each year develops and publishes in the Federal Register annual rent adjustment factors for selected standard metropolitan statistical areas (SMSAs) and four census regions.

Until the most recent factors were published, they were based on "rent residential" and "fuel and other utilities" components of the housing component of the CPI. For each SMSA and census region

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a single factor was developed for adjusting contract rents, excluding utilities. A matrix of 105 separate factors reflecting differences for various rent ranges and bedroom sizes was developed for adjusting the rents on units, including utilities. The factors, published in January 1982, also included a matrix for the units excluding utilities, and the formula, in addition to the BLS data, included data from the 1978 and 1979 annual housing survey.

Section 8 assistance is substantial and as rents go up so do Federal payments. Direct Federal payments for section 8-assisted households in fiscal year 1981 totaled approximately \$3.1 billion. As of September 30, 1981, approximately 1.1 million units provided shelter for section 8-assisted households. Rent increases on these units increase the Federal payment unless the tenant's income also increases. Tenants' contributions are limited to a percentage of their adjusted income. Most tenants now pay a maximum of 26 percent of their income for rents, but this percentage will be increased gradually to 30 percent by 1986. The Omnibus Budget Reconciliation Act of 1981 raised the tenant contribution to 30 percent of adjusted income.

In addition to having a direct effect on Federal expenditures, the use of automatic adjustment factors or clauses is controversial. In 1978 we opposed the General Services Administration's requirement that escalation clauses be used in all leases. <sup>1/</sup> The use of automatic adjustment clauses in utility rates have attracted critics as well as supporters. Most often, however, these clauses have been criticized as reducing efficiency; being tied to inappropriate indicators; being subject to manipulation; leading to distortions in the relative use of inputs, thus reducing efficiency; and abrogating the utility commissions responsibility.

Congressional concern over the present method used to grant rent increases on section 8 projects was evident in 1981. Because of the high costs of this program, the Congress made a number of changes including the basis for granting rent increases. Section 324 of the Omnibus Budget Reconciliation Act of 1981 limits project rent increases to operating cost increases experienced by comparable dwelling units in the same market area. Where no comparable dwelling units exist in the same market area, the Secretary is authorized to approve rent increases in accordance with the best available data on operating cost increases. HUD is currently reviewing proposed regulations implementing this change which will apply to all new section 8 projects.

#### Objective, Scope and Methodology of GAO Review

Our objective was to determine the reasonableness of HUD procedures for granting rent increases on section 8 housing units.

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<sup>1/</sup>"Use of Escalation Clauses for Operating Costs on all GSA Leases"  
(LCD-78-340, November 13, 1978.)

Our work was focused on how the annual adjustment factors were developed. We reviewed records and held discussions with officials at HUD headquarters to determine the methodology used to develop the annual adjustment factors. We held discussions with officials at BLS headquarters and field offices and reviewed appropriate records to determine whether the use of BLS data to develop the annual adjustment factors was reasonable. Our preliminary review was made in accordance with our current "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

#### PROCESS FOR ADJUSTING RENT IN THE SECTION 8 PROGRAM NEEDS REEXAMINATION

The process HUD uses to develop the annual adjustment factors needs reexamination because the BLS data used to compute the factors is gathered from samples that are not designed to yield precise local estimates. Our review of the BLS sample design indicated that the data as used by HUD to develop factors for local areas could contain sampling errors  $\frac{1}{2}$  so high for some of the areas that the estimates are meaningless from a statistical standpoint, or at least so imprecise that the results may be questionable.

The BLS data HUD uses was gathered with samples designed to show national changes in the residential rent component of the CPI. BLS publishes rent indexes for the Nation, 4 census regions, and 28 SMSAs. The Chief of BLS' headquarters Division of Consumer Statistical Methods and Evaluation Research told us that this data was not designed to yield highly accurate local estimates even though published by BLS. In November 1980 HUD used this data to develop the automatic adjustment factor for 34 SMSAs and 4 census regions. Based upon estimates HUD officials made to us, approximately 50 percent of the section 8 units have the rents adjusted based on the SMSA factors.

#### How BLS Designed the Rent Component Samples

The estimated indexes of rental costs were based on a stratified multistage probability sample. The entire country was divided into primary sampling units. Each large standard metropolitan statistical area (28) constituted its own primary sampling unit. The remaining counties were grouped into contiguous units and each contiguous unit was designated as a primary sampling unit. The units were then stratified into 85 strata based on the following characteristics:

- Percent population increase--1960-70
- Major industry
- Percent nonwhite population
- Percent urban population

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1/Sampling error is a measure of the difference which occurs by chance between sample results and the results that would be obtained by complete coverage.

From each stratum, a single primary sampling unit was selected by a random procedure for inclusion in the CPI survey.

After these steps, a further breakdown occurred. Within each sample unit, probability selection of clusters of year-round housing units (owner and renter) from 1970 Census enumeration district data supplemented for new construction was made. All housing units were then screened to determine tenure (owner or renter). This resulted in 21,000 rental units being in the nationwide survey. It is HUD's use of the local level data from this nationwide survey to produce local estimates of rent increases for section 8 units that we believe is questionable.

#### Problems in HUD's Use of BLS Data

Although BLS has not computed the sampling errors of the regional or local housing component or the rental component of the CPI, estimates BLS officials made to us indicate that these sampling errors could be substantial.

BLS officials in both headquarters and the field expressed concern about the way HUD uses the rent indexes in the section 8 program. The Chief of the Division Consumer Statistical Methods and Evaluations Research raised the question concerning whether HUD was aware of the magnitude of the sampling error in the local statistics. The Chief of the Division of Consumer Prices said that the rent sample is statistically valid for BLS purposes--CPI for the Nation--but that a valid question did exist as to whether the sample is good enough to be used in the section 8 program. The Chief of the Prices Branch at the BLS Chicago Regional Office questioned whether HUD's use of the BLS data was appropriate. She said that the sample size for areas such as Chicago may be too small to use as a local index. She further said that HUD should assess its data needs and then request BLS to determine a sampling methodology that fulfills those needs.

Officials in HUD's Economic and Market Analysis Division who are responsible for developing the automatic adjustment factors said that time constraints and costs contributed to HUD's initial decision to use existing data rather than generating new data for the section 8 program. As a result, it was decided to use BLS rent and utility component data. These officials were not aware of BLS concerns regarding the use of the local rent indexes to develop annual adjustment factors.

In a May 3, 1982, meeting, the Director of the Economic and Market Analysis Division told us that data from local areas is critical for determining rent increases in the section 8 program because housing costs can vary considerably from one locale to another. He said the CPI data is the only data on local areas that is available on a timely basis. He agreed, however, that for some local areas the sampling error rates could be higher than is acceptable. He said that based on our inquiries, discussions had already begun with BLS officials to determine the accuracy of the

BLS data for making local estimates and that these discussions would continue. He further stated that HUD would explore alternatives with BLS to improve the accuracy of the data used to develop rent increase factors for local areas.

#### CONCLUSIONS

The procedures HUD follows in making rent adjustments under the section 8 program need to be carefully reexamined. Some of the BLS data used to develop the annual adjustment factors is not appropriate for HUD's purposes without further refinement. The problem stems from the use of data from a nationwide sample to develop annual adjustment factors for local areas. Our review of the sampling design indicates that using the local data from a nationwide sample to produce local estimates of rent increases could result in sampling errors so high for some areas that the estimates may be meaningless from a statistical standpoint, or at least so imprecise as to be questionable.

The direct impact the annual adjustment factors have on the substantial Federal rental subsidies paid under the section 8 program strongly suggests that HUD should make every reasonable effort to insure the appropriateness and adequacy of the data used to develop the factors.

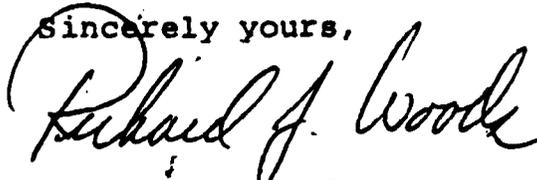
#### RECOMMENDATION

We recommend that HUD reexamine both its procedures and the data it uses to develop annual rent adjustment factors and, in cooperation with BLS, develop a sound and supportable methodology for making rent adjustments.

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We would appreciate being advised of any corrective action taken on the matter discussed in this report.

Sincerely yours,



Richard J. Woods  
Associate Director

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