

**U.S. Department of Housing and Urban Development
Office of Policy Development and Research**

Regulatory Impact Analysis for the Housing Trust Fund

This memorandum provides a Regulatory Impact Analysis (RIA) for the Department of Housing and Urban Development's rulemaking for the formula allocation of the Housing Trust Fund. This analysis is required under Executive Order 12866 because the rule is part of the implementing regulation for a program expected to have more than \$100 million in annual funding, thereby having an economic impact exceeding the threshold.

I. Summary of the Housing Trust Fund

The Housing and Economic Recovery Act of 2008 (HERA) authorized a new Housing Trust Fund (HTF) by adding Section 1338 to the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4501 *et seq.*) (FHEFSSA). The law provides that the purpose of the Housing Trust Fund is to provide grants to States for use (A) to increase and preserve the supply of rental housing for extremely low- and very low-income families, including homeless families; and (B) to increase homeownership for extremely low- and very low-income families.

Section 1338(c) directs HUD to establish, by a regulation the formula for the purpose of providing affordable housing to extremely low- and very low-income households. The subject proposed rule commences the process to meet the deadline established in section 1338(c). HUD proposes to codify the regulations for the Housing Trust Fund in a new part 93 of title 24 of the Code of Federal Regulations. Further, HUD intends to implement the Housing Trust Fund through two separate rulemakings. The proposed rule would establish new 24 CFR part 93, and codify the formula for grant allocations under the Housing Trust Fund. A future rulemaking will propose the requirements and procedures governing operation of the Housing Trust Fund.

The HTF is statutorily targeted to primarily assist extremely low-income households: 75 percent of the funds used to increase or preserve rental housing must serve households below 30 percent of the area median income (i.e., extremely low-income households) and the remaining 25 percent must serve households below 50 percent of the area median income (i.e., very low-income households). No more than 10 percent of the funds may be used to increase homeownership and up to 10 percent of the funds may be used to pay for administrative costs. Although Congress has not appropriated funds for the HTF to date, Section 1338(c) of FHEFSSA requires HUD to implement the program, including proposing and finalizing regulations for allocating the funds according to the statutory formula, within 12 months of enactment on July 30, 2008.

The economic impact of HTF consists of a transfer from the taxpayer, through State governments, to extremely low and very low-income families. By expanding and preserving the supply of housing and lowering financial barriers to homeownership, the HTF will reduce the housing costs of extremely low and very-low income families, and thus raise the consumer surplus of the program's beneficiaries.

II. Proposed Allocation Formula

The HTF formula is based on Sec. 1338(c)(3) of FHEFSSA, as amended by HERA. The law provides that allocations for the 50 States, District of Columbia, the Commonwealth of Puerto Rico, and the Insular Areas are to be based on four housing needs factors and a construction cost adjustment factor. However, the data from readily available standardized data sources for the Insular Areas differ from those available from those sources for the 50 states, the Commonwealth of Puerto Rico, and the District of Columbia. Therefore, a separate allocation process for Insular Areas had to be proposed and is explained below. Except for the Insular Areas, each of the four factors is expressed as a ratio of the state relative to the nation. There is a statutory minimum allocation of \$3,000,000 to each of the 50 States and the District of Columbia.

HUD proposes to determine HTF allocations using the following process.

- 1) Determine allocations to Insular Areas based on the proportion of renters that reside in those areas relative to the sum of all renters in Insular Areas, the U.S. and the Commonwealth of Puerto Rico.
- 2) Determine allocations to the 50 States, Washington, DC, and the Commonwealth of Puerto Rico using the statutory formula, with these steps:
 - a) Estimate the relative level of housing needs using the statutory housing needs factors as interpreted by HUD:

Factor 1: Shortage of ELI rental units. The ratio of the shortage of standard rental units both affordable and available to extremely low-income (ELI) renter households in the State to the aggregate shortage of standard rental units both affordable and available to ELI renter households in all the States.¹ In each case, the shortage is the mathematical difference between the number of ELI renter households and the number of ELI-affordable rental units that either are currently occupied by ELI households or are vacant and available at affordable rents.

Factor 2: Shortage of VLI rental units. The ratio of the shortage of standard rental units both affordable and available to very low income (VLI) renter households in the State to the aggregate shortage of standard rental units both affordable and available to VLI renter households in all the States.² In each case, the shortage is the mathematical difference between the number of renter households with incomes 30-50 percent of area median and the number of affordable rental units that either are currently occupied by households in this income range or are vacant and available at rents affordable at this income range.

Factor 3: Housing problems of ELI renters. The ratio of the ELI renter households in the State living with (i) incomplete kitchen or plumbing facilities, or (ii) having more than one person per room, or (iii) paying more than 50 percent of

¹ ELI renter households are those whose income does not exceed 30 percent of area median income, with adjustments for family size. Affordable units are those with a rent that is not in excess of 30 percent of household income.

² VLI renter households are those whose income does not exceed 50 percent of area median income, with adjustments for family size. Affordable units are those with a rent that is not in excess of 30 percent of household income.

income for housing costs, to the aggregate number of ELI renter households having those respective characteristics in the U.S.

Factor 4: Severe cost burdens of VLI renters. The ratio of the VLI renter households in the State paying more than 50 percent of income on rent relative to the aggregate number of VLI renter households paying more than 50 percent of income on rent in all States.

- b) Weight the four housing needs factors, assigning a weight of 50.0 percent to Factor 1, 12.5 percent to Factor 2, 25.0 percent to Factor 3, and 12.5 percent to Factor 4. The two factors addressing needs of extremely low-income households, Factors 1 and 3, thus have a combined weight of 75 percent in keeping with statutory targeting of funds.
- c) Determine initial allocations by multiplying the amount of appropriation remaining after the Insular Areas allocation by the weighted factors.
- d) Determine cost-adjusted initial allocations by multiplying initial allocations by a construction cost adjustment factor that is developed as follows:
 - 1) Use R.S. Means construction cost data, which are available for selected cities in each State.
 - 2) Calculate a weighted average construction cost for each State, where the construction cost of each sampled city is weighted by the city's share of the State's population.
 - 3) Calculate relative construction cost estimates for each state by dividing the State's average cost by the overall average of state average costs.
- e) Determine final state allocations by increasing cost-adjusted initial allocations to a statutory minimum of \$3,000,000 where necessary, and reallocating the remaining funds in proportion to cost-adjusted initial allocations.

Sample allocations for States and Insular Areas based on the above method using a special tabulation of 2000 Census Data, assuming a hypothetical \$1 billion appropriation, are as follows:

Alabama	\$8,720,107	Nevada	\$7,931,973
Alaska	\$3,000,000	New Hampshire	\$3,198,815
Arizona	\$15,014,513	New Jersey	\$34,238,242
Arkansas	\$5,729,332	New Mexico	\$4,706,454
California	\$181,347,211	New York	\$141,142,794
Colorado	\$13,813,907	North Carolina	\$18,216,583
Connecticut	\$13,346,005	North Dakota	\$3,000,000
Delaware	\$3,000,000	Ohio	\$31,034,016
District of Columbia	\$4,690,762	Oklahoma	\$7,540,209
Florida	\$46,280,204	Oregon	\$14,004,222
Georgia	\$19,490,039	Pennsylvania	\$36,786,929
Hawaii	\$6,278,329	Rhode Island	\$5,133,920
Idaho	\$3,000,000	South Carolina	\$8,007,699
Illinois	\$46,493,749	South Dakota	\$3,000,000
Indiana	\$14,230,848	Tennessee	\$12,199,762
Iowa	\$5,804,727	Texas	\$56,210,923
Kansas	\$5,417,514	Utah	\$4,274,613
Kentucky	\$9,330,790	Vermont	\$3,000,000
Louisiana	\$12,780,191	Virginia	\$19,637,925
Maine	\$3,204,713	Washington	\$22,874,429
Maryland	\$13,935,155	West Virginia	\$4,453,347
Massachusetts	\$28,702,725	Wisconsin	\$15,750,514
Michigan	\$26,051,930	Wyoming	\$3,000,000
Minnesota	\$13,690,638	Puerto Rico	\$9,194,290
Mississippi	\$6,008,713	American Samoa	\$59,069
Missouri	\$13,755,977	Guam	\$555,248
Montana	\$3,000,000	Northern Marianas	\$263,620
Nebraska	\$3,857,056	Virgin Islands	\$609,270

Data Inadequacy and Insular Areas Allocations

HERA provides that the HTF will provide allocations to the Insular Areas: American Samoa, Guam, the Northern Marianas Islands, and the Virgin Islands. However, HUD determined that the data that would be needed to make allocations to these areas using the four formula factors do not exist in detail comparable to the 50 States, District of Columbia and Puerto Rico. In particular, neither the long-form decennial Census nor the American Community Survey data would enable HUD to determine the number of households in extremely low- and very low-income categories and the number of housing units affordable to these households in these income categories.³

³ The Government Accountability Office recently examined the adequacy of the two major data sources that potentially could address insular areas, the Current Population Survey and the American Community Survey, in a review of data adequacy for the Medicaid program. GAO concluded that CPS and ACS data are not available for the insular areas except for Puerto Rico. Options to update demographic information for the other four insular areas between decennial censuses are to fund the Census Bureau to “implement survey programs to collect demographic, socioeconomic, and housing data” or to “update certain demographic data through its Population

As mentioned above, HUD resolved the data limitation by adopting a more basic assessment of housing need in Insular Areas compared with the entire country: the percentage of renters residing in Insular Areas relative to the sum of all renters in Insular Areas, the U.S. and Puerto Rico.

The small shares of renters residing in Insular Areas (0.01 percent in American Samoa, 0.06 percent in Guam, 0.03 percent in the Northern Marianas, and 0.06 percent in the Virgin Islands) make the Insular Area allocations insignificant for the purposes of this rule. Aggregate allocations for Insular Areas total \$1.487 million for a hypothetical \$1.0 billion appropriation. For comparison purposes, the Insular Areas receive \$3.65 million out of the \$1.825 billion FY 2009 HOME Investment Partnerships Program appropriation.

III. Assessing Effects of HUD's Discretionary Choices in Defining the Allocation Formula

In developing the Housing Trust Fund allocation formula, HUD tested several alternatives to determine to what extent the resulting economic outcomes are sensitive to modest discretionary choices. None of the discretionary choices have any impact on Insular Areas.

The Department proposes to assign Factor 1 (shortage of ELI rental units) with 50 percent of the total weight. By further giving a 25 percent weight to Factor 3 (housing problems of ELI renters), the weights will correspond with the statute's 75 percent requirement for targeting rental housing funds toward extremely low-income households. HUD proposes equal weights of 12.5 percent for Factor 2 (shortage of very low-income units) and Factor 4 (severe cost burdens of very low-income renters). The Department's proposed allocation formula can be considered to use a 50-12.5-25-12.5 weighting approach for the four factors, and produces the allocations shown in the table below.

To examine the importance of this weighting for allocation outcomes, HUD also ran the allocation formula with alternative weight structures. The first alternative was to retain the 50 percent priority weight for Factor 1 but remove the overweighting of Factor 3 so that it equals Factors 2 and 4, resulting in a 50-16.7-16.7-16.7 structure. HUD also tested two additional levels of preference for Factor 1, one applying a weight 10 percentage points below and the other 10 points above the proposed 50 percent value. Both of these alternatives provide equal weights for the other factors.

Alternative 1: 50-16.7-16.7-16.7 weights. Relative to the proposed formula's 50-12.5-25-12.5 weighting, removing the additional preference for Factor 3 has distributional impacts. Under a \$1 billion total appropriation and using Census 2000 data⁴, the alternative 50-16.7-16.7-16.7 formula structure would provide additional benefits (substantially) exceeding \$500,000 to the large states of California and Florida, and reductions of \$500,000 or more would occur for New York, Illinois, Ohio, and Michigan. Overall, 15 states would gain, while

Estimates Program." These approaches are unsatisfactory for HUD's needs for allocating HTF to insular areas, because of the excessive cost and delay in the former case and the lack of housing needs data in the latter case. GAO-09-558R (June 2009) "Federal Medicaid and CHIP Funding in the U.S. Insular Areas."

⁴ The Department expects that for allocating funds expected to be appropriated for FY 2010, it would use a special tabulation of 3-year average American Community Survey data. The special tabulation was not yet available for this analysis.

29 states would lose, although for 27 states the change would be less than 1 percent from the proposed allocation.

Alternative 2: 40-20-20-20 weights. Without the overweighting of Factor 3, the two weighting alternatives for Factor 1 —10 points higher or 10 points lower—do not produce the roughly symmetrical gains or losses that might be anticipated for any given State. Notably, California and Florida would benefit relative to the proposed rule whether the Factor 1 prioritization were stronger or weaker. Overall, reducing the weight of Factor 1 through the 40-20-20-20 structure has a result similar to that of eliminating the Factor 3 overweight, but with slightly more concentrated impacts. The number of gainers (20) and losers (25) is more even, but the average gain and average loss are both greater, primarily because of a large gain by California and a large loss by New York.

Alternative 3: 60-13.3-13.3-13.3 weights. Compared with the first and second alternatives, increasing the weight of Factor 1 to 60 percent in the 60-13.3-13.3-13.3 approach produces smaller changes in allocations relative to the proposed formula. The 13 states that gain would receive an average of \$359,000 more in their allocations, while the 31 states that lose would average \$150,000 less. A significant gain by California makes it the single major outlier under this alternative.

IV. Selection of Alternative for Proposed Rule

In eliminating the alternatives discussed above, HUD's decision is complicated by the fact that California and New York both are large states with high levels of housing needs under various formula factors, and yet differ in which factor has the higher need. Differing structures of needs mean that these states benefit most from different formulas. Further, formula choices that differentially affect allocations to California or New York have secondary effects on allocations to other states that may not be directly affected by the formula choice. The proposed formula strikes a balance between these competing priorities.

HUD's analysis of the sensitivity of State allocations to various prioritizations of the needs of extremely low-income renters under Factor 1 and Factor 3 revealed that about half of the States are not affected greatly by any of the weighting alternatives, as 23-30 states experiencing changes of less than 1 percent. For larger states, effects tend to be more pronounced, yet only rarely exceeding 3 percent relative to HUD's proposed formula. HUD concludes that providing priority weighting for both ELI factors in the proposed 50-12.5-25-12.5 structure accommodates states for which ELI needs take different forms, while responding as closely as feasible to the statutory requirement that 75 percent of rental assistance funds provided by the HTF should serve ELI households.

V. Summary of Impacts

As noted above, the statute is very specific about the factors to be used in the formula and different weighting schemes have only modest impact on allocation grants. The largest impact on allocation grants is the amount made available for the program. Under current statute, the Housing Trust Fund would be funded through profits from the Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac. Currently those agencies do not

have profits so for the FY 2010 HUD budget request to Congress, the President requested that \$1 billion be appropriated for the program as a transfer from the federal government to state governments. The direct federal cost of the program will be the amount eventually provided by Congress.

No rule currently exists for the Housing Trust Fund. The Housing Trust Fund is a new program created in the Housing and Economic Recovery Act of 2008. Failure to create a rule would be in violation of the Act. There is no alternative to this regulation.

This rule provides the details for the methodology on how funds made available for the Housing Trust Fund will be distributed to states. The funds will be used to support the development of primarily rental housing affordable to households with incomes at or below 30 percent of area median income adjusted for family size. The formula in this rule is intended to target funds primarily to states with a shortage of rental housing affordable to extremely low-income households. Specifically, this program provides funding to add supply to market places where there is strong evidence of inadequate supply. This program represents a strong complement to the demand side program, the Housing Choice Voucher program, which provides a tenant based subsidy for primarily extremely low-income households to afford existing privately owned rental housing. The limitation of the Housing Choice Voucher program is that it does not work well in markets where there is inadequate housing supply⁵, a problem sought to be addressed through careful targeting of housing trust fund dollars in this rule to markets with inadequate supply.

The primary benefits of the Housing Trust Fund are expected to be similar to the Housing Choice Voucher program. The “Effects of Housing Vouchers” random assignment evaluation of the impact of receiving a housing voucher versus not receiving a housing voucher showed the primary benefit of housing assistance programs to be reducing homelessness and doubling up among extremely low income families.⁶ Thus, the primary benefit of the program against no funding or funding without targeting will be to reduce the number of homeless families and individuals in relatively tight housing markets.

⁵ Finkel, Meryl and Larry Buron. Study on Section 8 Voucher Success Rates Volume I: Quantitative Study of Success Rates in Metropolitan Areas, U.S. Department of Housing and Urban Development, November 2001.

⁶ Mills, Gregory, et al. Effects of Housing Vouchers on Welfare Families, U.S. Department of Housing and Urban Development, September 2006.