
**DEPARTMENT OF HOUSING AND
URBAN DEVELOPMENT**
24 CFR Parts 888, 982, 983, and 985

[Docket No. FR-5855-F-03]

RIN 2501-AD74

Establishing a More Effective Fair Market Rent System; Using Small Area Fair Market Rents in the Housing Choice Voucher Program Instead of the Current 50th Percentile FMRs**AGENCY:** Office of the Secretary, HUD.**ACTION:** Final rule.

SUMMARY: This final rule applies the use of Small Area Fair Market Rents (Small Area FMRs) in the administration of the Housing Choice Voucher (HCV) program for certain metropolitan areas. This final rule provides for the use of Small Area FMRs, in place of the 50th percentile rent, the currently codified regulations, to address high levels of voucher concentration in certain communities. The use of Small Area FMRs is expected to give HCV tenants access to areas of high opportunity and lower poverty areas by providing a subsidy that is adequate to cover rents in those areas, thereby reducing the number of voucher families that reside in areas of high poverty concentration.

DATES: *Effective:* January 17, 2017.

FOR FURTHER INFORMATION CONTACT: For information about this rule, contact Peter B. Kahn, Director, Economic and Market Analysis Division, Office of Economic Affairs, Office of Policy Development and Research, U.S. Department of Housing and Urban Development, 451 7th Street SW., Washington, DC 20410, telephone (202) 402-2409 or Becky L. Primeaux, Director, Housing Voucher Management and Operations Division, U.S. Department of Housing and Urban Development, 451 7th Street SW., Washington, DC 20410, telephone (202) 708-0477; email: SAFMR_Rule@hud.gov. The listed telephone numbers are not toll-free numbers. Persons with hearing or speech impairments may access this number through TTY by calling Federal Relay Service at (800) 877-8339 (this is a toll-free number).

SUPPLEMENTARY INFORMATION: Under this final rule, public housing agencies

(PHAs) operating in designated metropolitan areas are required to use Small Area FMRs, while PHAs not operating in the designated areas have the option to use Small Area FMRs in administering their HCV programs. Other programs that use FMRs would continue to use area-wide FMRs. This final rule also provides for regulatory implementation of certain provisions of the Housing Opportunity Through Modernization Act (HOTMA) related to FMRs, as well as conforming regulatory changes to part 982 concerning the reduction in payment standards during the term of the Housing Assistance Payment (HAP) contract in the HCV program. Specifically, the final rule provides for publication of FMRs by way of the World Wide Web, and provides that PHAs are no longer required to reduce the payment standard for a family under HAP contract when the PHA is required to reduce the payment standard for its program as the result of a reduction in the FMR.

I. Executive Summary*A. Purpose of the Regulatory Action*

This final rule establishes a more effective means for HCV tenants to move into areas of higher opportunity and lower poverty by providing the tenants with a subsidy adequate to make such areas accessible and, consequently, help reduce the number of voucher families that reside in areas of high poverty concentration. Prior to this rule, subsidy for HUD's HCV program is determined by a formula that considers rent prices across an entire metropolitan area. However, rents can vary widely within a metropolitan area depending upon the size of the metropolitan area and the neighborhood in the metropolitan area within which one resides. The result of determining rents on the basis of an entire metropolitan area is that a voucher subsidy may be too high or may be too low to cover market rent in a given neighborhood. To date, HUD's policy for addressing high concentrations of voucher holders raises the level of the FMR from the 40th percentile to the 50th percentile (roughly a 7–8 percent increase) in the whole FMR area. This level of added subsidy has not been targeted to areas of opportunity, and consequently, this formula has not proven effective in addressing the problem of concentrated poverty and economic and racial segregation in neighborhoods. Experience with the 50th percentile regime has shown that the majority of HCV tenants use their vouchers in neighborhoods where rents are low but

poverty is generally high. Small Area FMRs will complement HUD's other efforts to support households in making informed choices about units and neighborhoods with the goal of increasing the share of households that choose to use their vouchers in low poverty opportunity areas.

This rule provides that in lieu of determining rents on the basis of an entire metropolitan area, rents will be determined on the basis of ZIP codes for those metropolitan areas with both significant voucher concentration challenges and market conditions where establishing FMRs by ZIP code areas has the potential to significantly increase opportunities for voucher families. ZIP codes are small enough to reflect neighborhood differences and provide an easier method of comparing rents within one ZIP code to another ZIP code area within a metropolitan area. Based on early evidence from PHAs using Small Area FMRs that are in place in certain metropolitan areas in the U.S., HUD believes that Small Area FMRs are more effective in helping families move to areas of higher opportunity and lower poverty.

B. Summary of the Major Provisions of the Regulatory Action

The major provisions of this final rule are set out in two sections: (1) Those that were in the proposed rule and retained at the final rule; and (2) those that were revised at the final rule or are new provisions at the final rule stage, developed in response to public comment: The major provisions are as follows:

1. Major Provisions at the Proposed Rule Stage Retained by This Final Rule

- Defines Small Area FMR areas as the U.S. Postal Service ZIP code areas within a designated metropolitan area.
- Provides for criteria by which Small Area FMRs will be set. Small Area FMRs will be set for metropolitan areas where the area includes the following criteria: number of HCVs under lease (initially, 2,500 or more); the standard quality rental stock, within the metropolitan area, that is in small areas (that is ZIP codes) where the Small Area FMR is more than 110 percent of the metropolitan FMR (initially 20 percent or more); and the percentage of voucher holders living in concentrated low-income areas relative to all renters within these areas over the entire metropolitan area exceeds a specified threshold (initially 1.55). (This final rule also adopts additional criteria for setting Small Area FMRs for a metropolitan area, see below.)

- Defines "concentrated low-income areas" to mean those census tracts in the metropolitan FMR area with a poverty rate of 25 percent or more; or any tract in the metropolitan FMR area where 50 percent or more of the households earn incomes at less than 60 percent of the area median income (AMI) and are designated as Qualified Census Tracts in accordance with section 42 of the Internal Revenue Code (26 U.S.C. 42).

- Provides for designation of Small Area FMR areas at the beginning of a Federal fiscal year and makes additional area designations every 5 years thereafter as new data becomes available.

- Requires if a metropolitan area meets the criteria for application of Small Area FMRs, that all PHAs administering HCV programs in that area will be required to use Small Area FMRs.

- Provides that a PHA that is administering an HCV program in a metropolitan area that is not subject to application of Small Area FMRs may opt to use Small Area FMRs by seeking approval of HUD's Office of Public and Indian Housing through written request to such office.

- For all rent determinations of FMRs, 40th percentile or Small Area FMRs, replaces "the most recent decennial census" with the "most recent American Community Survey conducted by the U.S. Census Bureau."

- Provides that metropolitan areas with FMRs set at the 50th percentile rent will transition to either (1) the 40th percentile rent at the expiration of the 3-year period for the 50th percentile rent, or (2) designation as a Small Area FMR area in accordance with the criteria for determining a Small Area FMR area.

- Provides that a PHA with jurisdiction in a 50th percentile FMR area that reverts to the standard 40th percentile FMR may request HUD approval of payment standard amounts based on the 50th percentile rent in accordance with the regulations in 24 CFR 982.503(f) that are changed by this final rule. PHAs, however, would be required to continue to meet the provisions of 24 CFR 982.503(f) annually in order to maintain payment standards based on 50th percentile rents.

- Removes the existing regulations at 24 CFR 888.113 that provide for FMRs to be set at the 50th percentile rent. However, for areas not selected for implementation of Small Area FMRs, the final rule does not revoke any FMR currently set at the 50th percentile rent, and for which the current 3-year term

for retaining a 50th percentile rent has not expired.

2. Major Provisions—New Provisions or Changes Made at Final Rule Stage

- Confirms the regulations at § 982.505(c)(3) with the portion of section 107 of the Housing Through Opportunity Modernization Act (HOTMA), Public Law 114–201, which provides PHAs with the option to hold families under a Housing Assistance Payments (HAP) contract harmless from payment standard reductions that are currently required at the family's second annual recertification if the family's payment standard falls outside of the basic range as the result of a decrease in FMRs (including a decrease in FMR attributable to the implementation of Small Area FMRs). As an additional protection, the final rule provides that should a PHA choose not to hold the payment standard at its current level for families under HAP contract in an area experiencing a payment standard reduction, the PHA may set the payment standard for families that remain under HAP contract at any amount between the current payment standard and new normally applicable payment standard amount, and may further reduce the payment standard for families under HAP contract over time to gradually bring the family's payment standard down to payment standard that is normally applicable to the area for the PHA's program or reduce the gap between the two payment standards. The rule further extends these same flexibilities to the PHA in cases where the payment standard decrease is not the result of a FMR decrease.

The rule further provides that if the PHA chooses to apply a reduction in the payment standard to the family's subsidy calculation during the HAP contract term, the earliest the PHA may implement the initial reduction in the payment standard is the second regular reexamination following the effective date of the decrease in the payment standard amount. Section 107 of HOTMA also provides new requirements for publishing HUD's FMRs.

- Additional criteria by which Small Area FMRs will be set.

- Adds the vacancy rate of an area as a criterion to the selection parameters for Small Area FMRs. The vacancy rate will be calculated in the following manner: Using data from the 1-year American Community Survey (ACS) tabulations, the vacancy rate is the number of Vacant For Rent Units divided by the sum of the number of Vacant For Rent Units, the number of Renter Occupied Units, and the number

of Rented, not occupied units. The vacancy rate will be calculated from the 3 most current ACS 1 year datasets available and average the 3 values. Initially, this threshold will be set at 4 percent, meaning areas designated for Small Area FMRs must have vacancy rates higher than 4 percent.

- Adds an additional requirement to the voucher concentration ratio included in the proposed rule. In addition to requiring the ratio of the proportion of voucher tenants in concentrated low-income areas (CLIAs) to the proportion of renter occupied units in CLIAs to exceed a minimum threshold (initially 155 percent), the final rule requires that the numerator of the ratio (the proportion of voucher tenants in CLIAs) meet or exceed a minimum threshold. Initially, this threshold will be set at 25 percent.

- Exempts all project-based vouchers from required application of Small Area FMRs but allows a PHA operating under the Small Area FMRs for its tenant-based program to apply Small Area FMRs to future PBV projects (and to current PBV projects provided the owner mutually agrees to the change).

- Provides that a PHA's selection to use Small Area FMRs for PBVs would not require HUD approval but should be undertaken in accordance with guidance issued by HUD and indicated in the PHA's administrative plan.

- Rather than codify both the selection criteria and the selection values in the regulatory text as in the proposed rule, the final rule codifies the selection criteria in the regulatory text, but does not codify the selection values in the regulatory text. The selection values for the first round of Small Area FMR areas is announced in a separate notice published in today's **Federal Register**. The selection values for future designations of Small Area FMR areas will be made available for public comment via **Federal Register** notice before HUD selects additional areas to be designated as Small Area FMR Areas.

- Makes two changes to the exception payment standard requirements in response to public comments:

- PHAs not operating in Small Area FMR designated areas may establish exception payment standards for a ZIP code area of up to 110 percent of the relevant Small Area FMR by notifying HUD; and

- The 50 percent population cap (24 CFR 982.503(c)(5)) will not be applicable to Exception Payment Standards in Small Area FMR areas.

- Exempts manufactured home space rental from Small Area FMRs.

- Provides that PHAs have up to three months from the date when the new

FMRs go into effect in which to update their payment standards if a change is necessary to fall within the basic range of new FMRs. For example, if the new FMR went into effect on October 1, 2017, the PHA would need to update their payment standard if necessary to fall within the basic range of the new FMRs no later than January 1, 2018.

- Provides HUD may suspend a Small Area FMR designation for a metropolitan area, including at the request of a PHA, where HUD determines such action is warranted based on a documented finding of adverse rental housing market conditions that will be set out by notice (for example, the metropolitan area experiences a significant loss of housing units as a result of a natural disaster).

- Provides that HUD may provide an exception payment standard for a PHA administering the HCV program under Small Area FMRs for an entire ZIP Code area in accordance with the conditions and procedures provided by notice in the **Federal Register**. The requirements at § 982.503(c) do not apply to these exception payment standard requests.

C. Costs and Benefits

The main benefit of the final rule is that, through setting rental subsidy amounts at a more local level, assisted households will be more able to afford homes in areas of high opportunity than under current policy. Such moves are expected to benefit both individual households, for example, through access to better schools or safer neighborhoods, and areas as a whole through reducing concentrated neighborhood poverty. Other benefits could arise through the reduction of overpayment of rent in areas where the neighborhood rent is below the metropolitan average. Early evidence from current Small Area FMR locations suggests that there could be per-voucher cost decreases relative to 50th percentile rents, depending on the choices made by tenants. Evidence also suggests that families moved to better neighborhoods with higher rents, although not greatly in excess of the metropolitan FMR, which resulted in no overall program cost increases.¹ Finally, the final rule eliminates the year to year volatility of some areas changing to and from 50th percentile FMRs.

Potential costs of the final rule include the administrative expenses associated with implementation on the part of PHAs. Additionally, if there are barriers to households moving to areas

of higher opportunity beyond housing costs, such as transportation expenses or social factors, assisted households might be worse off if they can no longer afford their current units in their neighborhoods. This may be particularly true for elderly families or families with a disabled member; however, HUD regulations allow PHAs wide latitude in setting payments standards for disabled tenants as "reasonable accommodations" of their disabilities. Finally, if the long-term impacts of the final rule cause per-voucher costs to rise, fewer households would receive assistance without an overall increase in program funds.

II. Background

The Housing Choice Voucher Program and Fair Market Rents

HUD's HCV program helps low-income households obtain standard rental housing and reduces the share of their income that goes toward rent. Vouchers issued under the HCV program provide subsidies that allow individuals and families to rent eligible units in the private market. A key parameter in operating the HCV program is the FMR. In general, the FMR for an area is the amount that would be needed to pay the gross rent (shelter rent plus utilities) of privately owned, decent, and safe rental housing of a modest (non-luxury) nature with suitable amenities. In addition, all rents subsidized under the HCV program must meet rent reasonableness standards. Rent reasonableness is determined by PHAs with reference to rents for comparable unassisted units.

In the HCV program, the FMR is the basis for determining the "payment standard amount" used to calculate the maximum monthly subsidy for a voucher household (see § 982.503). PHAs may establish payment standards between 90 and 110 percent of the FMR.² HCV program households receive a housing assistance payment equal to the difference between the lower of the gross rent of the unit or the payment standard established by the PHAs and the family's Total Tenant Payment (TTP), which is generally 30 percent of the household's adjusted monthly income. Participants in the voucher program can choose to live in units with gross rents higher than the payment standard, but would be required to pay the full cost of the difference between the gross rent and the payment standard, in addition to their TTP.

¹ Please see Collinson and Ganong, "The Incidence of Housing Voucher Generosity", available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2255799.

² Moving to Work (MTW) agencies have the authority to waive § 982.503 and can propose, for HUD approval, alternate rent policies in their Annual MTW Plan.

Please note that at initial occupancy the family's share cannot exceed 40 percent of adjusted monthly income.

HUD establishes FMRs for different geographic areas. Because payment standards are based on FMRs, housing assistance payments on behalf of the voucher household are limited by the geographic area in which the voucher household resides. HUD calculates FMRs for all nonmetropolitan counties and metropolitan areas. To date, the same FMR is applicable throughout a nonmetropolitan county or metropolitan area, which generally is comprised of several metropolitan counties. FMRs in a metropolitan area (Metropolitan FMR) represent the 40th percentile (or in special circumstances the 50th percentile) gross rent for typical non-luxury, non-substandard rental units occupied by recent movers in a local housing market.³

As noted earlier, HUD regulations have allowed a PHA to set a payment standard between 90 percent and 110 percent (inclusive) of the FMR. PHAs may determine that payment standards that are higher than 110 percent, or lower than 90 percent, are appropriate for subareas of their market; in this instance, a PHA would request HUD approval for a payment standard below 90 percent or an exception payment standard above 110 percent. The total population of a HUD-approved exception payment area (*i.e.*, an area covered by a payment standard that exceeds 110 percent of the FMR) may not include more than 50 percent of the population of the FMR area (see § 982.503).

On October 2, 2000, at 65 FR 58870, HUD published a rule (2000 rule) establishing policy, currently in HUD's codified regulations, to set FMRs at the 50th percentile for "areas where higher FMRs are needed to help families, assisted under HUD's program as well as other HUD programs, find and lease decent and affordable housing." This policy was put in place to achieve two program objectives: (1) Increase the ability of low-income families to find and lease decent and affordable housing; and (2) provide low-income families with access to a broad range of housing opportunities throughout a metropolitan area. The policy further provides that PHAs that had been authorized to use FMRs set at the 50th percentile rent may later be required to use FMRs set at the 40th percentile rent. This would occur if the FMR were set

at the 50th percentile rent to provide a broad range of housing opportunities throughout a metropolitan area for three years, but the concentration of voucher holders in the metropolitan area did not lessen.

Since HUD established the 50th percentile FMRs 16 years ago, research has emerged⁴ that indicates that 50th percentile FMRs are not an effective tool in increasing HCV tenant moves from areas of low opportunity to higher opportunity areas. Specifically, it appears that much of the benefit of increased FMRs simply accrues to landlords in lower rent submarket areas in the form of higher rents rather than creating an incentive for tenants to move to units in communities with more and/or better opportunities. As provided in HUD's currently codified regulation, to determine the 50th percentile program's effectiveness, HUD must measure the reduction in concentration of HCV tenants (objective 2 above) presumably from high poverty areas, over a 3-year period. If there is no measurable reduction in the concentration of HCV tenants, the FMR area loses the 50th percentile FMRs for a 3-year period. A large number of areas have been disqualified from the 50th percentile program for failure to show measurable reduction in voucher concentration of HCV tenants since 2001 when the program started, which strongly suggests that the deconcentration objective is not being met.⁵

History of Small Area FMRs

Since the establishment of the 50th percentile program, HUD has developed Small Area FMRs to reflect rents in ZIP code based areas with a goal to improve HCV tenant outcomes. Small Area FMRs have been shown to be a more direct approach to encouraging tenant moves to housing in lower poverty areas by increasing the subsidy available in specific ZIP codes to support such moves.⁶ Since 2010, when the United States Census Bureau made available data collected over the first 5 years of the American Community Survey

(ACS), HUD has considered various methodologies that would set FMRs at a more granular level. HUD's goal in pursuing the Small Area FMR methodology is to create more effective means for HCV tenants to move into higher opportunity, lower poverty areas by providing them with subsidy adequate to make such areas accessible and to thereby reduce the number of voucher families that reside in areas of high poverty concentration.

Toward this end, through a **Federal Register** notice published on May 18, 2010, at 75 FR 27808, HUD announced that in Fiscal Year (FY) 2011 it would seek to conduct a Small Area FMR demonstration project to determine the effectiveness of FMRs which are published using U.S. Postal Service ZIP codes as FMR areas within metropolitan areas. HUD also solicited public comment on the proposed demonstration. On November 20, 2012, at 77 FR 69651, HUD announced the commencement of the Small Area FMR Demonstration, for which advance notice was provided on May 18, 2010, and further announced the participation of the following PHAs: The Housing Authority of the County of Cook (IL), the City of Long Beach (CA) Housing Authority, the Chattanooga (TN) Housing Authority, the Town of Mamaroneck (NY) Housing Authority, and the Housing Authority of Laredo (TX).

Through a second **Federal Register** notice published on August 4, 2010, at 75 FR 46958, HUD mandated the use of Small Area FMRs in place of metropolitan-area-wide-FMRs to settle litigation in the Dallas, TX, HUD Metro FMR Area. Small Area FMRs have been in operation in Dallas, Texas, as part of a court settlement since 2010, and in a small number of PHAs since 2012.

HUD Proposals To Move to Small Area FMRs

On June 2, 2015, at 80 FR 31332, HUD published an advance notice of proposed rulemaking (ANPR) entitled "Establishing a More Effective Fair Market Rent (FMR) System; Using Small Area Fair Market Rents (Small Area FMRs) in Housing Choice Voucher Program Instead of the Current 50th Percentile FMRs." In this ANPR, HUD announced its intention to amend HUD's FMR regulations applicable to the HCV program to provide HCV tenants with subsidies that better reflect the localized rental market, including subsidies that would be relatively higher if they move into areas that potentially have better access to jobs, transportation, services, and educational opportunities. The ANPR sought public

³ General information concerning FMRs including more detailed information about their calculation is available at <https://www.huduser.gov/portal/datasets/fmr.html>.

⁴ From 2000 to 2010, however, voucher concentration *rose* in the largest metro areas, even though most of those areas used 50th percentile FMRs for at least part of that period. Kirk McClure, Alex F. Schwartz, and Lydia B. Taghavi, "Housing Choice Voucher Location Patterns a Decade Later," November, 2012, p 7. In 2010, 24 percent of vouchers in the 50 largest areas were used in tracts where at least 10 percent of households used vouchers, compared to 16 percent in 2000, p 7.

⁵ Areas may subsequently requalify for 50th percentile status after a 3-year period.

⁶ Please see Collinson and Ganong, "The Incidence of Housing Voucher Generosity", available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2255799.

comment on the use of Small Area FMRs for the HCV program within certain metropolitan areas. HUD received 78 public comments in response to the ANPR.

On June 16, 2016, at 81 FR 39218, HUD published a proposed rule that require the use of Small Area FMRs in place of the 50th percentile rent to address high levels of voucher concentration. The proposed rule addressed the issues and suggestions raised by public commenters on the ANPR. (See 81 FR 39222 through 39224.) In addition to responding to public comments on the ANPR, HUD specifically requested comment on certain issues. (See 81 FR 39224 through 39226.) HUD received 113 comments on its June 16, 2016, proposed rule. The public comments can be found at <https://www.regulations.gov/docket?D=HUD-2016-0063>.

The significant issues raised by the public commenters and HUD's responses are provided in the following section of this preamble.

III. Discussion of Public Comments and HUD's Responses

General Comments

Commenters were divided in their support for the rule. For those commenters that supported the rule they stated that this new methodology was long overdue because the current system was not working. Commenters stated that the current system was not working and HUD's proposal sounded like a good solution. Commenters stated that creating a system where cities, counties and municipalities could have a finer laser point on their rental markets could increase subsidy utilization rates and customer choice. The commenters stated that they highly recommended not only looking at the proposed methodologies but also collecting and refining more data from cities on their housing stock and availability. A commenter stated that setting FMRs for smaller areas is an ingenious solution because it will put an end to unnecessarily high subsidies in high poverty areas, and will gradually erode the legacy of segregation by giving HCV households more access to low-poverty neighborhoods. Another commenter stated that this FMR change is a welcome innovative step toward increasing housing choices for low-income individuals and families. Other commenters stated that the goal of the Small Area FMR rule will benefit people with disabilities by affording them better opportunities for integration into the community.

For those commenters that opposed the rule they offered the following concerns. A commenter stated HUD's proposal would result in Section 8 recipients in designated ZIP codes experiencing decreases in their subsidies, and these recipients would be obliged to increase their out-of-pocket share. Other commenters stated that research indicates low poverty rates are not 100 percent indicative of high opportunity areas. The commenters stated that given this information, Small Area FMRs are not an indicator of areas of opportunity and cannot be substituted for more robust mobility efforts resulting in poverty deconcentration, racial/ethnic deconcentration, and other positive outcomes associated with areas of opportunity. Other commenters similarly stated that voucher holders access to opportunity/higher market neighborhoods is only partially impacted by adequate payment standards. The commenters stated that while higher payment standards are essential this is not a solution to moving low-income families with children into opportunity neighborhoods. Commenters stated that HUD should not implement Small Area FMRs unless HUD revises the HCV funding formula to ensure that implementation of the rule does not result in fewer households being subsidized under the voucher program.

The following presents the specific issues that commenters raised on the proposed rule and HUD's responses.

Specific Comments

In the proposed rule, HUD sought comment on 13 specific areas presented below.

1. Should HUD provide for PBVs that are in the pipeline to continue using metropolitan FMRs even if the area is designated as a Small Area FMR area? Additionally, should HUD require newly proposed PBVs post Small Area FMR designation to use Small Area FMRs?

Comment: In response to the question of whether PBVs in the pipeline in a designated area, and newly proposed PBVs post-designation, should use Small Area FMRs, commenters expressed wide-ranging views. Many stated that applying Small Area FMRs to existing PBV projects or those in the pipeline could destabilize deals (e.g., impact their value for LIHTC allocation, etc.). Some commenters indicated Small Area FMRs would assist in placing PBV units in high opportunity areas and reduce incentives to develop units in high-poverty areas. Other commenters stated Small Area FMRs would not be

high enough to achieve the goal of creating units in high opportunity areas. Some suggested Small Area FMRs should not apply to PBVs at all because PBVs are essential to revitalization and preservation strategies. In summary, commenters offered differing views: Some recommend PBVs be excluded entirely (with or without an opt-in provision); some recommend voluntary adoption for new or pipeline projects, and others advocate application to all new projects to encourage placement of PBVs in high opportunity areas. One commenter requested HUD remove the word "jurisdiction" in proposed § 888.113(h), to clarify that the new Small Area FMRs apply in any zip code where a PHA's voucher is placed in the metropolitan area.

HUD Response: HUD appreciates that PBVs relationship to FMRs is different than tenant-based vouchers; for example, PBVs are often used for preservation in low-income neighborhoods where the Small Area FMR would be lower than current FMRs—however, Small Area FMRs that are higher than current FMRs could help PBVs reach high opportunity neighborhoods. In the context of HUD's Rental Assistance Demonstration (RAD), the use of Small Area FMRs for PBV may limit PHA options in terms of deciding whether PBV or PBRA is the appropriate choice for the RAD conversion.

Given the range and variation among public comments, and the range of uses of PBV within HUD's rental assistance programs, HUD is choosing to exempt all current and future PBVs from Small Area FMRs at this time. However, if a PHA is operating its tenant-based program under the Small Area FMRs, the PHA may apply Small Area FMRs to all future PBV projects if it establishes such a policy in its PHA administrative plan. In such a case, the PHA may also choose to also establish a policy that allows the PHA to apply the Small Area FMRs to current PBV projects, provided the owner is willing to mutually agree to do so. The application of the Small Area FMR to the PBV project must be prospective. The PHA and the PBV project owner operating under the Small Area FMRs may not subsequently choose to revert back to the metropolitan-wide FMR, regardless of whether the PHA subsequently changes its administrative policy to no longer apply Small Area FMRs to PBV projects. HUD believes this approach offers maximum flexibility for varied circumstances and HUD will closely monitor the results of the policy including for any fair housing or civil rights concerns.

HUD is also removing the term “jurisdiction” in § 888.113(h) for consistency since HUD provides approval to a “PHA” that requests to voluntarily use Small Area FMRs under 982.113(c) as opposed to a “PHA jurisdiction”.

2. The proposed rule provides for Small Area FMR area selection parameters to be codified in regulatory text. HUD is seeking comment on whether these parameters should be codified or should be incorporated into each annual proposed FMR notice to provide HUD, PHAs, and other stakeholders with flexibility, in any given fiscal year, to offer changes to these selection parameters and have the opportunity to comment before any changes to the parameters are made.

Comment: Some commenters proposed codifying area selection criteria with limited flexibility in the specific parameter values for reach (percentages, populations). They recommended HUD should codify the criteria for selecting Small Area FMR areas but the final regulations should allow HUD to revise the Small Area FMR criteria if necessary, through notice and opportunity for public comment, in the **Federal Register**. Commenters suggested this would be the way to ensure changes are guaranteed to fall under the informal administrative rulemaking process. However, other commenters preferred incorporating the parameters into the annual notice as a way to allow for comments and perhaps changes before final Small Area FMRs are issued for that year—enabling potential flexibility for changes on an annual basis. Commenters indicate that HUD should make clear whether Small Area FMRs designations are permanent.

HUD Response: In order to provide specificity to FMR users, and flexibility to HUD, the final rule codifies the definitions of selection parameters in regulatory text but will not include the specific values for these selection criteria in the regulatory text. The values of the selection parameters for the first round of Small Area FMR area selections are specified in a separate **Federal Register** notice published today. The values of selection parameters for subsequent Small Area FMR Area designations, which will be made every 5 years, will be specified through **Federal Register** notice with opportunity for public comment as new Small Area FMR designations are made. Further, once an area is selected to use Small Area FMRs, the selection is permanent. In future years, HUD intends to make additional selections

based on updated information and different selection parameter values.

3. Several commenters to HUD’s ANPR suggested that HUD provide for tenant rent protections in ZIP codes where the Small Area FMR is below the metropolitan area and tenants choose not to move. No additional tenant protections were instituted for tenants serviced by PHAs accepting HUD’s invitation to participate in the Small Area FMR demonstration nor were additional tenant protections implemented for tenants living in the Dallas, TX HUD Metropolitan Area when Small Area FMRs were implemented there. However, as part of a transition strategy between Metropolitan FMRs and Small Area FMRs, HUD seeks comment on what additional policies or requirements the final rule should include that would mitigate the impact of significant and abrupt decreases in the FMRs for certain ZIP code areas on families currently under HAP contract in those impacted areas.

Comment: Commenters suggested a range of additional policies or requirements that would mitigate the impact of significant or abrupt decreases in the FMR for families currently in those areas. Many requested that HUD hold all current tenants harmless permanently if they remain in their same unit (or, as some suggested, neighborhood); others suggested until tenants move or remain for more than 5 years; and others still suggested hold harmless should only apply to certain populations. Commenters urged HUD to fund support mechanisms for impacted households, such as mobility counseling, training and guidance on reasonable accommodation procedures, and others. Some commenters stated that no additional protections were necessary. In addition, commenters also raised concerns about specific populations, exception payment standards, phasing in of payment standard reductions, and incorporation of vacancy rates; those comments are handled elsewhere in the response to comments within this preamble as other questions more directly focus on that content.

HUD Response: Based on the comments received, HUD agrees that it is important to protect tenants, and therefore, the following changes have been incorporated within this final rule. The final rule makes conforming regulatory changes in accordance with Section 107 of HOTMA, which provides PHAs with the option to establish an administrative policy that would hold harmless those families remaining in place from payment standard reductions

that are currently required at the family’s second annual recertification if the family’s payment standard falls outside of the basic range as the result of a decrease in FMRs (including a decrease in FMR attributable to the implementation of Small Area FMRs). This will be done without requiring individual exception payment standard requests.

In addition, the final rule provides PHAs with the option to establish a new payment standard for families under HAP contract between the full “hold harmless” option provided under HOTMA and the new payment standard based on the Small Area FMR. Under this option, the PHA would have greater flexibility than what is afforded under HOTMA (which essentially requires the PHA to either hold the in-place families completely harmless or transition them to the new payment standard). This policy would allow the PHA to still achieve some budgetary flexibility by reducing the payment standard for families under HAP at the second reexamination, while ensuring the reduction in subsidy is modest and does not place families at risk of displacement.

The rule further extends these same flexibilities to the PHA if the payment standard decrease is not the result of a decrease in the FMR.

Finally, in order to ensure that a suitable amount of units remain available during the transition to Small Area FMRs, this final rule limits the annual decrease in Small Area FMRs to no more than 10 percent of the area’s FMR in the prior fiscal year. That is, the current FMR may be no less than 90 percent of the area’s FMR in the previous fiscal year. In addition, the final rule provides that HUD may approve exception payment standards for PHAs administering their HCV programs under Small Area FMRs for an individual ZIP code area in accordance with conditions and procedures set forth in a separate **Federal Register** notice as opposed to the normally applicable requirements at 982.503(c).

4. Related to question 3, HUD seeks comment on whether the final rule should limit the potential decline in the FMR for a ZIP code area resulting from the implementation of Small Area FMRs in order to ensure that sufficient housing opportunities remain available to voucher holders? If so, HUD seeks recommendations on specific policies or requirements that should be included in the final rule to achieve the desired outcome.

a. For example, an approach would be to allow the PHA to establish exception payment standards above the basic

range for impacted ZIP code areas meeting certain conditions through a streamlined HUD approval process. One example of this may be that PHAs could have the discretion of setting their payment standards at up to 130 percent of the Small Area FMR in the 1st year of transition, at up to 120 percent of the Small Area FMR in the 2nd year of transition, and at up to 110 percent of the Small Area FMR in the 3rd and subsequent years following implementation.

b. With respect to protections for tenants currently under HAP contract, one possibility may be to increase the amount of time that the family is held harmless from a decrease in the payment standard. For instance, instead of the lower payment standard going into effect on the second reexamination following the effective date of the decrease in the payment standard, the final rule could provide that the lower payment standard would not go into effect for a family under HAP contract until a later re-examination (e.g., third, fourth, or fifth reexamination).

Comment: Many commenters urged HUD to provide flexibility for PHAs to set rent levels and to protect tenants served by PHAs that do not choose to hold tenants harmless as allowed under HOTMA. Commenters urged HUD to implement the provision in HOTMA that gives PHAs the discretion to hold harmless decreases in Small Area FMRs and FMRs for current tenants. Others suggested PHA-administered phase-ins and increased timeframes before decreases are required are not necessarily helpful, as such phase-ins and timeframes add to administrative tracking requirements and increase program audit risks for the administering agency, as well as cause confusion for residents and landlords.

Regarding the proposal in which PHAs could have exception payment standards above the basic range, some commenters embraced the proposal; however, others felt it would not go far enough, and only delay the onset of rent burdens. Compared to a Small Area FMR phase-in, some commenters suggested it would protect fewer families since it is likely that only some PHAs would implement the higher payment standards. Other commenters suggested HUD could permit PHAs to set payment standards for eligible voucher holders that fall anywhere between the Small Area FMR and the metro-level FMR. Commenters also suggested that HUD limit the amount the FMR or payment standard could fall below metropolitan FMRs each year. Suggestions offered by the commenters ranged from suggesting Small Area

FMRs be set no lower than 90–95 percent of the metropolitan FMR, no lower than 80–90 percent the second year, and so on in 5 percent or 10 percent increments.

Some commenters supported limiting annual FMR reductions by 3 percent or 5 percent, while others suggested the decreases should occur over a 5-year instead of a 3-year period (for all areas, or for only those areas that decrease by more than 10 percent), or the total drop be no more than 5 percent. Other commenters suggested changes included removing or increasing the cap on Small Area FMR values.

Regarding the proposal to increase the amount of time that the family is held harmless from a decrease in the payment standard, some commenters suggested HUD hold the rent harmless until at least the fifth reexamination following implementation of Small Area FMRs. Other commenters stated that if HUD implements the HOTMA payment standard provision, there would be no need to implement a hold harmless provision that holds payment standards harmless in the third, fourth, or fifth reexamination.

HUD Response: As noted above, the final rule implements a number of tenant protection policies: First, the final rule conforms the regulation in accordance with Section 107 of HOTMA, which provides PHAs with the option to maintain an in-place family's current payment standard at a level above a payment standard at the top of the basic range of the a new, lower FMR. Second, the final rule further provides PHAs with the option to establish a new payment standard for families under the HAP contract between the full "hold harmless" option provided under HOTMA and a payment standard based on the basic range of the new lower Small Area FMR. It is noted that the rule also extends these same flexibilities to the PHA in cases where the payment standard decrease is not a result of a decrease in the FMR.

The rule maintains that in cases where the PHA will apply a decrease in the payment standard to families during the term of the HAP contract, the earliest that the PHA may apply the initial reduction to the payment standard amount is the second regular reexamination following the effective date of the change in the payment standard amount. This provides at minimum a family with no less than the amount of time previously provided under the regulations before a reduction in the payment standard may take effect during the term of the family's HAP contract. The final rule also provides the PHA with the administrative flexibility

to further reduce the payment standard for the families that remain under HAP contract if the PHA wishes to gradually reduce or eliminate the difference between the family's payment standard and the normally applicable payment standard on the PHA's payment standard schedule over time.

HUD notes that section 78001 of the Fixing America's Surface Transportation Act (or FAST Act), amended the 1937 Act to allow PHAs to undertake full income reexaminations for families with 90 percent or more of their income from fixed-income sources every three years instead of annually. HUD recognizes that implementation of this change in the frequency of reexaminations may have significant ramifications in terms of when a decrease in a payment standard could take effect during the term of the HAP contract for some families given that under this rule the decrease may not take effect until the second regulation reexamination. Rather than try to incorporate changes to the tenant protection provisions of this rule in anticipation of those potential complications, HUD will instead consider if any changes are necessary as part of the forthcoming rule-making for implementation of those FAST Act provisions.

The final rule further provides that the PHA may establish different policies regarding how decreases in payment standards will apply during the term of the HAP contract for designated areas within their jurisdiction (e.g., for different zip code areas). However, the PHA must apply the same policies to all families under HAP contract within that designated area.

Fourth, controlling for extremely large decreases in FMRs, the final rule protects families, by limiting the maximum amount the FMR may decrease year over year to 10 percent of the prior year's FMR for the area. This protection applies to all tenants—families under HAP contract, current participants that either want or are required to move to new units, and families from the waiting list who are issued vouchers to begin their initial housing search, and to metropolitan and non-metropolitan county FMRs.

Fifth, the final rule permits a PHA that is administering its HCV program under the Small Area FMRs to request and HUD to approve exception payment standards for a ZIP Code Area under the conditions and procedures set forth in a **Federal Register** Notice instead of the requirements under 982.503(c). This will allow HUD to establish a process by which a PHA may request and receive approval to establish an exception payment standard promptly for a ZIP

Code area if necessary to react to rapidly changing market conditions or to ensure sufficient rental units are available for voucher families.

5. The proposed rule adds a new paragraph (i) to § 888.113 to address the transition of metropolitan areas that were previously subject to 50th percentile FMRs. HUD believes that the Small Area FMR methodology will provide HCV tenants with greater access to areas of opportunity than metropolitan area wide 50th percentile FMRs. As a result, this rule proposes that a 50th percentile metropolitan area designated for Small Area FMRs would transition to Small Area FMRs on the effective date of the Small Area FMR designation. HUD is also proposing that a 50th percentile FMR area that is not designated for Small Area FMRs would remain under 50th percentile FMRs until the end of the existing 3-year period for the 50th percentile FMRs prior to reverting to the standard 40th percentile FMRs. The rule does not eliminate provisions that permit a PHA with jurisdiction in a 50th percentile FMR area that reverts to the standard 40th percentile FMR to request HUD approval of payment standard amounts based on the 50th percentile rent in accordance with the existing § 982.503(f); however, HUD is specifically seeking comment on whether this provision should be eliminated in order to phase out the use of 50th percentile rents for deconcentration purposes. HUD would also appreciate comments as to whether or not the current SEMAP deconcentration standard is appropriate as the basis for PHAs requesting HUD to approve payment standards based on 50th percentile rents under existing § 982.503(f). HUD is specifically seeking comment on these proposed policies, as well as suggestions for alternative approaches or other recommendations on how best to phase-out 50th percentile rent FMRs for impacted metropolitan areas and transition the area to either the Small Area FMRs or the standard metropolitan-wide 40th percentile FMRs.

Comment: Commenters responses to this issue varied. Some commenters requested continuation of the 50th percentile policy in its entirety (including expanding it so that all FMRs would be set at the 50th percentile). Other commenters recommended it be optional if areas proved successful deconcentration using it, and others recommended phasing out 50th percentile rents altogether. Some commenters responded that the SEMAP standard should be considered an appropriate basis for PHAs to request

payment standards based on the 50th percentile until such time as the Section Eight Management Assessment Program (SEMAP) provision for deconcentration is modified. Others commented that if HUD allows agencies that earn the SEMAP deconcentration bonus to retain 50th percentile FMRs, it should also require such agencies to demonstrate that retaining 50th percentile FMRs would be more effective in enabling voucher holders to live in high-opportunity areas than adopting Small Area FMRs, and others still indicated that before determining this, HUD should clarify proposed mobility factors of SEMAP reform.

HUD Response: It is impractical to maintain both 50th percentile FMRs and Small Area FMRs as the FMR tools that HUD provides to help deconcentrate voucher tenants in metropolitan areas. However, HUD recognizes that some PHAs have attained deconcentration success using 50th percentile FMRs. Therefore, as in the proposed rule, the final rule provides that current 50th percentile areas that are designated for Small Area FMR usage will transition to using Small Area FMRs when Small Area FMRs become effective and areas not designated for Small Area FMR usage will remain 50th percentile areas until the end of their 3-year designated period and then will revert to 40th percentile areas. PHAs operating in 50th percentile areas that do not convert to Small Area FMR areas and do not choose to opt-in to using Small Area FMRs may follow the procedures available at 24 CFR 982.503(f) to apply to continue to use payment standards based on 50th percentile rents.

6. HUD is specifically seeking comment on how to reduce the administrative burden on PHAs and simplify the transition to Small Area FMRs. For example, HUD is proposing to change the percentage decrease in FMRs that triggers rent reasonableness redeterminations from 5 percent to 10 percent for Small Area FMR PHAs. HUD requests comments, however, regarding whether 10 percent is the right trigger for program-wide rent reasonableness redetermination, whether HUD should limit this proposal to Small Area FMR decreases, or also change the percentage of decrease that triggers rent reasonableness for all FMRs, and whether it should revise the trigger for program-wide rent reasonableness redeterminations at all. In regards to potentially expanding the 10 percent trigger for rent reasonableness redetermination to a program-wide requirement, HUD seeks comments on the trade-offs between administrative relief and decreased program oversight

on rent levels. HUD also requests comments on what other changes would reduce the potential administrative burden and complexity for PHAs impacted by the implementation of Small Area FMRs.

Comment: Commenters emphasized that that Small Area FMRs and other recent programmatic changes represent increased administrative burden. Many commenters supported increasing the threshold at which an FMR decline triggers a rent reasonableness redetermination from 5 percent to 10 percent as a way to reduce that burden. However, others recommended changing the trigger from 5 percent to 35 percent and allowing the PHA to make that change through their annual plan process. Some commenters opposed changing the standard altogether. Other commenters stated that they do not believe a change from 5 percent to 10 percent is enough to reduce administrative burden sufficiently given the number of rent redeterminations expected from the transition to Small Area FMRs.

Aside from whether and at what level to change the trigger, some commenters recommended this be program-wide, and not just for Small Area FMRs. Commenters urged HUD to issue updated rent reasonableness guidance—including for high opportunity neighborhoods to avoid methods disallowing rents if the methods do not adequately consider location. Commenters also urged HUD to require PHAs to be transparent with the data used to perform the analysis and make it publicly available.

Other commenters urged HUD to publish new FMRs and Small Area FMRs far in advance of their effective date to avoid requiring PHAs to redo redeterminations. Commenters asked HUD to provide at least six months after publication of Small Area FMR designations before they are required to have Small Area FMR-based payment standards in place.

Some commenters raised concerns about increasing the trigger for PBV because it would trigger rent reasonable studies that result in a significant loss of income to owners of PBV contracts. The commenters stated that for properties in which this income was assumed as part of initial financing or refinancing, the property is likely to become financially unstable and unable to meet its obligations. Other commenters stated that aside from rent reasonableness, the increased administrative costs of administering Small Area FMRs come at a time when PHAs are not being paid fully to administer the HCV program.

HUD Response: Based on public comment, HUD agrees that a reduction in administrative burden is necessary. Therefore, HUD is adopting the proposed rule provisions which change the required rent reasonableness review standard from a 5 percent to a 10 percent decrease in the FMR. This change would apply not just to voucher units in Small Area FMR areas but to units in all FMR areas. Moreover, the final rule implements a policy that limits the annual decrease in FMRs (including Small Area FMRs). This change is being implemented in response to comments on the need for additional tenant protections, but should also provide some administrative relief to PHAs by having more certainty around the path of Small Area FMRs within areas where the Small Area FMR is below the metropolitan FMR as well as FMR decreases more generally.

7. HUD is currently proposing, through this rulemaking, to expand the use of Small Area FMRs within the HCV program. HUD seeks public comment as to whether or not other HUD rental assistance programs would benefit from using Small Area FMRs in their operations. For example, would the rental assistance component of the Housing Opportunities for Persons with AIDS (HOPWA) programs be a candidate for Small Area FMR treatment? Frequently, metropolitan FMRs are inadequate for HOPWA-assisted tenants to find units near health care facilities, or in neighborhoods with better job opportunities. Should the HOPWA program regulations be amended to allow participating jurisdictions the flexibility to set tenant-based assistance rents according to Small Area FMRs either in areas that would be designated Small Area FMR areas or for the HOPWA program more generally? Would other HUD programs benefit as well?

Comment: Commenters responses to this issue were varied. Some commenters were against expansion to any other program, and some urged HUD to wait until Small Area FMRs could be studied more fully. Other commenters stated that they believed new tenants in tenant-based rental assistance programs could benefit from Small Area FMRs (e.g., HOPWA, CoC Rental Assistance, Legacy Shelter Plus Care program, HOME tenant-based rental assistance.). The commenters that recommended expansion to other programs stated that applying the same Small Area FMR scheme would be less burdensome on PHAs and landlords than multiple standards.

HUD Response: HUD appreciates the suggestions, but at this time, due the myriad of programs and program rules, it is beyond the scope of this rulemaking to make changes to these programs; therefore, HUD is proceeding solely with implementation of Small Area FMRs for the HCV program, which includes traditional vouchers and special purpose vouchers. HUD will consider the comments received for future rulemaking or other program implementation strategies for the various programs as the opportunity arises.

8. As currently proposed, the Small Area FMR policy would apply to all residents within a ZIP code who receive housing vouchers. HUD seeks comment on whether there are certain situations or any specific groups of voucher recipients within the general population, such as persons with disabilities or elderly voucher recipients, where an alternate policy should apply that should exempt them from having their voucher level change as a result of this policy due to specific hardships they may encounter by having to choose between staying in their current area and receiving a smaller voucher or moving to a new area for the sake of obtaining a larger voucher?

Comment: Many commenters urged HUD to hold all existing tenants harmless, and if HUD declined to do this, to hold disabled and elderly tenants harmless.

HUD Response: In response to the commenters request that HUD hold disabled and elderly tenants harmless under this policy, HUD is prohibited from treating one or more protected class differently under the Fair Housing Act and other civil rights requirements, absent statutory authority. HUD in this rule is implementing robust tenant protections for all tenants, including those enacted in HOTMA, as outlined earlier in this preamble. HUD will study the specific impact on elderly and disabled voucher recipients as a result of this rule change to determine if additional policy changes are necessary.

9. Are there specific groups within the general population of voucher holders for whom this policy change would be particularly burdensome? What are the ways in which this policy change could create a disproportionate burden on certain groups like elderly and disabled voucher holders?

Comment: Commenters stated that there are specific groups of voucher holders for whom this policy change would be particularly burdensome. The commenters stated that these specific groups include the elderly, people with

disabilities, and families with children. Commenters raised the concern that each group could face increased housing cost burdens, displacement, prohibitively expensive moves, and homelessness. Other commenters raised the concern that all tenants may have chosen their current location based on community, religious, medical, service provider, and social networks.

Specifically, certain commenters stated that tenants with disabilities may not be able to find accessible units in higher rent neighborhoods and may face limited public transportation options. They may also face discrimination in these areas. Commenters stated that it is insufficient to suggest that these tenants are not at risk because they can request reasonable accommodation. The commenters stated that many people do not know enough about their rights to request the accommodation and will not be informed of them by landlords seeking higher payments. The commenters further stated that responding to requests for accommodations from a significant portion of voucher holders may be administratively burdensome for HUD. Specific recommendations from commenters focused exception payment standards (EPS) in which HUD should (1) notify all tenants who will experience a reduced payment standard of their right to a reasonable accommodation based on disability, (2) identify tenants, based on their participant file, who might be entitled to an EPS based on disability and take affirmative steps to accommodate them, and (3) publish additional guidance with the final rule that directs PHAs to allow EPS as a reasonable accommodation in any instance when a voucher family will experience a disability-related hardship as a result of being forced to pay over 30 percent of their income in rent or move.

Commenters stated that elderly tenants may also share similar challenges finding accessible units, and that stability in a neighborhood may be more of an opportunity than mobility. Commenters also suggested families with children may be adversely impacted, as having a large number of children can act as a barrier to being able to find suitable housing. Commenters stated that families report longer search times and far fewer options.

HUD Response: HUD agrees that the concerns raised by the commenters pose serious challenges for the specific populations raised above. As such, the final rule implements robust tenant protections for all tenants and a lengthened transition to full Small Area

FMR implementation as outlined earlier in this preamble. In addition, the final rule clarifies that reasonable accommodation requests may include exception payment standards of more than 120 percent of the published FMR, consistent with HOTMA. Consistent with current practice, for such requests, the focus of HUD's review will be on the exception payment standard requested by the PHA.

10. HUD is seeking comment on the criteria that HUD selected for determining which metropolitan areas should be impacted by the shift to a Small Area FMR instead of the current 50th percentile policy. Did HUD use the correct criteria in making these choices? What other criteria should HUD be using to select metropolitan areas that will be impacted by this rule change and why are those criteria important?

Comment: Commenters provided a range of responses on many topics, outlined below:

- Vacancy: Many commenters urged HUD to factor in vacancy data into the formula. Their recommendations included:

- Excluding low vacancy markets (those with a 4 percent, 5 percent or 6 percent vacancy rates).

- Allow PHAs with low vacancy rates to opt out of Small Area FMRs, even if they meet HUD's criteria, and require PHAs with low vacancy rates that choose to adopt Small Area FMRs to hold current tenants harmless.

- Exempt low vacancy areas from decreases in authorized Section 8 rent levels for existing tenants; Small Area FMRs should be implemented only for new tenants (or existing tenants who move) in these areas.

- Revising the formula

- Considering relative voucher concentration by measuring the difference—rather than the ratio—between the voucher and renter concentration shares. HUD should use the criteria that there must be at least a 15 percent difference between renter and voucher holder concentration in low-income areas.

- Compare voucher concentration to the distribution of all housing units rather than just rental units.

- Reduce the required proportion of rental units in areas over 110 percent of the regional FMR to 17 percent, to capture more of our most deeply segregated metro areas. An alternative approach would prioritize metropolitan areas with the highest proportion of families with young children living in concentrated poverty neighborhoods.

- Lower this threshold for the share of rental units in ZIP codes with Small

Area FMRs above 110 percent of the metro FMR at least to 15 percent.

- Change criterion to better target metropolitan areas in which overall segregation is the highest, with less focus on concentration of voucher households in high poverty areas relative to other renters.

- Exclusions and other comments
 - Commenters also suggested that, in order not to impede PHAs whose program management has already resulted in participants living in higher opportunity/lower poverty areas, HUD should require adoption of Small Area FMRs only by those PHAs in Metro areas meeting the Small Area FMR designation criteria whose percentage of voucher holders living in concentrated low-income areas relative to all renters in concentrated low-income areas over the entire Metro FMR area exceeds 155 percent.

- The use of Qualified Census Tracts (QCTs) in the criteria for designating Small Area FMR areas is inappropriate. In the LIHTC program, the purpose of QCTs is to increase the supply of affordable housing in these areas. It is contradictory to incentivize the construction of affordable rental units in certain areas on the one hand, and use Small Area FMRs to move residents out of those areas on the other.

- In addition to modifying the criteria, HUD should also revise the proposed regulation to give itself flexibility to designate highly segregated areas as Small Area FMR areas if it concludes that this is needed to further fair housing.

HUD Response: While SAFMRs may be a useful tool for expanding choice and providing voucher holders with access to more units in opportunity areas, public comments on the proposed rule raised concerns with HUD's knowledge of how well SAFMRs will work in areas experiencing low vacancy rates. HUD agrees that areas with extremely low vacancy rates are indicative of rental markets in disequilibrium and the final rule includes additional selection criterion to those provided in the proposed rule. In order for the rental housing market to function in an orderly manner, there needs to be an ample supply of available vacant units. Once the vacancy rate falls below a certain percentage, typically when the quantity of units demanded exceeds the quantity of units supplied, this places upward pressure on rental prices. The solution is typically the creation of additional supply; however, in the short run, a market clearing price is harder to achieve and the rental market ceases to function normally. Therefore, the final rule includes

vacancy rate as an additional selection criterion to those provided in the proposed rule. Commenters provided varied feedback on the level of vacancy for which areas should be excluded from Small Area FMR designation. The American Community Survey (ACS) provides the most comprehensive data measuring rental vacancies across all metropolitan areas; however, due to the manner in which vacancies are assessed in the ACS, as detailed in the Regulatory Impact Analysis of this rule, HUD research indicates that ACS based vacancy rates tend to underrepresent the actual level of vacancies across most markets; consequently, the final rule excludes any metropolitan area with an ACS based vacancy rate of 4 percent or lower from designation as a Small Area FMR designated area as a 4 percent vacancy rate measured by the ACS is roughly equivalent to an actual vacancy rate of 5 percent under reasonable assumptions.

While HUD believes the criterion should remain focused on voucher concentration rather than residential segregation, HUD also agrees with commenters that the voucher concentration criterion should be improved to better target communities where voucher concentration is most severe. Consequently, in addition to the voucher concentration ratio included in the proposed rule, the final rule also requires the numerator of this measure, the concentration of voucher holders within concentrated low income areas, to meet a minimum standard level (25 percent).

HUD notes the other suggestions made by commenters and will evaluate program effects including access to neighborhoods with better employment opportunities, better schools, lower crime rates and lower racial and ethnic isolation to inform any future expansion of the program.

11. The proposed rule makes no changes to 24 CFR 888.113(g), the FMR for Manufactured home space rental for voucher tenants that own manufactured housing units. Under this proposed rule Small Area FMRs would apply to manufactured home space rentals in areas designated for Small Area FMRs (*i.e.*, FMRs for space rentals would be set at 40 percent of the 2-bedroom Small Area FMR). Given the costly nature of moving a manufactured home, HUD is seeking comment on whether or not current voucher holders using their voucher for a manufactured home space should be exempt from Small Area FMRs at their current address?

Comment: Most commenters suggested HUD should exempt manufactured home space rental from

Small Area FMRs wholesale. Others suggested an exemption for existing voucher holders so long as the voucher holder remains at the current address. Some suggested HUD exempt only when the Small Area FMR is lower than the metro FMR; some pointed out that voucher holders in ZIP codes where the payment standard will increase under Small Area FMR should be permitted to benefit from the increased payment standard. Others commented that Small Area FMRs should be voluntary altogether, including for those areas which may have vouchers for manufactured home space. Manufactured homes are often limited by local regulation to particular sites. Residents should not be penalized in subsidy available to support their housing choice based on the ZIP code location of allowable manufactured home sites.

HUD Response: Based on public comment, the final rule exempts vouchers used to subsidize the rent of a manufactured home space from the use of Small Area FMRs.

12. HUD has proposed to amend the Exception Payment Standard rules at 24 CFR 982.503 to account for the fact that FMR areas in Small Area FMR designated metropolitan areas will be ZIP codes. HUD is seeking public comment to determine if there are other amendments HUD should make to the Exception Payment Standard Regulations to better facilitate the approval process of Exception Payment Standards. For example, the current exception payment standard regulations require that an exception payment standard may not include more than 50 percent of the population of the FMR area. This may be an impractical requirement when determining exception payment standards within a ZIP code. Similarly, given that ZIP codes more narrowly define the FMR area, the provision within the regulation that program justification may include helping families find housing outside areas of high poverty may not be applicable even though an exception payment standard may be necessary. Therefore, HUD is soliciting feedback to ensure that the exception payment standard regulations are revised so that PHAs may use this component of the regulations to optimize the administration of their HCV programs.

Comment: Some commenters offered that under Small Area FMRs, EPSs become much less necessary, other than to group neighborhoods into payment standard buckets to simplify program administration and limit significant volatility between years.

Specific requests of commenters included eliminating the population cap that prevents more than 50 percent of an area to be covered by an EPS, and clarify that that exception rents may exceed 150 percent of Small Area FMR. Commenters also suggested HUD clarify how exceptions will work for Census tracts and other small geographic areas. Some commenters suggested EPS should be available up to 130 percent in the first two years of the program; others request up to 150 percent of the FMR. Another commenter stated that HUD should publish additional guidance with the final rule that directs PHAs to allow EPS as a reasonable accommodation in any instance when a voucher family will experience hardship or pay over 30 percent of their income in rent.

Commenters recommended that PHAs be able to set a payment standard up to 120 percent of the FMR without requesting HUD approval. Other suggested eliminating the distinction between exceptions above and below 120 percent of FMR, as the differences and processes are complex. If they are kept separate, commenters suggested HUD should revise the regulation for 110–120 percent to eliminate the requirements that PHAs submit information other than data on market rents or inability to secure housing and, for standards below the basic range, rent burdens. If HUD retains the requirement that increases above 120 percent prevent financial hardship, it is crucial that HUD revise the regulation or provide guidance making clear that this includes potential hardship that deters families from moving to the exception area in the first place.

As far as the process, overall, commenters requested streamlined processes, clear guidance and an expedited path for approvals that is standardized across local HUD offices and HUD headquarters. Some commenters suggested a system in which HUD's Office of Policy Development and Research obtains data from local housing authority rent reasonable databases to immediately grant exception payment standards that will support the utilization of vouchers and prevent families from falling into homelessness or remain homeless. Commenters suggested allowing exception payment standards to remain in place for a prolonged period without PHA action. HUD could review existing exception every so many years.

HUD Response: This final rule addresses the operation of exception payment standards with respect to Small Area FMRs. Specifically, the rule allows PHAs to request exception

payment standards within ZIP codes. Additionally, for the purposes of exception payment standards within the context of Small Area FMRs, the final rule removes the 50 percent population cap for exception payment standards within ZIP codes. Furthermore, HUD is also simplifying the procedures for PHAs not using Small Area FMRs to run their HCV program. The final rule provides that PHAs in non-Small Area FMR areas may request an exception payment standard from the HUD Field Office of up to 110 percent of the relevant Small Area FMR with no additional supporting information. Finally, as noted earlier the final rule provides that HUD may approve a request by a PHA administering the HCV program under the Small Area FMRs for an exception payment standard for a ZIP Code area in accordance with the conditions and procedures set forth in a **Federal Register** Notice as opposed to the formerly applicable requirements under 982.503(c). This will allow HUD to establish a streamlined and responsive process for Small Area FMR ZIP Code area exception payment standard requests.

HUD has decided against proposing comprehensive changes to its EPS regulations at this time due to the implementation of Small Area FMRs and the potential to learn from PHA experiences with their adoption and operation. The suggestions offered through the public comment process will however be taken into consideration whenever HUD does revisit its EPS regulations.

13. HUD makes administrative data for research into HUD's programs available in a variety of ways (*i.e.*, Public Use Microdata Sample—PUMS data, Research Partnerships, and Data License Agreements). HUD seeks comment on what additional data or dissemination strategies would be helpful to the public to assess the impact of the implementation of the Small Area FMR proposed rule.

Comment: Commenters requested both data and dissemination at the federal and PHA levels. They include:

- PUMS data set should include geographic identifiers for the census tract and ZIP code tabulation area, and HUD Fair Market Rent Metro Areas (HMFAs), so researchers can incorporate neighborhood information from, for example, the American Community Survey. Because HMFAs often diverge from OMBs definitions of metropolitan areas, it would also be helpful to append key HMFA-level variables (poverty rate, median gross rent, income, etc.) to the microdata.

- Number of voucher landlords and units associated with those landlords by ZIP code to which PHAs provide access to new voucher holders. This data is public, but not easily available or centralized.

- Ensure assessments of fair housing provide data at the ZIP code level.

- Study the impact the rule has on households' ability to use their voucher within the allowable time.

- Data from the evaluation of the Small Area FMR demonstration.

- List of ZIP codes by jurisdiction and the associated FMR rather than a list at the level of metropolitan area.

- All data used in the formula to designate the areas required to implement Small Area FMRs

- Data on whether increases to FMR for higher rent neighborhoods effectuates an increase in leasing activity in these neighborhoods.

- External evaluation of the Small Area FMR implementation parallel to implementation.

- Data not only for designated Small Area FMR areas and PHAs that opt in, but also for other areas and PHAs in order to allow comparison:

- Number of voucher holders by ZIP code including relevant data on race, ethnicity, disability status and other factors relevant to fair housing concerns.;

- Voucher success rates by PHA (if available and reliable); PHAs should report the average time it takes to lease-up for new and continuing voucher participants (who continue in their current jurisdiction or attempt to port their voucher);

- Voucher turnover rates; to assess the impact of Small Area FMRs on program participants, it is essential that data is collected on the number of participants leaving and entering the program each year;

- Voucher program exit and new admission rates by PHA;

- Number of voucher holders with rent burdens at various levels (30 percent of income or less, 31–40 percent, 41–50 percent, and so forth) by PHA or by ZIP code;

- Number of units on lists provided to families issued vouchers, broken down by ZIP code and PHA.

- Technical Assistance opportunities for impacted landlords and beneficiaries to understand the policy revisions and rationales.

- Information on what strategies PHAs used in conjunction with the Small Area FMRs.

- HUD should determine and publicize what payment standards PHAs use, and make this information available to help HCV households with their housing search.

- Publicly Available ZIP-Code-Level Counts of Voucher Holders and Their Race: Currently, HUD makes the number of voucher holders in a particular area available in two ways: (1) On HUD's Open Data Web site and (2) as part of the underlying data used in the AFH Data and Mapping Tool. Both give voucher counts on the Census tract level, while the latter source includes a count of the number of non-white voucher holders in each tract. Although HUD releases a crosswalk file that matches Census tracts and ZIP Code Tabulation Areas (ZCTAs), the process of converting HUD's tract-level data to ZCTAs is complex and riddled with potential for errors. Since Small Area FMRs use ZCTAs, not Census tracts, as the primary unit of analysis, HUD should release voucher counts at the ZCTA level in order to evaluate the impact of Small Area FMRs. The data made available by race will also allow evaluation of how the Small Area FMR rule impacts jurisdictions' AFFH obligations.

- Whether increasing available asking rents impact local land use decisions.

- Data on total tenant payments by age group over the course of voucher lease-up and through Small Area FMR transitions, payment standard changes by housing agencies within Small Area FMR areas, and the use and value of PBVs.

- Availability of health services in new/old neighborhoods, the rate at which households retain their vouchers in new/old neighborhoods, and the financial costs of moving beyond rent payments (transportation, deposits, etc.).

HUD Response: HUD thanks the public for these helpful comments, and will take these recommendations under advisement. HUD does not need to undertake rulemaking to release additional data or information but does need to carefully consider the ramifications and disclosure issues associated with many of the suggestions. As HUD determines what additional information is releasable, HUD will continue to post Small Area FMR-relevant data online at <https://www.huduser.gov/portal/datasets/fmr/smallarea/index.html>.

Comment: Commenters provided a vast array of requests through this question that support a variety of objectives:

- The ability to assess the efficacy of Small Area FMRs.

- The ability to do additional research into the Housing Choice Voucher program.

- The ability to better administer the Housing Choice Voucher program.

HUD Response: Within the context of the final rule, HUD will release Small Area FMRs accompanied by both the minimum and maximum basic range amounts (90 percent and 110 percent) for each bedroom unit count Small Area FMR. HUD will further sort the ZIP code based Small Area FMRs for each metropolitan area from least to greatest to facilitate PHAs wishing to group multiple ZIP codes together into Payment Standard regions. HUD is taking the rest of these recommendations under advisement and will continue to post Small Area FMR-relevant data online at <https://www.huduser.gov/portal/datasets/fmr/smallarea/index.html>.

Other Comments

Commenters provided a variety of other comments regarding the proposed rule. Two of these topic areas include Moving To Work (MTW) PHAs, and comments on the methods for calculating FMRs.

Issue: Moving To Work (MTW) PHAs and the use of Small Area FMRs.

Comment: Commenters asked HUD to clarify whether or not MTW PHAs operating in metropolitan areas designated for Small Area FMR usage will have to use Small Area FMRs.

HUD Response: The proposed Rule pointed out that MTW PHAs have the ability to set alternative rent policies, outside of the standard regulations governing the use of FMRs in setting payment standards with approval from HUD. To clarify, MTW PHAs administering the HCV program can exercise flexibility in regards to establishing rent in accordance with the terms of their respective MTW Agreement and approved Annual MTW Plan. If an MTW PHA has not exercised flexibility through their Annual MTW Plan, the Small Area FMR requirements set forth in this Final Rule will apply to the MTW PHA, and the MTW PHA will be required to use Small Area FMRs in place of metropolitan-wide FMRs if the PHA jurisdiction is located within a designated Small Area FMR metropolitan area.

Issue: Methodology for Calculations of Metropolitan Fair Market Rents and Small Area Fair Market Rents.

Comment: Several commenters provided HUD with unsolicited feedback regarding the methods that HUD uses to calculate metropolitan-wide and Small Area FMRs. Several commenters suggested that HUD should modify the process HUD uses to calculate FMRs to be more reflective of market rents.

Overall FMR concerns: Many commenters discussed concerns

regarding overall FMRs, including data lags and gap between local rents that will be embedded into Small Area FMRs.

- Specific suggestions included:
 - Fine tuning current formula to include rent variations for different bedroom size units, and ensuring that the five-year American Community Survey is keeping pace with actual rents in each ZIP code, particularly in the targeted metro areas, and to make upward adjustments as needed.
 - Alter the current FMR methodology to account for trends in local rental markets; cease using the “Trend Factor” to calculate FMRs, which measures the forecasted changes in national gross rents, and instead use the percentage change in metropolitan area-wide rents published as part of HUD PD&R’s quarterly U.S. Housing Market Conditions Regional Reports.
 - Revising the formula
 - Some commenters urged HUD to adopt a methodology for calculating Small Area FMRs that would better ensure access to 40% of units in all ZCTAs.
 - Urged consideration of methodology other than ZIP codes, such as independent analyses of local housing submarkets. ZIP codes may be too large to get desired impact.
 - Calculate 40th-percentile rents with data specific to different unit sizes (rather than indexing the rents to the 2-bedroom units),
 - Rely upon local rather than national CPI data in order to trend FMRs forward

HUD Response: HUD appreciates the breadth of comments provided to HUD regarding the methods used to calculate FMRs (both metropolitan-wide and Small Area FMRs). As stated earlier in the response to comments, in this final rule HUD is implementing a floor on the amount that FMRs can decrease from year to year. This is being done to provide in-place tenants with an additional element of subsidy protection during the transition from metropolitan FMRs to Small Area FMRs. Additionally, limiting the annual decrease in FMRs will help ensure a sufficient supply of affordable units during the transition to both existing tenants who wish to move and new voucher families entering the market. The final rule does not otherwise affect the data or methods HUD uses to estimate FMRs or Small Area FMRs. Due to provisions within HOTMA, HUD will be publishing **Federal Register** notices of proposed material changes in the methods for calculating FMRs for public comment before these changes are incorporated into the calculation of

FMRs. HUD will respond to comments on FMR methodology provided in response to the proposed Small Area FMR rule as well as the notice announcing Fiscal Year 2017 FMRs in an upcoming Notice of Proposed Material Change in FMRs.

Issue: Rulemaking is premature.

Comment: A commenter stated that given that demonstrations of this idea in five locations are well underway, HUD’s proposal is premature. The commenter stated that demonstrations have the admirable purpose of working out the problems that occur even with proposals that are highly meritorious in general terms before implementing them at large scale.

HUD Response: While HUD acknowledges that more information on the overall effects of the Small Area FMR approach will be forthcoming when the results of the Small Area FMR demonstration are available to inform broad policy, HUD believes that it is not premature to implement Small Area FMRs on this limited basis in those areas where it has the potential to address significant voucher concentration concerns. Through this final rule, HUD seeks not only to employ a better tool than the 50th percentile policy to expand housing opportunities for families where voucher concentration is a particular challenge but to also provide PHAs with the administrative flexibility to implement appropriate tenant protections to families currently under HAP contract and to address changing market conditions.

Issue: Continuation in Small Area FMRs in the Dallas, TX HUD Metro FMR Area.

Comment: A commenter noted that the Dallas, TX HUD Metro FMR Area, which has been operating under Small Area FMRs since 2010 pursuant to a court settlement, was very close to the thresholds for inclusion as a Small Area FMR area, and raised concerns that it might be excluded from continuing as a Small Area FMR area in the final rule or in the future.

HUD Response: While the final rule establishes a permanent Small Area FMR program, the final does not void the settlement agreement by which PHAs in the Dallas, TX HUD Metro FMR Area are required to operate with Small Area FMRs. PHAs in the Dallas TX, HUD Metro FMR Area will continue to be required to operate using Small Area FMRs in accordance with this final rule. The final rule contains no provisions for discontinuing Small Area FMRs once they have been implemented for a FMR Area.

IV. Findings and Certifications

Regulatory Planning and Review

OMB reviewed this final rule under Executive Order 12866 (entitled “Regulatory Planning and Review”). This rulemaking was determined to be an “economically significant regulatory action,” as defined in section 3(f)(1) of the order. The accompanying Regulatory Impact Analysis (RIA) for this rulemaking addresses the costs and benefits that would result from implementation of this final rule and the RIA can be found at <http://www.regulations.gov>.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments and the private sector. This final rule does not impose any federal mandate on any state, local, or tribal government or the private sector within the meaning of UMRA.

Environmental Impact

This final rule concerns the establishment of fair market rent schedules and related external administrative requirements or procedures that do not constitute a development decision that affects the physical condition of specific project areas or building sites. Accordingly, under 24 CFR 50.19(c)(6), this final rule is categorically excluded from environmental review under the National Environmental Policy Act of 1969 (42 U.S.C. 4321).

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*), generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. At the proposed rule stage, HUD prepared an Initial Regulatory Flexibility Analysis (IRFA) and HUD follows the IRFA with a Final Regulatory Flexibility Analysis (FRFA). HUD finds in the FRFA that this final rule will not have a significant economic impact on a substantial number of small entities. The FRFA, which is found in Appendix A to this final rule and can also be found at www.regulations.gov elaborates, and provides details on how HUD made this finding.

Executive Order 13132, Federalism

Executive Order 13132 (entitled "Federalism") prohibits, to the extent practicable and permitted by law, an agency from promulgating a regulation that has federalism implications and either imposes substantial direct compliance costs on state and local governments and is not required by statute or preempts state law, unless the relevant requirements of section 6 of the Executive order are met. This final rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive order.

Catalog of Federal Domestic Assistance Number

The Catalog of Federal Domestic Assistance number for 24 CFR part 982 is 14.871.

List of Subjects*24 CFR Part 888*

Grant programs-housing and community development, Rent subsidies.

24 CFR Part 982

Grant programs-housing and community development, Grant programs-Indians, Indians, Public housing, Rent subsidies, Reporting and recordkeeping requirements.

24 CFR Part 983

Grant programs-housing and community development, Low and moderate income housing, Rent subsidies, Reporting and recordkeeping requirements.

24 CFR Part 985

Grant programs-housing and community development, Public housing, Rent subsidies, Reporting and recordkeeping requirements.

Accordingly, for the reasons stated in the preamble, HUD amends 24 CFR parts 888, 982, 983, and 985 as follows:

PART 888—SECTION 8 HOUSING ASSISTANCE PAYMENTS PROGRAM—FAIR MARKET RENTS AND CONTRACT RENT ANNUAL ADJUSTMENT FACTORS

■ 1. The authority citation for part 888 continues to read as follows:

Authority: 42 U.S.C. 1437f and 3535d.

■ 2. In § 888.111, revise paragraph (a) to read as follows:

§ 888.111 Fair market rents for existing housing: Applicability.

(a) The fair market rents (FMRs) for existing housing are determined by HUD and are used in the Section 8 Housing Choice Voucher program (HCV program) (part 982 of this title), Section 8 project-based assistance programs and other programs requiring their use. In the HCV program, the FMRs are used to determine payment standard schedules. In the Section 8 project-based assistance programs, the FMRs are used to determine the maximum initial rent (at the beginning of the term of a housing assistance payments contract).

* * * * *

■ 3. Revise § 888.113 to read as follows:

§ 888.113 Fair market rents for existing housing: Methodology.

(a) *Basis for setting fair market rents.* Fair Market Rents (FMRs) are estimates of rent plus the cost of utilities, except telephone. FMRs are housing market-wide estimates of rents that provide opportunities to rent standard quality housing throughout the geographic area in which rental housing units are in competition. The level at which FMRs are set is expressed as a percentile point within the rent distribution of standard quality rental housing units in the FMR area. FMRs are set at the 40th percentile rent, the dollar amount below which the rent for 40 percent of standard quality rental housing units fall within the FMR area. The 40th percentile rent is drawn from the distribution of rents of all units within the FMR area that are occupied by recent movers. Adjustments are made to exclude public housing units, newly built units and substandard units.

(b) *Setting FMRs at the 40th percentile rent.* Generally, HUD will set the FMRs at the 40th percentile rent, but no lower than 90 percent of the previous year's FMR for the FMR area.

(c) *Setting Small Area FMRs.* (1) HUD will set Small Area FMRs for certain metropolitan FMR areas for use in the administration of tenant-based assistance under the HCV program. HUD will establish the selection values used to determine those metropolitan areas through a **Federal Register** notice on November 16, 2016 and may update the selection values through a **Federal Register** notice, subject to public comment. The selection criteria used to determine those metropolitan areas are:

(i) The number of vouchers under lease in the metropolitan FMR area;

(ii) The percentage of the standard quality rental stock, within the metropolitan FMR area is in small areas (ZIP codes) where the Small Area FMR is more than 110 percent of the metropolitan FMR area;

(iii) The percentage of voucher families living in concentrated low income areas;

(iv) The percentage of voucher families living in concentrated low income areas relative to the percentage of all renters within these areas over the entire metropolitan area; and

(v) The vacancy rate for the metropolitan area.

(2) For purposes of determining applicability of Small Area FMRs to a metropolitan area, the term "concentrated low-income areas" means:

(i) Those census tracts in the metropolitan FMR area with a poverty rate of 25 percent or more; or

(ii) Any tract in the metropolitan FMR area where at least 50 percent of the households earn less than 60 percent of the area median income and are designated by HUD as Qualified Census Tracts in accordance with section 42 of the Internal Revenue Code (26 U.S.C. 42).

(3) If a metropolitan area meets the criteria of paragraph (c)(1) of this section, Small Area FMRs will apply to the metropolitan area and all PHAs administering HCV programs in that area will be required to use Small Area FMRs. A PHA administering an HCV program in a metropolitan area not subject to the application of Small Area FMRs may opt to use Small Area FMRs by seeking approval from HUD's Office of Public and Indian Housing (PIH) through written request to PIH.

(4) HUD will designate Small Area FMR areas at the beginning of a Federal fiscal year, such designations will be permanent, and will make new area designations every 5 years thereafter as new data becomes available. HUD may suspend a Small Area FMR designation from a metropolitan area, or may temporarily exempt a PHA in a Small Area FMR metropolitan area from use of the Small Area FMRs, when HUD by notice makes a documented determination that such action is warranted. Actions that may serve as the basis of a suspension of Small Area FMRs are:

(i) A Presidentially declared disaster area that results in the loss of a substantial number of housing units;

(ii) A sudden influx of displaced households needing permanent housing; or

(iii) Other events as determined by the Secretary.

(5) Small Area FMRs only apply to tenant-based assistance under the HCV program. However, a PHA may elect to apply Small Area FMRs to project-based voucher (PBV) units at 24 CFR part 983

as provided in paragraph (h) of this section.

(d) *FMR areas.* FMR areas comprise metropolitan areas and nonmetropolitan counties and Small Area FMR areas as follows:

(1) Generally, FMR areas are metropolitan areas and nonmetropolitan counties. With several exceptions, the most current Office of Management and Budget (OMB) metropolitan area definitions of Metropolitan Statistical Areas (MSAs) are used because of their generally close correspondence with housing market area definitions. HUD may make exceptions to OMB definitions if the MSAs encompass areas that are larger than housing market areas. The counties deleted from the HUD-defined FMR areas in those cases are established as separate metropolitan county FMR areas. FMRs are established for all areas in the United States, the District of Columbia, and the Insular Areas of the United States.

(2) Small Area FMR areas are the U.S. Postal Service ZIP code areas within a designated metropolitan area.

(e) *Data sources.* (1) HUD uses the most accurate and current data available to develop the FMR estimates and may add other data sources as they are discovered and determined to be statistically valid. The following sources of survey data are used to develop the base-year FMR estimates:

(i) The most recent American Community Survey conducted by the U.S. Census Bureau, which provides statistically reliable rent data.

(ii) Locally collected survey data acquired through Address-Based Mail surveys or Random Digit Dialing (RDD) telephone survey data, based on a sampling procedure that uses computers to select statistically random samples of rental housing.

(iii) Statistically valid information, as determined by HUD, presented to HUD during the public comment and review period.

(2) Base-year recent mover adjusted FMRs are updated and trended to the midpoint of the program year they are to be effective using Consumer Price Index (CPI) data for rents and for utilities.

(f) *Unit size adjustments.* (1) For most areas the ratios developed incorporating the most recent American Community Survey data are applied to the two-bedroom FMR estimates to derive FMRs for other bedroom sizes. Exceptions to this procedure may be made for areas with local bedroom intervals below an acceptable range. To help the largest most difficult-to-house families find units, higher ratios than the actual

market ratios may be used for three-bedroom and larger-size units.

(2) The FMR for single room occupancy housing is 75 percent of the FMR for a zero bedroom unit.

(g) *Manufactured home space rental.* The FMR for a manufactured home space rental (for the HCV program under 24 CFR part 982) is 40 percent of the FMR for a two-bedroom unit for the metropolitan area or non-metropolitan county, as applicable. Small Area FMRs under paragraph (c) of this section do not apply to manufactured home space rentals.

(h) *Small Area FMRs and Project-based vouchers.* Small Area FMRs do not apply to Project-based vouchers regardless of whether HUD designates the metropolitan area or approves the PHA for Small Area FMRs under paragraph (c)(3) of this section. The following exceptions apply:

(1) Where the PHA notice of owner selection under 24 CFR 983.51(d) was made on or before the effective dates of both the Small Area FMR designation and the PHA administrative policy, the PHA and owner may mutually agree to apply the Small Area FMR. The application of the Small Area FMRs must be prospective and consistent with the PHA administrative plan. The owner and PHA may not subsequently choose to revert back to the use of the metropolitan-wide FMRs for the PBV project. If the rent to owner will increase as a result of the mutual agreement to apply the Small Area FMRs to the PBV project, the rent increase shall not be effective until the first annual anniversary of the HAP contract in accordance with 24 CFR 983.302(b).

(2) Where the PHA notice of owner selection under 24 CFR 983.51(d) was made after the effective dates of both the Small Area FMR designation and the PHA administrative policy, the Small Area FMRs shall apply to the PBV project if the PHA administrative plan provides that Small Area FMRs are used for all future PBV projects. If the PHA chooses to implement this administrative policy, the policy must apply to all future PBV projects and the PHA's entire jurisdiction. An owner and the PHA may not subsequently choose to apply the metropolitan area FMR to the project, regardless of whether the PHA subsequently changes its administrative plan to revert to the use of metropolitan-wide FMR for future PBV projects.

(3) For purposes of this section, the term "effective date of the Small Area FMR designation" means:

(i) The date that HUD designated a metropolitan area as a Small Area FMR area; or

(ii) The date that HUD approved a PHA request to voluntarily opt to use Small Area FMRs for its HCV program, as applicable.

(4) For purposes of this section, the term "effective date of the PHA administrative policy" means the date the administrative policy was formally adopted as part of the PHA administrative plan by the PHA Board of Commissioners or other authorized PHA officials in accordance with § 982.54(a).

(i) *Transition of metropolitan areas previously subject to 50th percentile FMRs.* (1) A metropolitan area designated as 50th percentile FMR areas for which the 3-year period has not expired prior to January 17, 2017 shall transition out of 50th percentile FMRs as follows:

(i) A 50th percentile FMR area that is designated for Small Area FMRs in accordance with paragraph (c) of this section will transition to the Small Area FMRs upon the effective date of the Small Area FMR designation;

(ii) A 50th percentile metropolitan FMR area not designated as a Small Area FMRs in accordance with paragraph (c) of this section, will remain a 50th percentile FMR until the expiration of the three-year period, at which time the metropolitan area will revert to the standard FMR based on the 40th percentile rent for the metropolitan area.

(2) A PHA with jurisdiction in a 50th percentile FMR area that reverts to the standard 40th percentile FMR may request HUD approval of payment standard amounts based on the 50th percentile rent in accordance with 24 CFR 982.503(f).

(3) HUD will calculate the 50th percentile rents for certain metropolitan areas for purposes of this transition and to approve success rate payment standard amounts in accordance with 24 CFR 982.503(e). As is the case for determining 40th percentile rent, the 50th percentile rent is drawn from the distribution of rents of all units that are occupied by recent movers and adjustments are made to exclude public housing units, newly built units and substandard units.

■ 4. Revise § 888.115 to read as follows:

§ 888.115 Fair market rents for existing housing: Manner of publication.

(a) *Publication of FMRs.* FMRs will be published at least annually by HUD on the World Wide Web, or in any other manner specified by the Secretary. HUD will publish a notice announcing the

publication of the FMRs in the **Federal Register**, to be effective October 1 of each year, and provide for a minimum of 30 days of public comments and requested for reevaluation of the FMRs in a jurisdiction. The FMRs will become effective no earlier than 30 days after the date the notice publishes in the **Federal Register** (e.g., if HUD fails to publish FMRs 30 days before October 1, the effective date will be 30 days after publication), except for areas where HUD receives comments during the minimum 30-day comment period requesting reevaluation of the FMRs in a jurisdiction. After HUD reviews a request for reevaluation, HUD will post on the World Wide Web the final FMRs for the areas that have been reevaluated and publish a notice in the **Federal Register** announcing the publication and the effective date.

(b) *Changes in methodology.* HUD will publish for comment in the **Federal Register** a document proposing material changes in the method for estimating FMRs and shall respond to public comment on the proposed material changes in the subsequent **Federal Register** document announcing the availability of new FMRs based on the revised method for estimating FMRs.

PART 982—SECTION 8 TENANT-BASED ASSISTANCE: HOUSING CHOICE VOUCHER PROGRAM

■ 5. The authority citation for part 982 continues to read as follows:

Authority: 42 U.S.C. 1437f and 3535d.

■ 6. In § 982.54, revise paragraph (d)(14) and add paragraph (d)(23) to read as follows:

§ 982.54 Administrative plan.

* * * * *

(d) * * *

(14) The process for establishing and revising payment standards, including policies on administering decreases in the payment standard during the HAP contract term (see § 982.505(d)(3)).

* * * * *

(23) Policies concerning application of Small Area FMRs to project-based voucher units (see § 888.113(h)).

■ 7. Amend § 982.503 as follows:

- a. Add a sentence to the end of paragraph (b)(1)(i);
- b. Revise paragraph (b)(1)(iii) and add paragraphs (b)(1)(iv) through (vi);
- c. Revise paragraph (b)(2);
- d. Revise paragraphs (c)(2) introductory text, (c)(2)(ii), and (c)(5);
- e. In paragraphs (f) introductory text and (f)(2), remove “§ 888.113(c)” and add in its place “§ 888.113(i)(3)”.

The addition and revisions read as follows:

§ 982.503 Payment standard amount and schedule.

* * * * *

(b) * * *

(1) * * *

(i) * * * The PHA must revise the payment standard amount no later than 3 months following the effective date of the published FMR if a change is necessary to stay within the basic range.

* * * * *

(iii) A PHA that is not in a designated Small Area FMR area or has not opted to voluntarily implement Small Area FMRs under 24 CFR 888.113(c)(3) may establish exception payment standards for a ZIP code area above the basic range for the metropolitan FMR based on the HUD published Small Area FMRs. The PHA may establish an exception payment standard up to 110 percent of the HUD published Small Area FMR for that ZIP code area. The PHA must notify HUD if it establishes an exception payment standard based on the Small Area FMR. The exception payment standard must apply to the entire ZIP code area.

(iv) At the request of a PHA administering the HCV program under Small Area FMRs under § 888.113(c)(3), HUD may approve an exception payment standard for a Small Area FMR area above the 110 percent of the published FMR in accordance with conditions set forth by Notice in the **Federal Register**. The requirements of paragraph (c) of this section do not apply to these exception payment standard requests and approvals.

(v) The PHA may establish an exception payment standard of not more than 120 percent of the published FMR if required as a reasonable accommodation in accordance with 24 CFR part 8 for a family that includes a person with a disability. Any unit approved under an exception payment standard must still meet the reasonable rent requirements found at § 982.507.

(vi) The PHA may establish an exception payment standard of more than 120 percent of the published FMR if required as a reasonable accommodation in accordance with 24 CFR part 8 for a family that includes a person with a disability after approval from HUD. Any unit approved under an exception payment standard must still meet the reasonable rent requirements found at § 982.507.

(2) Except as described in paragraphs (b)(1)(iii) through (v) of this section, the PHA must request HUD approval to establish a payment standard amount that is higher or lower than the basic range. HUD has sole discretion to grant or deny approval of a higher or lower

payment standard amount. Paragraphs (c) and (e) of this section describe the requirements for approval of a higher payment standard amount (“exception payment standard amount”).

(c) * * *

(2) *Above 110 percent of FMR to 120 percent of published FMR.* The HUD Field Office may approve an exception payment standard amount from above 110 percent of the published FMR to 120 percent of the published FMR (upper range) if the HUD Field Office determines that approval is justified by the median rent method or the 40th percentile rent or the Small Area FMR method as described in paragraph (c)(2)(ii) of this section (and that such approval is also supported by an appropriate program justification in accordance with paragraph (c)(4) of this section).

* * * * *

(ii) *40th percentile rent or Small Area FMR method.* In this method, HUD determines that the area exception payment standard amount equals application of the 40th percentile of rents for standard quality rental housing in the exception area or the Small Area FMR. HUD determines whether the 40th percentile rent or Small Area FMR applies in accordance with the methodology described in 24 CFR 888.113 for determining FMRs. A PHA must present statistically representative rental housing survey data to justify HUD approval.

* * * * *

(5) *Population.* The total population of HUD-approved exception areas in an FMR area may not include more than 50 percent of the population of the FMR area, except when applying Small Area FMR exception areas under paragraph (b)(1)(iii) of this section.

* * * * *

■ 8. In § 982.505, revise paragraph (c)(3) and add a sentence at the end of paragraph (d) to read as follows:

§ 982.505 How to calculate housing assistance payment.

* * * * *

(c) * * *

(3) *Decrease in the payment standard amount during the HAP contract term.* If the amount on the payment standard schedule is decreased during the term of the HAP contract, the PHA is not required to reduce the payment standard amount used to calculate the subsidy for the families under HAP contract for as long as the HAP contract remains in effect.

(i) If the PHA chooses to reduce the payment standard for the families currently under HAP contract during

the HAP contract term in accordance with their administrative plan, the initial reduction to the payment standard amount used to calculate the monthly housing assistance payment for the family may not be applied any earlier than the effective date of the family's second regular reexamination following the effective date of the decrease in the payment standard amount.

(ii) The PHA may choose to reduce the payment standard amount for families that remain under HAP contract to the current payment standard amount in effect on the PHA voucher payment standard schedule, or may reduce the payment standard amount to an amount that is higher than the normally applicable payment standard amount on the PHA voucher payment standard schedule. The PHA may further reduce the payment standard amount for the families during the term of the HAP contract, provided the subsequent reductions continue to result in a payment standard amount that meets or exceeds the normally applicable payment standard amount on the PHA voucher payment standard schedule.

(iii) The PHA must provide the family with at least 12 months' notice that the payment standard is being reduced during the term of the HAP contract before the effective date of the change.

(iv) The PHA shall administer decreases in the payment standard amount during the term of the HAP contract in accordance with the PHA policy as described in the PHA administrative plan. The PHA may establish different policies for designated areas within their jurisdiction (e.g., for different zip code areas), but the PHA administrative policy on decreases to payment standards during the term of the HAP contract applies to all families under HAP contract at the time of the effective date of decrease in the payment standard within that designated area. The PHA may not limit or otherwise establish different protections or policies for certain families under HAP contract.

* * * * *

(d) * * * A PHA may establish a payment standard greater than 120 percent of the FMR by submitting a request to HUD.

■ 9. In § 982.507, revise paragraph (a)(2)(ii) to read as follows:

§ 982.507 Rent to owner: Reasonable rent.

- (a) * * *
- (2) * * *

(ii) If there is a 10 percent decrease in the published FMR in effect 60 days before the contract anniversary (for the unit size rented by the family) as compared with the FMR in effect 1 year before the contract anniversary.

* * * * *

PART 983—PROJECT-BASED VOUCHER (PBV) PROGRAM

■ 10. The authority citation for part 983 continues to read as follows:

Authority: 42 U.S.C. 1437f and 3535d.

■ 11. In § 983.301, revise paragraph (a)(3) to read as follows:

§ 983.301 Determining the rent to owner.

(a) * * *

(3) The rent to owner is also redetermined in accordance with § 983.302.

* * * * *

■ 12. In § 983.302, revise paragraph (a)(2) to read as follows:

§ 983.302 Redetermination of rent to owner.

(a) * * *

(2) When there is a 10 percent decrease in the published FMR.

* * * * *

■ 13. In § 983.303, revise paragraph (b)(1) to read as follows:

§ 983.303 Reasonable rent.

* * * * *

(b) * * *

(1) Whenever there is a 10 percent decrease in the published FMR in effect 60 days before the contract anniversary (for the unit sizes specified in the HAP contract) as compared with the FMR in effect 1 year before the contract anniversary.

* * * * *

PART 985—SECTION 8 MANAGEMENT ASSESSMENT PROGRAM (SEMAP)

■ 14. The authority citation for part 985 continues to read as follows:

Authority: 42 U.S.C. 1437a, 1437c, 1437f, and 3535(d).

■ 15. In § 985.3, revise paragraphs (b)(1), (b)(3)(i)(B), and (b)(3)(ii) and add a sentence to the end of paragraph (i)(1) to read as follows:

§ 985.3 Indicators, HUD verification methods and ratings.

* * * * *

(b) * * *

(1) This indicator shows whether the PHA has and implements a reasonable

written method to determine and document for each unit leased that the rent to owner is reasonable based on current rents for comparable unassisted units: At the time of initial leasing; if there is any increase in the rent to owner; at the HAP contract anniversary if there is a 10 percent decrease in the published fair market rent (FMR) in effect 60 days before the HAP contract anniversary. The PHA's method must take into consideration the location, size, type, quality and age of the units, and the amenities, housing services, and maintenance and utilities provided by the owners in determining comparability and the reasonable rent. (24 CFR 982.4, 24 CFR 982.54(d)(15), 982.158(f)(7) and 982.507)

* * * * *

(3) * * *

(i) * * *

(B) Based on the PHA's quality control sample of tenant files, the PHA follows its written method to determine reasonable rent and has documented its determination that the rent to owner is reasonable in accordance with § 982.507 of this chapter for at least 98 percent of units sampled at the time of initial leasing, if there is any increase in the rent to owner, and at the HAP contract anniversary if there is a 10 percent decrease in the published FMR in effect 60 days before the HAP contract anniversary. 20 points.

* * * * *

(ii) The PHA's SEMAP certification includes the statements in paragraph (b)(3)(i) of this section, except that the PHA documents its determination of reasonable rent for only 80 to 97 percent of units sampled at initial leasing, if there is any increase in the rent to owner, and at the HAP contract anniversary if there is a 10 percent decrease in the published FMR in effect 60 days before the HAP contract anniversary. 15 points.

* * * * *

(i) * * *

(1) * * * For purposes of this paragraph, payment standards that do not exceed 110 percent of the current applicable published FMRs include exception payment standards established by the PHA in accordance with 982.503(c)(iii).

* * * * *

Dated: November 3, 2016.

Nani A. Coloretti,
Deputy Secretary.

Appendix A—Final Regulatory Flexibility Analysis

Final Regulatory Flexibility Analysis Establishing a More Effective Fair Market Rent System; Using Small Area Fair Market Rents in Housing Choice Voucher Program Instead of the Current 50th Percentile FMRs

1. Introduction

The Regulatory Impact Analysis of the final Small Area Fair Market Rent (Small Area FMR) rule identifies two types of small entities that would be affected by the rule: Small Public Housing Agencies (PHAs) and small private landlords. The Final Regulatory Flexibility Analysis (FRFA) furthers the analysis of the impact of the rule on small entities by including more data on the relevant sectors as well as a more rigorous definition of what is a “small” PHA. The analysis of the final rule satisfies Section 604 of the Regulatory Flexibility Act. The requirements of the FRFA are listed below.⁷

(a) Each final regulatory flexibility analysis required under this section shall contain—

(1) A statement of the need for, and objectives of, the rule: *This requirement is met by Sections 2.2 and 2.3 of the FRFA. A lengthier discussion can be found in the Regulatory Impact Analysis and the Preamble of the Final Rule.*

(2) A statement of the significant issues raised by the public comments in response to the initial regulatory flexibility analysis, a statement of the assessment of the agency of such issues, and a statement of any changes made in the proposed rule as a result of such comments; *This requirement is met by Sections 3 of the FRFA. A discussion concerning all public comments submitted on the proposed rule can be found in the Preamble of the Final Rule.*

(3) The response of the agency to any comments filed by the Chief Counsel for Advocacy of the Small Business Administration in response to the proposed rule, and a detailed statement of any change made to the proposed rule in the final rule as a result of the comments; *This requirement is met by Section 3 of the FRFA.*

(4) A description of and an estimate of the number of small entities to which the rule will apply or an explanation of why no such estimate is available: *This requirement is met Sections 4.2 and 5.2 of the FRFA.*

(5) A description of the projected reporting, recordkeeping and other compliance requirements of the rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record: *This requirement is met by Section 4.2 of the FRFA.*

(6) A description of the steps the agency has taken to minimize the significant economic impact on small entities consistent with the stated objectives of applicable statutes, including a statement of the factual, policy, and legal reasons for selecting the alternative adopted in the final rule and why

each one of the other significant alternatives to the rule considered by the agency which affect the impact on small entities was rejected: *This requirement is met by Section 6 of the FRFA.*

(b) The agency shall make copies of the final regulatory flexibility analysis available to members of the public and shall publish in the **Federal Register** such analysis or a summary thereof. *This requirement is satisfied by the present FRFA.*

HUD expects a variety of economic effects stemming from implementation of the final rule. Transfers involving vouchers would be the most sizable of those effects. PHAs will face both costs and benefits from the implementation of this rule. Social benefits and costs associated with the rule could be generated by a new settlement pattern among voucher holders. Quantified incremental impacts include an expected transfer of \$151 million among participants and \$2 million of implementation costs to PHAs. The Regulatory Impact Analysis accompanying the final rule includes a lengthy description of qualitative impacts as well details concerning the calculation of the quantitative impacts.

2. Statement of the Need for, and Objectives of, the Rule

Section 2 documents the need for the final Small Area FMR rule as well as the objectives of the final rule.

2.1. Overview of Final Rule

This final rule requires the use of Small Area Fair Market Rents (Small Area FMRs) in the administration of the Housing Choice Voucher (HCV) program for certain metropolitan areas. HUD is implementing the use of Small Area FMRs in place of the current 50th percentile rent to address high levels of voucher concentration. HUD believes that Small Area FMRs gives HCV tenants a more effective means to move into areas of higher opportunity and lower poverty areas by providing them with subsidy adequate to make such areas accessible and to thereby reduce the number of voucher families that reside in areas of high poverty concentration.

HUD is using several criteria to determine which metropolitan areas would best be served by application of Small Area FMRs in the administration of the HCV program. These criteria include a threshold number of vouchers within a metropolitan area, the concentration of current HCV tenants in low-income areas, and the percentage of renter occupied units within the metropolitan area with Small Area FMRs above the payment standard basic range. Public housing agencies (PHAs) operating in designated metropolitan areas would be required to use Small Area FMRs. PHAs not operating in the designated areas would have the option to use Small Area FMRs in administering their HCV programs. Other programs that use FMRs would continue to use area-wide FMRs.

Note to Reader: A more comprehensive summary of the rule can be found in the Regulatory Impact Analysis and the Rule itself.

2.2. Need for the Rule

HUD's current rule for addressing high concentrations of voucher tenants in metropolitan areas, the 50th percentile Fair Market Rent rule, has not succeeded in providing voucher tenants access to high opportunity areas within a Fair Market Rent area. Therefore, the Small Area FMR rule is needed to replace the current regulatory provision with a new framework intended to provide voucher families with increased opportunities to find suitable units in higher opportunity areas.

2.3. Objectives of Rule

This final rule, through establishment of Small Area FMRs as a means of setting rents in certain metropolitan areas, is intended to facilitate the Housing Choice Voucher (HCV) program in achieving two program objectives: (1) Increasing the ability of low-income families to find and lease decent and affordable housing; and (2) providing low-income families with access to a broad range of housing opportunities throughout a metropolitan area. HUD's goal in pursuing this rulemaking is to provide HCV tenants with a greater ability to move into areas where jobs, transportation, and educational opportunities exist.

3. Significant Issues Raised by the Public Comments in Response to the Initial Regulatory Flexibility Analysis and Comments filed by the Chief Counsel for Advocacy of the Small Business Administration, Agency Assessment of Such Issues, and Changes Made in the Proposed Rule as a Result of Such Comments

3.1. Public Comments Filed Regarding the Initial Regulatory Flexibility Analysis

No public comments were filed that discussed or provided feedback on the Initial Regulatory Flexibility Analysis. Consequently, there is nothing for HUD to assess regarding these types of comments and no changes were made to the proposed rule based on IRFA comments.

3.2. Comments Filed by Chief Counsel for Advocacy of the Small Business Administration

No public comments were filed from the Chief Counsel for Advocacy of the Small Business Administration. The Small Business Administration provided comments during the interagency clearance process preceding publication of the proposed rule that were incorporated in the published document; however, no further changes to the proposed rule were made.

4.0. Description and Estimate of the Number of Small Entities to Which the Rule Will Apply

4.1. Industry Data: Lessors of Residential Building and Dwellings

The Small Business Administration defines a lessor of residential real estate to be a small business if it earns annual revenues (sales receipts) of less than \$27.5 million. In the 2012 Economic Census, the Census counted approximately 50,000 of which approximately 43,000 operated for the entire year of 2012. Our comparisons are made

⁷ HUD is not a covered agency, as defined in section 609(d)(2), and so is not required to comply with (6)1.

using the full-year data to be more consistent with the definition of what is small (firms operating the entire year).

Of the 42,911 firms operating all year, 42,618 can be considered small firms. Total annual revenue of the industry was \$84 billion,⁸ compared to \$43 billion for small

firms. Approximately 300,000 individuals were employed by firms operating all year during the pay period observed in March 2012; 200,000 of them were employed by small firms. Small lessors account for 99 percent of all firms, 51 percent of all revenue, 57 percent of all payroll, and 67 percent of

employees hired during the first quarter. The industry is dominated by small firms in numbers of firms and employees, but is roughly equivalent to all large firms in terms of revenue and payroll.

LESSORS OF RESIDENTIAL BUILDINGS AND DWELLINGS (NAICS INDUSTRY 531110) OPERATED FOR THE ENTIRE YEAR 2012, UNITED STATES

Firm size by revenue	Firms	Revenue (\$1,000)	Payroll (\$1,000)	Employees for period including March 12
All firms *	42,911	83,593,387	9,838,805	303,135
Revenue less than \$25,000,000	42,618	42,908,437	5,574,606	202,381
Proportion small firms**	99%	51%	57%	67%

* Note that there were 50,664 firms altogether but that 42,911 operated all year. Using the larger base would reduce the proportion of small firms.

** The official size standard of the SBA is \$27.5 million. Statistics are not available for this cut-off so we use the closest one leading to a slight underestimate of the proportion "small."

HUD is able to provide information on the number of owners who participate in the housing choice voucher program. Note that counting real estate owners is not equivalent to lessors that operate the property. One would expect there to be many more owners than lessors. Nonetheless, the data provides

insight as to the distribution of vouchers. It is evident that the overwhelming proportion of owners rent to very few voucher tenants. Approximately two-thirds of owners who rent to voucher tenants rent to only one voucher tenant household. Many of these are likely owners of single-family homes for

whom the rental income is not the primary source of income. Approximately 90 percent rent to no more than 4 voucher tenant households, which could be housed in a large two-story building. Very few owners rent to enough voucher tenants to occupy multiple buildings.

U.S. RESIDENTIAL REAL ESTATE OWNERS RENTING TO VOUCHER TENANT HOUSEHOLDS *

Category of owner with voucher tenant households	Number of owners with voucher tenant households*	Percent of owners with voucher tenant households
1 Voucher	435,653	67.2
2-4 Vouchers	142,925	22.1
5-19 Vouchers	55,206	8.5
20-49 Vouchers	10,773	1.7
50-99 Vouchers	2,564	0.4
100-199 Vouchers	687	0.1
200 or more Vouchers	148	0.0
All	647,956	100.0

* This table describes voucher tenants but NOT non-voucher tenants. It is likely that many owners rent to additional tenants, making the above table a slight overestimate of the small landlords affected by the rule.

The data on the distribution of owners by number of vouchers implies that industry structure is not significantly different for vouchers than for other residential rental properties. The tables do not correspond perfectly because one describes property managers and the other property owners. In addition, the table for owners shows information for voucher tenants only and does not include any unassisted tenants.

HUD estimates that 18 percent of all vouchers are likely to be affected by the rule. If the number of lessor firms is proportional to the number of vouchers, then approximately 7,700 firms operating all year round (or 9,000 firms operating at any time) would manage units in Small Area FMR areas. They do not necessarily provide housing for voucher tenants but would be affected by any market externalities

engendered by the rule. The median share of voucher holders in a census tract is 3.1 percent. Again, assuming proportionality we expect 400-500 NAICS industry 531110 firms to manage units occupied by voucher tenants in the Small Area FMR areas created by the proposed rule. The number of voucher units managed by any one firm will vary.

4.2. Economic Impacts and Compliance Requirements on Small Landlords

There are two types of possible effects of the rule on property owners and managers. The first is *direct*: An owner (and lessor) who receives income from a voucher tenant may experience a change in rental income without changing the contract or tenant. Consider a low-rent area in which the subsidy will decline. The owner (and lessor) would be held harmless if the tenant chose to make up

the difference. However, suppose that the subsidy declined by a critical amount such that the tenant can no longer afford the unit. The owner has two choices: Search for a new tenant who will pay the market rent or lower the rent by enough to maintain the current tenant. The former strategy would be chosen if the housing submarket were characterized by adequate demand. The latter strategy would be chosen if the reduction in rents are offset by the costs of finding a new tenant. Thus, while the owner (and lessor) may lose a particular voucher tenant, they will not lose the rental income from that unit. The rule may generate revenue for lessors of residential building and dwellings if a significant number of moves result. Managing turnover is one of the primary services provided by a lessor to an owner. This would not be a major effect but could serve to

⁸ American Community Survey data indicate that the lessor industry revenue is approximately 20 percent of aggregate rents. The industry collects

twice the average 10 percent commission for property managers. This difference could be explained by: Realtors' commissions, other

activities, and lessors owning property and thus collecting the full rent.

counterbalance any minor adverse effects on lessors.

The second type of effect is *indirect* (a pecuniary externality). A reduction (increase) of the voucher subsidy would lower (raise) the demand for housing in that submarket. Even properties without any voucher tenants would be affected by such a market-wide effect. However, a decline in demand would only result if voucher households make up a sufficiently large portion of rental households in a given neighborhood. Market spillovers are expected to be minimal in many areas due to the limited size of the voucher program in relation with the entire housing market. Of the 10,800 Census tracts in the areas affected by the final rule, the median share of voucher households is 3.2 percent. Even in areas where the share is larger, the rule does not eliminate the subsidy but reduces it. Small lessors will be disproportionately impacted by market effects only if the units leased by small lessors are disproportionately concentrated in low-rent areas.

The final rule does not impose any additional reporting, recordkeeping and other compliance requirements. Compliance and unit standards remain the same. An additional effect of the rule is that eight current 50th percentile areas will revert to 40th percentile FMRs, as the Small Area FMR rule uses different selection criteria than the 50th percentile rule. These areas currently cover 82,000 vouchers. On average, the FY16 40th percentile FMR is \$77 lower than the 50th percentile FMR, meaning a *transfer* of \$6.3 million is expected through a combination of landlords accepting lower rent, tenants increasing out of pocket rent, or tenants moving to lower cost, less desired units.

5. Public Housing Agencies Affected

PHAs operating in metropolitan areas that meet the established Small Area FMR criteria of the final rule will be required to use Small Area FMRs in their HCV programs. As of issuance of this final rule, there are 24 areas listed that meet these criteria. These areas contain approximately 368,000 (18 percent) of the HCV households nationwide.⁹ Of these 368,000 vouchers, 219,000 vouchers are administered by PHAs that may not yet use multiple payment standards.

5.1. Data: Small PHAs

A small PHA is defined by HUD to be one of less than 250 units.¹⁰ Using this definition, approximately half of the PHAs (1,100 out of 2,200) that administer HCVs are considered small. In the 24 metropolitan areas affected by the proposed rule, there are 217 PHAs, of which 71 are small. The Regulatory Flexibility Analysis authorizes an agency to adopt and apply definitions of small, “which are appropriate to the activities of the

⁹ This number includes areas that have already implemented Small Area FMRs and Moving to Work Agencies, which may not be compelled to adjust their payment standards as a result of the rule. The analysis below considers these exceptions.

¹⁰ For regulatory definitions of small PHAs, see: Deregulation of Small PHAs Final Rule, 24 CFR part 902, 903, and 985.

agency” for each category of small entity.¹¹ The 250-unit limit is one traditionally used by HUD in data collection as well as by city governments. In addition, it has been shown that PHAs of this size class face greater average costs of administering housing choice vouchers.¹² A greater average cost is an indicator for smaller entities is suggestive evidence of fixed costs of operation. Small PHAs make up 32 percent of the PHAs in affected areas and would manage no more than 2 percent of the vouchers.

5.2. Economic Impacts and Compliance Requirements for PHAs

PHAs administering Small Area FMRs will likely face higher administrative costs. Initial costs would include training employees and setting up new systems. Periodic costs include costs related to payment standard and rent determinations as well any increase in moves and contract rent changes than those operating under one metropolitan FMR. PHAs change their payment standards as the FMR changes. Once the payment standard is established, and the PHA board approves, the PHA creates materials to inform their customers (and landlords) of the new payment standards. Making the transition from one to many payment standards is likely to impose some burden at initial implementation of the Small Area FMR rule.

There are at least two ways that a PHA would respond to the increased complexity of multiple payment standards. First, it could pursue a more labor-intensive solution and ask staff to determine the payment standard manually. This would not be particularly difficult for a small PHA with few payment standards. Small PHAs typically have smaller service areas with fewer ZIP codes and therefore fewer Small Area FMR-based payment standards to determine and administer than do larger PHAs. Another solution is to make an upfront investment to automate the process of subsidy determination. A unit’s address is already entered into a PHA’s database. All that is needed is a tool that calculates the rental subsidy as a function of the address. HUD has the intention of developing such an application for PHAs and voucher holder tenants. For it to work, PHAs will have to provide data on their payment standard decisions to HUD. Thus, compliance costs of PHAs are expected to rise slightly but not significantly. Because the tool will be developed, tested, and provided by HUD, it is not expected that the cost of implementation will be disproportionate.

A 2015 study¹³ reports that, according to a Dallas PHA official, implementation costs of multiple payment standards were minimal at roughly \$10 a household. Though it is unclear what this estimate considers, and assuming it can be applied elsewhere, as a rough measure of magnitude this would mean \$2.2 million to \$3.7 million in implementation costs over the 24 areas designated and 217 PHAs affected by this

¹¹ The RFA standard definition of a “small governmental jurisdiction” is the government of a city, county, town, school district or special district with a population of less than 50,000.

¹² Abt Associates, 2015.

¹³ Collinson and Ganong, (2015, May).

final rule. The more accurate estimate is the lower because it is based on PHAs that do not already use multiple payment standards. Both were considered for completeness. The impact on small entities would be a fraction of this impact. Assuming that all PHAs are affected and that all small PHAs are at the maximum, then the total impact on all small PHAs would be \$177,500 (71 × 250 × \$10). Such a conservative estimate would reduce any downwards bias in the estimate of the impact stemming from returns to scale.

The Small Area FMR rule will be beneficial to PHAs in some important respects. First, the rule intends to eliminate the possibility that an area will cycle in and out of the 50th percentile FMR as it can currently occur under the 2000 rule. This change is expected to reduce the year-to-year administrative uncertainty and the costs of adjusting the program to changing FMR calculations over time. Second, the final rule is also expected to facilitate PHA and regional compliance with consolidated planning and Fair Housing requirements and allow counseling and similar efforts to be more effective.¹⁴ Finally, the use of Small Area FMRs is expected to decrease the costs of rent reasonableness determinations as the payment standards better reflect local rent levels.

6. Alternatives Which Minimize Impact on Small Entities

Under the Final Regulatory Flexibility Analysis, HUD must discuss alternatives that minimize the economic impact on small entities. In order to lessen the burden on PHAs, and specifically small PHAs, HUD has taken, or is committed to taking, several measures in implementing Small Area FMRs designed to facilitate transition to this approach and minimize costs and burdens. Specifically, HUD is pursuing the following strategies to mitigate adverse impacts:

- *Publish Small Area FMRs grouped by overlapping potential payment standards.* Although the final rule does not specifically address the format of HUD’s publication of Small Area FMRs, in on-line materials HUD will provide a version of Small Area FMRs formatted and organized so as to facilitate compliance by PHAs.

- *Develop a mobile application to automate payment standard identification and significantly reduce administrative costs of implementing the Small Area FMR rule for all parties involved (tenant, landlord, PHA).* As noted above, HUD will be developing such an application for PHAs, voucher holders, and landlords.

- *Allow the rounding of Small Area FMRs to the nearest ten dollars to make it easier to arrange the small areas into payment standard groups.* Although the final rule does not specify the calculation methods for Small Area FMR estimates, HUD’s practice in the Dallas, TX HUD Metro FMR Area and in the Small Area FMR demonstration sites has been to round Small Area FMR estimates to the nearest \$10.00 to make it easier to arrange small areas into payment standard groups. Doing so reduces the number of payment standards PHAs would be required to administer.

¹⁴ Advancing mobility is one of the costliest activities of a PHA.

- *Consider an exemption for PHAs administering very few vouchers in Small Area FMR areas.* The final rule exempts HUD Metropolitan FMR Areas with less than 2,500 HCVs under lease from using Small Area FMRs.

In addition to the above, the presentation of the information in HUD's proposed revision to its PHA administrative fee formula would also soften any adverse impact by providing additional resources to small PHAs generally.

7. Conclusion

The majority of lessors of residential real estate and a substantial fraction of PHAs are characterized as small. If there were disproportionate effects on small entities, then a more detailed regulatory flexibility analysis would be merited. However, after an in-depth discussion of the industry structure and impact of the rule, HUD cannot conclude that there is a significant and disproportionate impact on small entities. It is true that many lessors may receive income from voucher tenants but it is not likely that they will be adversely affected once market forces are accounted for. Small PHAs could face an additional administrative burden but HUD has offered solutions to significantly reduce any burden.

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