

DOCUMENT RESUME

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Review of Recent Policy Changes in Managing and Disposing of HUD-Owned Multifamily Housing Projects. September 26, 1978. 11 pp.

Testimony before the House Committee on Government Operations: Manpower and Housing Subcommittee; by Henry Eschwege, Director, Community and Economic Development Div.

Contact: Community and Economic Development Div.
Organization Concerned: Department of Housing and Urban Development.

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Since May 1977, the Department of Housing and Urban Development (HUD) has changed its management and disposition policies for HUD-owned formerly subsidized multifamily properties to provide that: tenants residing in HUD-owned properties pay not more than 25% of their income for rent and utilities, the properties be rehabilitated before disposition, and the properties not be sold unless a subsidy can be provided to maintain the low- and moderate-income characteristics of the project. For the year ending February 28, 1978, it cost HUD about \$20 million annually to operate the 21,000 multifamily housing units it owns. After full implementation of the 25% income limitation policy, HUD's costs could increase to as much as \$28.5 million. The properties appear to be undergoing a transition from a low- and moderate-income tenancy to a primarily very low-income tenancy which will increase HUD's costs. Both HUD and project managers need to improve management and monitoring of these projects. An estimated 28,000 formerly subsidized and unsubsidized units need to be rehabilitated at a cost of \$122 million or an average of \$4,350 per unit. These costs will be absorbed by insurance funds, and a HUD official indicated that the rehabilitation cost will be recovered when the properties are sold. HUD plans to sell most of its previously subsidized properties with a commitment of section 8 subsidies. It could cost \$260 million annually or \$3.9 billion for the maximum 15-year commitment period to dispose of the 85,000 units which are or appear likely to be HUD-owned properties. (RRS)

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STATEMENT OF
HENRY ESCHWEGE, DIRECTOR
COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION

BEFORE THE
SUBCOMMITTEE ON MANPOWER AND HOUSING
COMMITTEE ON GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES

ON
REVIEW OF RECENT POLICY CHANGES IN
MANAGING AND DISPOSING OF
HUD-OWNED MULTIFAMILY HOUSING PROJECTS

MADAM CHAIRWOMAN AND MEMBERS OF THE SUBCOMMITTEE:

WE ARE HERE TODAY AT YOUR REQUEST TO DISCUSS THE PRELIMINARY RESULTS OF OUR ONGOING REVIEW OF RECENT POLICY CHANGES IN HUD'S MANAGEMENT AND DISPOSITION OF HUD-OWNED FORMERLY SUBSIDIZED MULTIFAMILY PROPERTIES.

WE PREVIOUSLY DISCUSSED HUD'S MANAGEMENT AND DISPOSITION OF HUD-OWNED MULTIFAMILY PROPERTIES ON SEPTEMBER 23, 1975 IN HEARINGS BEFORE THIS SUBCOMMITTEE. SINCE THAT TIME HUD HAS MADE SEVERAL POLICY CHANGES AFFECTING THE MANAGEMENT AND DISPOSITION OF THESE PROPERTIES. MY TESTIMONY TODAY WILL FOCUS ON THE EFFECTS OF THESE POLICY CHANGES ON THE CURRENT AND POTENTIAL COSTS OF OPERATING AND DISPOSING OF FORMERLY SUBSIDIZED MULTIFAMILY PROPERTIES.

SINCE MAY 1977, HUD HAS CHANGED ITS MANAGEMENT AND DISPOSITION POLICIES TO PROVIDE:

--THAT TENANTS RESIDING IN HUD-OWNED PROPERTIES PAY NOT MORE THAN 25-PERCENT OF THEIR INCOME FOR RENT AND UTILITIES,

--THAT THE PROPERTIES BE REHABILITATED BEFORE DISPOSITION, AND

--THAT THE PROPERTIES NOT BE SOLD UNLESS A SUBSIDY (MOST LIKELY SECTION 8) CAN BE PROVIDED TO MAINTAIN THE LOW AND MODERATE INCOME CHARACTERISTICS OF THE PROJECT.

I WOULD LIKE FIRST TO HIGHLIGHT OUR PRELIMINARY OR TENTATIVE OBSERVATIONS AND THEN GO INTO SOME DETAIL.

--HUD OWNS 21,000 MULTIFAMILY HOUSING UNITS IN FORMERLY SUBSIDIZED PROPERTIES. FOR THE YEAR ENDING FEBRUARY 28, 1978, IT COST HUD ABOUT \$20 MILLION ANNUALLY TO OPERATE THESE UNITS. WE ESTIMATE THAT AFTER FULL IMPLEMENTATION OF THE 25-PERCENT INCOME LIMITATION POLICY, HUD'S COSTS COULD INCREASE TO AS MUCH AS \$28.5 MILLION ANNUALLY. FURTHERMORE, WITH THE ACQUISITION OF 64,000 UNITS WHICH ARE NOW UNDERGOING FORECLOSURE OR ARE 13 MONTHS OR MORE DELINQUENT, THESE COSTS COULD INCREASE TO ABOUT \$115 MILLION ANNUALLY.

--BOTH HUD AND PROJECT MANAGERS NEED TO IMPROVE THEIR MANAGEMENT AND MONITORING OF THESE PROPERTIES,

PARTICULARLY IN VERIFYING REPORTED TENANT INCOME.

--THE PROPERTIES APPEAR TO BE UNDERGOING A TRANSITION FROM A LOW-AND MODERATE-INCOME TENANCY TO A PRIMARILY VERY LOW INCOME TENANCY WHICH WILL FURTHER INCREASE HUD'S COSTS.

--HUD ESTIMATES THAT 28,000 FORMERLY SUBSIDIZED AND UNSUBSIDIZED UNITS NEED TO BE REHABILITATED AT A COST OF \$122 MILLION; AN AVERAGE OF \$4,350 PER UNIT.

--HUD HAS SOLD 13 PROPERTIES WITH SECTION 8 SUBSIDIES WITH AN AVERAGE MAXIMUM MONTHLY PAYMENT OF \$256 PER UNIT. BASED ON THIS AVERAGE, IT MAY COST UP TO \$3.6 MILLION ANNUALLY OR \$72 MILLION FOR THE 20-YEAR TERM OF THESE COMMITMENTS. HUD HAS PUBLISHED NEW INTERIM REGULATIONS THIS MONTH LIMITING THESE SECTION 8 COMMITMENTS TO 15 YEARS. WE ESTIMATE THAT IT COULD COST \$260 MILLION ANNUALLY, OR \$3.9 BILLION FOR THE MAXIMUM 15-YEAR COMMITMENT PERIOD TO DISPOSE OF THE 85,000 UNITS WHICH EITHER ALREADY ARE, OR APPEAR LIKELY TO BE, OWNED BY HUD.

HUD HAS NOT BEEN GIVEN AN OPPORTUNITY TO FORMALLY COMMENT ON OUR OBSERVATIONS, BUT WE DISCUSSED THESE OBSERVATIONS, INCLUDING SEVERAL INSTANCES OF APPARENT INADEQUATE PROJECT MANAGEMENT AND INSUFFICIENT HUD OVERSIGHT WITH A HEADQUARTERS OFFICIAL. SHORTLY THEREAFTER HUD EMPHASIZED TO ITS FIELD OFFICES THE NEED TO COMPLY WITH HUD INSTRUCTIONS TO ACHIEVE QUALITY MANAGEMENT AT HUD PROJECTS.

COST IMPACT OF HUD RENT POLICY

BEFORE HUD INSTITUTED ITS 25-PERCENT INCOME LIMITATION POLICY, TENANTS OF HUD-OWNED FORMERLY SUBSIDIZED PROPERTIES WERE PAYING THE AUTHORIZED RENT. WE CALCULATED THE AVERAGE NET MONTHLY OPERATING LOSS TO BE \$80 PER UNIT FOR THESE PROPERTIES DURING THE PERIOD WHEN THIS POLICY WAS BEING IMPLEMENTED. INCLUDED IN THIS LOSS ARE SUCH COSTS AS MAINTENANCE, UTILITIES, MANAGEMENT FEES, AND REAL ESTATE TAXES BUT NOT INTEREST AND DEPRECIATION OF HUD'S ACQUISITION COSTS. IF THE \$80 MONTHLY LOSS WERE APPLIED TO THE PRESENT INVENTORY OF 21,000 UNITS, HUD'S OPERATING LOSS WOULD BE \$20 MILLION ANNUALLY.

IMPLEMENTATION OF THE 25-PERCENT INCOME LIMITATION POLICY REDUCES PROPERTY INCOME. OUR LIMITED ANALYSIS OF THIS REDUCED INCOME ATTRIBUTED TO HUD'S FULL IMPLEMENTATION OF THE 25-PERCENT INCOME LIMITATION POLICY SHOWED THAT THE AVERAGE MONTHLY UNIT COST COULD INCREASE TO \$113 OR A TOTAL OF ABOUT \$28.5 MILLION ANNUALLY FOR THE PRESENT INVENTORY. THESE COSTS COULD BE EVEN HIGHER IN THE FUTURE BECAUSE ABOUT 20,500 UNITS ARE IN FORECLOSURE, AND ABOUT 43,200 UNITS ARE 13 OR MORE MONTHS DELINQUENT IN THEIR MORTGAGE PAYMENTS. IF ALL THESE UNITS COME INTO THE INVENTORY, WE ESTIMATE THAT TOTAL ANNUAL OPERATING COSTS WILL BE ABOUT \$115 MILLION.

THESE COSTS ARE BORNE BY THE GENERAL AND SPECIAL RISK INSURANCE FUNDS. THESE FUNDS HAVE BEEN IN A DEFICIT STATUS

SINCE 1969 AND HUD HAS BORROWED OVER \$5 BILLION THROUGH SEPTEMBER 1977 TO REPLENISH THE FUNDS.

HUD MANAGEMENT OF PROPERTIES
IN INVENTORY

ONCE HUD ACQUIRES A PROPERTY, IT MUST BE MANAGED WITH TWO GOALS IN MIND: (1) TO MAXIMIZE RETURN TO THE GOVERNMENT THROUGH AN ULTIMATE SALE AND (2) TO PROVIDE, IN THE INTERIM, DECENT, SAFE, AND SANITARY HOUSING TO EXISTING TENANTS.

AT THE FIVE PROPERTIES REVIEWED TO DATE, WE FOUND THAT THE PROPERTY MANAGERS ARE IMPROVING THE PHYSICAL CONDITION AND OCCUPANCY OF THE PROPERTIES. SPECIFICALLY HUD HAS:

- PAINTED THE INTERIOR AND EXTERIOR OF THE BUILDINGS
- REPLACED DAMAGED FIXTURES SUCH AS APPLIANCES, RANGES AND DRAPES
- MAINTAINED AND REPLACED LAWN AND SHRUBBERIES AS NEEDED
- IMPROVED PROJECT MANAGEMENT, AND
- PROVIDED ADDITIONAL SECURITY

THESE EFFORTS ARE CONSISTENT WITH THE ABOVE GOALS. HOWEVER, IN ACCOMPLISHING THESE IMPROVEMENTS, HUD HAS INCURRED SUBSTANTIAL OPERATING COSTS. FOR EXAMPLE, FOR FOUR OF THE FIVE PROPERTIES FOR WHICH WE WERE ABLE TO OBTAIN COST DATA, THE AVERAGE TOTAL MONTHLY OPERATING COST IS \$299 PER UNIT. THESE COSTS SEEM HIGH, ESPECIALLY SINCE NO MORTGAGE PRINCIPAL AND INTEREST COSTS ARE BEING INCURRED. THE AVERAGE MONTHLY RENTAL IS \$121 PER UNIT RESULTING IN A NET COST TO HUD OF

\$178 PER UNIT. WE HAVE NOT COMPLETED OUR REVIEW OF THE REASONABLENESS OF THE COSTS INCURRED.

ALSO THE DEFICITS BEING INCURRED IN OPERATING THE PROPERTIES COULD BE REDUCED BY IMPROVING THE VERIFICATION OF REPORTED TENANT INCOME.

INADEQUATE TENANT INCOME VERIFICATION

TENANTS MUST CERTIFY THAT THEIR TOTAL REPORTED FAMILY INCOME IS TRUE AND COMPLETE. THEY ALSO AUTHORIZE INQUIRIES TO BE MADE TO VERIFY THE REPORTED INCOME. SECTION 1001 OF TITLE 18 OF THE UNITED STATES CODE MAKES IT A CRIMINAL OFFENSE TO MAKE A WILLFULLY FALSE STATEMENT ON THE INCOME CERTIFICATION. BECAUSE RENT PAID AT HUD-OWNED PROPERTIES IS BASED ON INCOME, IT IS IMPORTANT THAT TENANT INCOME STATEMENTS ARE PROPERLY VERIFIED. OUR WORK TO DATE AT FIVE PROJECTS SUGGESTS THAT INCOME VERIFICATIONS ARE POORLY DONE, AND THAT THERE MAY BE SUBSTANTIAL UNDERREPORTING OF INCOME. AS WE SEE IT THERE IS A LACK OF INCENTIVES TO PROPERLY REPORT AND VERIFY INCOME AND PROJECT MANAGERS HAVE DIFFICULTY IN VERIFYING INCOME.

FOR EXAMPLE, BECAUSE TENANTS PAY HIGHER RENTS AS THEIR INCOMES RISE, THERE IS AN INHERENT DISINCENTIVE TO REPORT INCREASES IN INCOME. SIMILARLY, PROJECT MANAGERS WHO HAVE PRIMARY RESPONSIBILITY FOR THE VERIFICATION, HAVE LITTLE INCENTIVE TO THOROUGHLY VERIFY INCOMES BECAUSE OF THE WAY THAT THEIR MANAGEMENT FEES ARE COMPUTED. AT FOUR OF THE FIVE PROJECTS WE VISITED THE FEES ARE FIXED AT A PREDETERMINED

AMOUNT. THEREFORE, THE MANAGER RECEIVES NO ADDITIONAL COMPENSATION FOR ENSURING THAT TENANTS PAY THE PROPER RENT. AT THE OTHER PROJECT THE MANAGEMENT FEE IS BASED ON A PERCENTAGE OF RENTAL REVENUES. THE FOUR PROJECTS WITH A FIXED MANAGEMENT FEE HAD SIMILARLY BEEN ON A PERCENTAGE OF RENTAL REVENUE BASIS BEFORE THE 25-PERCENT INCOME LIMITATION POLICY WAS IMPLEMENTED. TWO OF THE PROJECT MANAGERS WHO HAD BEEN ON A PERCENTAGE OF RENTAL REVENUE BASIS TOLD US THAT WHILE FEES ARE RAISED WHEN INCOME VERIFICATION RESULTS IN HIGHER RENTS, SUCH A RAISE IN FEES DOES NOT OFFSET THE ADDITIONAL TIME AND WORK REQUIRED TO PROPERLY VERIFY TENANT INCOME. IT IS DIFFICULT FOR A PROJECT MANAGER TO VERIFY INCOME BECAUSE HE CAN ONLY VERIFY THE INCOME INFORMATION PROVIDED BY THE TENANTS. UNREPORTED INCOME OFTEN IS UNDETECTED BECAUSE PROJECT MANAGERS DO NOT HAVE READY ACCESS TO INCOME INFORMATION MAINTAINED BY INDEPENDENT INCOME SOURCES SUCH AS THE INTERNAL REVENUE SERVICE, SOCIAL SECURITY ADMINISTRATION AND THE PUBLIC ASSISTANCE OFFICE.

FOR EXAMPLE, AT FOUR PROPERTIES WE CHECKED THE NAMES OF TENANTS AGAINST LOCAL PUBLIC ASSISTANCE PAYMENTS AND FOUND THAT OF 144 TENANTS RECEIVING WELFARE PAYMENTS, 25 TENANTS DID NOT REPORT WELFARE INCOME. WE ESTIMATE THIS OMISSION COST HUD UP TO \$13,200 ANNUALLY IN LOST REVENUES AT THESE PROJECTS.

WE IDENTIFIED 40 ADDITIONAL INSTANCES OF POSSIBLE

UNDERREPORTING OF INCOME. TO VERIFY THE UNDERREPORTED INCOME WILL REQUIRE INQUIRIES TO INDEPENDENT SOURCES SUCH AS THE INTERNAL REVENUE SERVICE AND SOCIAL SECURITY ADMINISTRATION. WE WILL BE MAKING ARRANGEMENTS TO DOCUMENT THE AMOUNT OF UNDERREPORTING OF INCOME AS WE CONTINUE OUR REVIEW.

HUD ALSO HAS REVIEW RESPONSIBILITIES IN THE INCOME CERTIFICATION PROCESS. HOWEVER, PRELIMINARY INQUIRIES AT THREE FIELD OFFICES WE VISITED DISCLOSED THAT THIS FUNCTION IS GIVEN LOW PRIORITY. INCOME REVIEWS WERE LIMITED TO DESK AUDITS WHICH MERELY ENSURE THAT A CERTIFICATION FORM WAS PREPARED FOR EACH TENANT.

APPARENT TRANSITION FROM LOW-AND MODERATE-INCOME TO VERY LOW INCOME TENANTS

THE FIVE HUD-OWNED PROPERTIES WE REVIEWED WERE INITIALLY CONSTRUCTED AND SUBSIDIZED TO PROVIDE RENTAL HOUSING TO PERSONS WITH INCOMES TOO HIGH TO ENTITLE THEM TO LOW-RENT PUBLIC HOUSING BUT NOT HIGH ENOUGH FOR THEM TO OBTAIN AVAILABLE STANDARD HOUSING. HUD HAS ANOTHER PROGRAM UNDER WHICH AN ADDITIONAL RENT SUPPLEMENT IS PROVIDED FOR CERTAIN FAMILIES THAT CANNOT AFFORD TO PAY THE BASIC RENT IN SUBSIDIZED PROPERTIES. HOWEVER, THE NUMBER OF FAMILIES RECEIVING THE RENT SUPPLEMENTS WERE GENERALLY LIMITED TO TWENTY PERCENT OF THE UNITS IN A PROJECT.

IN TWO OF THE THREE LOCATIONS WE VISITED, WE NOTED THAT PUBLIC HOUSING AUTHORITIES, COUNTY WELFARE OFFICES, AND

LOCAL SOCIAL SERVICE AGENCIES ARE REFERRING PUBLIC HOUSING APPLICANTS TO THE HUD-OWNED PROPERTIES. TENANTS WHO QUALIFY FOR PUBLIC HOUSING RESIDED IN 333 OF 540 OCCUPIED UNITS IN THE FIVE PROPERTIES. THESE TENANTS' INCOMES ARE VERY LOW. FOR EXAMPLE, 25 OF 139 TENANTS IN ONE PROPERTY REPORTED INCOMES OF LESS THAN \$200 A MONTH. THEIR MONTHLY RENT VARIED FROM \$8 TO \$36. CONTINUATION OF THESE REFERRALS OF PUBLIC HOUSING APPLICANTS WILL FURTHER REDUCE HUD REVENUES DUE TO THE VERY LOW INCOME LEVELS OF THE TENANTS.

REHABILITATION AND DISPOSITION
WITH SECTION 8 SUBSIDIES

WE ARE ALSO EXPLORING OTHER ISSUES, INCLUDING THE COST TO REHABILITATE AND SELL HUD-OWNED MULTIFAMILY PROPERTIES.

IN APRIL 1978, HUD FIELD OFFICES WERE DIRECTED TO REPAIR HUD-OWNED FORMERLY SUBSIDIZED AND UNSUBSIDIZED PROPERTIES WHICH WERE SERVING LOW AND MODERATE INCOME TENANTS. HUD ESTIMATES THAT 28,000 HUD-OWNED UNITS NEED TO BE REHABILITATED AT A COST OF \$122 MILLION OR AN AVERAGE OF ABOUT \$4,350 PER UNIT. THESE COSTS WILL BE ABSORBED BY THE INSURANCE FUNDS. A HUD OFFICIAL STATED THAT THE REHABILITATION COST WILL BE RECOVERED WHEN THESE PROPERTIES ARE SOLD.

HUD ALSO PLANS TO SELL MOST OF ITS PREVIOUSLY SUBSIDIZED PROPERTIES WITH A COMMITMENT OF SECTION 8 SUBSIDIES. THE PURCHASER WILL RENT THE UNITS TO ELIGIBLE SECTION 8 HOUSING PROGRAM APPLICANTS. AS OF JUNE 1978, HUD HAD SOLD 13 PROPERTIES, CONSISTING OF 1,166 UNITS, WITH SECTION 8 SUBSIDIES.

THE SECTION 8 COMMITMENTS RUN FOR 5 YEARS WITH THREE ADDITIONAL 5-YEAR TERMS AVAILABLE AT THE PURCHASER'S OPTION. ON THE BASIS OF THE COMMITMENTS MADE ON THESE 13 PROPERTIES, HUD'S AVERAGE MAXIMUM MONTHLY PAYMENT IS \$256 PER UNIT OR A MAXIMUM ANNUAL COST OF \$3.6 MILLION. THIS REPRESENTS A MAXIMUM COST OF \$72 MILLION FOR THE 20-YEAR PERIOD.

HUD PUBLISHED NEW INTERIM REGULATIONS ON SEPTEMBER 11, 1978, REGARDING THE USE OF SECTION 8 SUBSIDIES AS A CONDITION OF SALE OF HUD-OWNED PROPERTIES. THESE REGULATIONS PROVIDE FOR A MAXIMUM TERM OF 15 YEARS FOR THESE SECTION 8 COMMITMENTS. IF THE MAXIMUM AMOUNTS COMMITTED FOR THE 13 PROPERTIES WE REVIEWED ARE TYPICAL OF COMMITMENTS LIKELY TO BE MADE IN DISPOSING OF THE PROPERTIES (95,000 UNITS) IN HUD'S INVENTORY, IN FORECLOSURE, AND IN A SERIOUSLY DELINQUENT STATUS, THE SECTION 8 COMMITMENTS COULD TOTAL \$260 MILLION ANNUALLY, OR \$3.9 BILLION FOR THE 15-YEAR COMMITMENT PERIOD.

WE ARE ALSO LOOKING INTO THE COSTS OF ALTERNATIVE OPTIONS WHICH HUD MIGHT EMPLOY, SUCH AS RETAINING THE PROPERTIES OR GIVING THEM TO LOCAL HOUSING AUTHORITIES WITH AN ANNUAL OPERATING SUBSIDY.

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IT IS TOO EARLY TO DRAW FIRM CONCLUSIONS OR RECOMMENDATIONS. WE PLAN TO COMPLETE OUR WORK NEXT SPRING.

THIS CONCLUDES MY PREPARED TESTIMONY AND I WILL BE
GLAD TO RESPOND TO ANY QUESTIONS WHICH YOU OR MEMBERS OF
THE SUBCOMMITTEE MAY HAVE.