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HOUSING AND URBAN
DEVELOPMENT

HUD's Reinvention Blueprint
Raises Budget Issues and
Opportunities

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Mr. Chairman and Members of the Subcommittee:

We are pleased to have this opportunity to comment on the Department of Housing and Urban Development's (HUD) fiscal year 1996 budget request. This year's request reflects the first steps HUD has proposed toward implementing its reinvention blueprint. Through the blueprint, HUD aims to restructure and consolidate its programs, transform public housing with direct assistance to tenants, and establish an entrepreneurial, government-owned Federal Housing Administration (FHA). HUD developed this budget assuming that the Congress would authorize substantial and sweeping legislative changes governing HUD's mission, functions, and organization, and HUD asks the Congress to make funding decisions consistent with these assumptions. Secretary Cisneros recently told the House that congressional authorization for change and funding will have to go hand in hand.

This year's budget request proposes to hold constant at the 1996 level its request for nearly all of HUD's programs over the next 5 years. This self-imposed limit goes beyond the cap that the Congress placed on federal discretionary spending through fiscal year 1998. In keeping with this limit, HUD has realigned, consolidated, and in some cases simplified its programs. However, HUD has not substantially reduced either its programs or its missions, despite congressional proposals calling for drastic reductions in both.

My statement today presents our views about HUD's proposed budget, the estimates it contains, and the budgetary impact of certain assumptions built into HUD's reinvention blueprint. Specifically, we believe that

- the soundness and reliability of the current estimates underlying HUD's mark-to-market proposal are questionable and subject to considerable error;
- by using average costs for all of public housing, HUD's justification for transforming public housing to tenant-based certificates obscures some wide variations in the costs at individual developments;
- HUD's request for funds to implement certain community development initiatives is premature;
- large, supplemental grants to troubled housing authorities for rehabilitating their distressed properties have not been linked to improvements in the authorities' management;
- HUD's plans for investing in information resources may not be consistent with its needs for such resources if all of its reinvention initiatives are implemented;

- HUD's fiscal year 1996 request for operating subsidies for public housing authorities (PHA) is probably insufficient;
- HUD's implementation of a project-based demonstration program is inconsistent with the emphasis in its reinvention blueprint on shifting future programs to tenant-based assistance; and
- opportunities exist for streamlining HUD's 1996 budget by reassessing certain programs and limiting funding to those that most support HUD's core missions.

HUD'S PROGRAMS AND BUDGET

Established in 1965, HUD is the principal federal agency responsible for programs dealing with housing and community development and fair housing opportunities. Among other things, HUD's programs provide (1) mortgage insurance to help families become homeowners and to help provide affordable multifamily rental housing for low- and moderate-income families, (2) rental subsidies for lower-income families and individuals, and (3) grants and loans to states and communities for community development and neighborhood revitalization activities.

HUD's fiscal year 1996 budget proposal requests about \$26 billion in budget authority and plans about the same level of outlays. Compared with HUD's fiscal year 1995 appropriation, this request represents about a 2-percent increase in budget authority and a 2-percent decrease in outlays. It also projects savings of \$51 billion in budget authority and \$13 billion in outlays for fiscal years 1996 through 2000--when compared with HUD's current services budget¹, which does not reflect the reinvention proposals.

I will now discuss certain aspects of HUD's programs and budget in more detail.

BUDGETARY IMPACT OF PROPOSED SHIFTS FROM PROJECT-BASED TO TENANT-BASED ASSISTANCE IS UNCERTAIN

To control costs, address management problems, and eventually reduce the federal government's involvement in housing, HUD is taking steps to change the way it provides housing assistance in its Section 8 and public housing programs. HUD plans to provide assistance directly to tenants rather than link the assistance to the dwellings.

¹A current services budget reflects the anticipated costs of continuing programs at present levels without policy or legislative changes and is developed as part of the annual budget process.

HUD's Mark-to-Market Cost Estimates Are Subject to Considerable Error

HUD's proposal to restructure its multifamily housing portfolio, an approach known as "mark-to-market," seeks to address a variety of problems affecting projects in HUD's multifamily portfolio. These projects have HUD-insured mortgages and receive rental subsidies tied to units in the projects (project-based assistance) under HUD's Section 8 rental assistance program. For example, in many cases HUD pays higher costs to subsidize properties than are needed to provide the households living in them decent affordable housing. In other cases, rents set by HUD are lower than required to maintain the properties' physical condition, thus contributing to poor living conditions for families with low incomes.

HUD's proposal rests upon the belief that the best way to eliminate excess subsidy costs and improve the poor physical condition of some of the properties is to rely primarily on market forces. Consequently, for properties that both have mortgages insured by FHA and receive project-based assistance, HUD generally proposes to replace the project-based assistance with tenant-based assistance, thereby requiring the properties to compete in the market place for tenants. The proposal would also restructure mortgages for properties if such action is needed for them to remain viable without the receipt of project-based assistance.

Forecasting the effects on HUD's budget of the mark-to-market proposal will be difficult. While it should result in substantial reductions in Section 8 subsidy costs, it will also trigger billions of dollars in claims against FHA's insurance fund. HUD deserves credit for attempting to estimate the costs of its mark-to-market proposal; however, its current estimates are based on a number of assumptions that may or may not prove accurate and reliable. Accordingly, in our view, these estimates may be subject to considerable error.

Proposed "Transformation" of Public Housing Results in Savings But Not at All Developments

HUD's proposed transformation of public housing would redirect funding for public housing--which currently flows through PHAs--to households in the form of housing certificates. HUD expects that this shift in policy will result in significant savings. Other advantages to this approach, according to HUD, would be greater housing choice for residents, reduced concentrations of very poor people in very poor neighborhoods, and added market discipline to improve the management of public housing.

Our analysis showed that the average costs HUD used to project significant savings from this proposal do not reveal the wide differences in the cost of these two options at individual public housing developments.² HUD calculated the average costs of converting to housing certificates versus continuing the current public housing program and concluded that the cost of using certificates will be less. However, we found that for some developments, the current average cost to provide public housing is less than half that of housing certificates; for those developments in the worst physical condition, the reverse is true.

These wide variations in cost raise a number of important issues, including whether the federal government should pay for the rehabilitation of public housing developments when their rental revenues could finance it and whether housing certificates should be targeted initially to developments where they are clearly cost-effective. The actual costs of converting to housing certificates will depend on how these and other issues are resolved. However, HUD has not performed the detail analysis that would provide important information for deciding these issues.

PROPOSED PERFORMANCE FUNDS FOR COMMUNITY DEVELOPMENT MAY BE PREMATURE

HUD is proposing to consolidate a wide range of programs for assisting communities under three funds: (1) a Community Opportunity Fund that builds largely on the Community Development Block Grant (CDBG) program; (2) an Affordable Housing fund that consolidates programs for housing production, housing rehabilitation, and home-ownership; and (3) a Homeless Assistance Fund that will consolidate existing McKinney Act programs for aiding the homeless and establish a single formula for awarding all grants. Each of these funds will rely on performance measures that will enable HUD to evaluate whether grantees meet their goals and a competitive bonus pool to reward grantees for meeting their goals. However, HUD's fiscal year 1996 budget request for bonus funds may be premature because communities will need time to become familiar with the consolidated planning process and to establish performance measures.

HUD is requesting an appropriation of \$4.85 billion for the Community Opportunity Fund, including \$250 million for the Job Creation Performance Bonus Pool. In the past, we found that although the CDBG program can stimulate economic development within communities, it is difficult, without a set of accepted performance measures, to evaluate the effectiveness of the program's

²Public Housing: Converting to Housing Certificates Raises Major Questions About Cost (GAO/RCED-95-195, June 1995).

activities.³ Thus, we question whether these funds could be distributed in fiscal year 1996.

Our recent report on comprehensive community revitalization stated that flexible funding and federal efforts to reduce fragmentation among programs for assisting distressed communities could aid communities taking a comprehensive approach to neighborhood improvement.⁴ However, we also found that community development researchers have had difficulty developing performance measures for these efforts because communities' needs differ and the results of some activities may not be quantifiable.

For 1996, HUD also is requesting \$3.3 billion for the Affordable Housing Fund and \$1.1 billion for the Homeless Assistance Fund. Each fund is to have a bonus pool of 10 percent of the appropriation. Because time is required to develop the performance measures and to allow the competitive process to occur, bonus pool funds from each of the three programs--totaling \$696 million--may not be distributed until 1997.

HOPE VI GRANTS TO TROUBLED
PUBLIC HOUSING HAVE NOT BEEN TIED TO
BETTER MANAGEMENT

HUD has identified several large housing authorities as low performers for most of the last 15 years. Evaluation of these authorities has shown that management and administration problems contribute to their poor performance. Attempts by HUD to motivate changes in housing authority management by withdrawing funding for day-to-day operations could unduly affect the welfare of the residents. A less drastic action might be to withhold or limit supplemental funding--especially the grants HUD provides through its HOPE VI program to rehabilitate severely distressed public housing--from housing authorities identified as low performers.⁵

Of the 3,400 PHAs that provide housing for approximately 1.3 million individuals and families, HUD classifies 92 as "troubled." Thirteen large (each operating 1,250 or more housing units)

³Community Development: Block Grant Economic Development Activities Reflect Local Priorities (GAO/RCED-94-108, Feb. 17, 1994)

⁴Community Development: Comprehensive Approaches Address Multiple Needs but Are Challenging to Implement (GAO/RCED/HEHS/95-69, Feb. 8, 1995).

⁵Under the Housing Opportunities for People Everywhere (HOPE) VI program, qualifying PHAs can obtain grants for up to \$50 million from HUD to plan for and implement rehabilitation of severely distressed housing developments.

troubled PHAs account for over 90 percent of the troubled units (see app. I for a listing of these authorities and their latest management assessment scores). Two recent nationwide studies attribute distressed conditions, in part, to deficiencies in the PHAs' management.⁶

To address both management problems and deficient housing conditions at large troubled housing authorities, HUD created the Office of Distressed and Troubled Housing Recovery in late 1994. This office is providing technical assistance and awarding HOPE VI grants to housing authorities so that problems with their severely distressed developments can be corrected. From fiscal years 1993 through 1995, HUD has obligated approximately \$1.4 billion in supplemental HOPE VI funding to 32 PHAs. Approximately 38 percent of this funding has been awarded to 12 large, troubled PHAs (see App. I for grant amounts). The troubled authorities had to raise their management assessment scores by at least 5 points to qualify for the supplemental funding.

We have recently begun to review HUD's approach and found that conditions have not changed appreciably since the Commission and the OIG gathered their data in the early 1990s. For example, HUD still designates 13 large housing authorities as troubled, and 5 of these have been troubled since 1979. In addition, supplemental funding for distressed properties is not contingent on the housing authority's demonstrating an ability to manage large capital grants effectively.

Although HUD has required some management enhancements for several of the troubled housing authorities receiving HOPE VI funding, these may not be enough to assure productive use of the HOPE VI funds. HUD has not used the supplemental funding as leverage to encourage the troubled housing authorities to make substantial management improvements. Moreover, raising a score from 40 to 45 out of a possible 100--when HUD considers 60 or below to be troubled--does not ensure that the housing authority can efficiently manage this substantial additional funding or that it can manage the property after it has been rehabilitated.

⁶In 1992, the National Commission on Severely Distressed Public Housing concluded that poor management operations, such as lack of controls over purchasing and lack of accountability in financial management, contribute to the physical decline of public housing developments. A 1993 review of 11 large, troubled PHAs by HUD's Office of Inspector General (OIG) disclosed that the overall condition of public housing was declining while operating and other costs were increasing. The OIG cited frequent management turnover as a primary cause of this situation and concluded that operations would improve only when, among several conditions, local PHAs strengthened their management practices and financial operations.

We recognize that the recovery of a long-troubled authority will require time, oversight, and possibly significant supplemental funding. However, we believe that linking supplemental funding to significant improvements in management would help to conserve funding for public housing, ensure that the funding is put to productive use, and motivate housing authorities to improve their management.

INFORMATION RESOURCE PLANS
MAY CHANGE WITH REINVENTION

HUD has requested \$47.6 million for strategic investments in information resources in fiscal year 1996. Although HUD officials did not provide us with details of these investments, they told us that their plans are based on continuing current missions, programs, and operations. Some of these strategic investments, such as integrating financial systems, are intended to correct long-standing problems in HUD's systems.

HUD will continue to need some of these improvements to address its longstanding problems even if all the initiatives in the reinvention blueprint are implemented. However, implementation likely will lead to changes in the list of strategic investments HUD needs. For example, the budget request includes over \$6 million for approximately 2,000 upgraded computer workstations--in addition to about 9,700 upgraded workstations that HUD will have in place by the end of fiscal year 1995. Also, HUD has requested funds for increasing its mainframe computer capacity and upgrading its networks. The need for this extensive expansion is uncertain, given that HUD plans to reduce its staff from the current 12,500 to 7,500 over the next few years as it converts many of its programs to block grants. If the budget request were fully funded, HUD could have more upgraded workstations than staff.

Until the reinvention issues are decided, we question whether HUD should continue its current technology investment plans rather than plan for investments that will be needed to support the programs and operations of a reinvented HUD.

REQUEST FOR OPERATING SUBSIDIES
SEEMS INSUFFICIENT

HUD's budget requests for public housing operating subsidies--which are intended to make up the difference between a PHA's operating expenses and the rents paid by tenants--have been insufficient for each of the last 3 fiscal years, resulting in funding shortfalls of \$398 million, \$244 million, and \$250 million for fiscal years 1995, 1994, and 1993, respectively. We believe that HUD's fiscal year 1996 budget will again result in such a shortfall--by as much as \$172 million--because, due to budget constraints, HUD is requesting 93 percent of the amount of the

subsidy for which PHAs are eligible.⁷ Of the \$3.2 billion requested for its public housing operation performance fund, HUD officials have told us they plan to allocate the same amount appropriated in fiscal year 1995--\$2.9 billion--to fiscal year 1996 operating subsidies.

HUD's operating subsidy requests have resulted in shortfalls because HUD has underestimated inflation and overestimated the growth in rental income.⁸ One result of these shortfalls, as we reported earlier this year, is deferred routine maintenance.⁹ In addition, because HUD is planning to set aside a portion of the operating subsidies--\$172 million--to award cash bonuses to PHAs that make a faster transition to tenant-based assistance, some PHAs will receive less than 93 percent of their eligibility.¹⁰

It is possible that both HUD's estimate of the subsidy needs and the potential shortfall could be higher than expected. In its estimate of subsidy eligibility, HUD assumes that it will realize the full \$22 million in savings it anticipated from proposed changes to the preference rules for admission to public housing. These changes, which would allow PHAs to admit more working families, require legislative authorization. If HUD does not get that authorization, or if it gets the authorization but its estimates are not correct, the increase in subsidy requirements--and in the shortfall--will be higher.

⁷HUD uses a formula--the Performance Funding System (PFS)--to calculate the amount of subsidy for which a PHA is eligible. This formula is based on a wide variety of factors, such as the age of the buildings and the number of families the PHA houses. PFS determines only eligibility, not appropriations; PHAs receive 100 percent of their PFS eligibility only when the Congress appropriates the full amount.

⁸Unlike the budget requests for previous years, HUD's fiscal year 1996 budget request assumes there will be no increase in rental income; hence, the potential shortfall at this time is lower. This assumption is consistent with a provision in the American Community Partnerships Act, which provides for HUD to revise its subsidy formula to eliminate the rental income increase factor.

⁹Housing and Urban Development: Reform and Reinvention Issues (GAO/T-RCED-95-129, Mar. 14, 1995).

¹⁰As a result, HUD's request provides an average subsidy of 93 percent of eligibility, with 87 percent being the minimum a PHA would receive. Depending on how HUD awards the bonuses, some PHAs could receive more than 93 percent.

In its subsidy request, HUD also estimates that PHAs will demolish 44,000 units of nonviable public housing through current efforts, plus some of the reforms it is seeking in its reinvention proposals. HUD expects that PHAs have begun to demolish or will demolish public housing during fiscal year 1995, resulting in a reduction of subsidy requirements for this fiscal year of \$14 million.¹¹ HUD estimates that PHAs will demolish an additional 38,000 units if it gets the demolition reforms it is seeking. However, a HUD official told us that the demolition of these units is not expected to affect HUD's operating subsidy budget until fiscal year 1997. This delay is largely due to the time it takes to plan, initiate, and complete the demolition of a public housing project, including hiring contractors, getting residents' input, and relocating anyone currently living in these units. Because of the time needed to complete a demolition, most of these 38,000 units will continue to receive a subsidy for at least part of fiscal year 1996.

PROJECT-BASED DEMONSTRATION
PROGRAM CONTINUING

Although the reinvention blueprint emphasizes that HUD is moving toward providing tenant-based housing assistance, the Department is continuing to implement a demonstration program that provides project-based assistance. This program, the Section 8 Community Investment Demonstration, seeks to attract pension fund investment in construction or substantial rehabilitation of multifamily, affordable rental housing. Each fund that HUD selects receives a set-aside of Section 8 funds to provide rental assistance to low-income families, which provides added assurance that the housing units will be rented and the vacancy rate generally will be low, thus making positive cash flow more of a certainty. In addition, HUD will pay a large portion of the rent for the assisted families.

This program's fiscal year 1995 appropriation of \$350 million has not yet been awarded, and it is still available for reconsideration by HUD or rescission by the Congress. For about \$250 million of the appropriation, HUD recently selected the pension funds that will receive these awards, but it has not yet begun negotiations to develop and execute a contract with each grantee that spells out the terms and conditions of the Section 8 assistance. For the balance of the appropriation, HUD has not yet solicited applications, but plans to do so as soon as it gets final approval from the Office of Management and Budget.

¹¹Since requirements were not fully funded for fiscal year 1995, this will not result in savings, but will reduce this year's shortfall if HUD's estimate of units to be demolished is correct.

REDUCTIONS IN FUNDING FOR CERTAIN PROGRAMS
COULD STREAMLINE HUD'S BUDGET

HUD's reinvention changes will require consensus-building and major legislative and regulatory changes. Whether these changes are effected during this fiscal year remains to be seen. For several years, pressure has been mounting on HUD to restructure its programs. In reporting on HUD's fiscal year 1994 appropriations, in September 1993 this Committee directed the Department to consolidate and simplify its programs. In late 1994, the National Academy of Public Administration (NAPA), as requested by the Congress, reported on its study of HUD. NAPA concluded that the Department should either restructure its programs and reform its management or face dismantling.

In December 1994, HUD's OIG also issued a lengthy report addressing program restructuring. The OIG concluded that 91 of the 240 programs about which it provided information are not directly related to the department's core mission. The total fiscal year 1995 funding for these 91 programs exceeds \$10 billion.

Recently, we reported to the Chairman of the Subcommittee on Housing and Community Opportunity, House Committee on Banking and Financial Services that several of the larger programs on this list seem to contribute directly to meeting the housing needs of low-income people.¹² However, we estimate that 27 programs from the OIG's report, funded at approximately \$1 billion in fiscal year 1995, could be reassessed to determine their continued need and relative value in achieving HUD's mission. These 27 programs provide services such as housing counseling, training, and technical assistance.

In response to these pressures, HUD has proposed to overhaul the current system of "dozens of separate, duplicative programs and the accompanying culture of micromanagement that places principal emphasis on procedural accomplishments rather than on real results." However, the fate of these proposals is not yet known, and the savings anticipated from them may not be realized in the near term.

In conclusion, back in January--before HUD provided the details behind its reinvention blueprint--we testified before this Subcommittee that HUD faces formidable challenges in addressing its

¹²Purpose of, Funding for, and Views on Certain HUD Programs
(GAO/RCED-95-189R, June 20, 1995).

long-standing management deficiencies.¹³ Today, we have a far more detailed understanding of the blueprint, but significant questions still remain: Can HUD estimate accurately the net effect of implementing its mark-to-market proposal? Has HUD done enough analysis to justify transforming all of its public housing to a tenant-based system? Does it make sense for HUD to create a community opportunity fund bonus pool before it develops performance measures for fund recipients? Will a reinvented HUD finally turn around long-troubled PHAs?

This budget presents you with both short-term funding questions and long-term decisions about the future of federal housing and community development policy. I hope that the information we have provided in this statement has answered some of your questions and will assist you and the other Members of the Committee in your deliberations.

¹³Housing and Urban Development: Major Management and Budget Issues (GAO/T-RCED-95-86, Jan. 19, 1995).

INFORMATION ON LARGE, TROUBLED PHAs

PHA	Number of units	PHMAP ^a score (as of 6/95)	Years classified as troubled (as of 6/95)	Other assistance from HUD's ODTHR, FY 1995 ^b	HOPE VI funding (millions)
Allegheny County, PA	4,052	54.06	1993-95	\$ 75,634	\$ 0
Atlanta, GA	14,722	36.59	1979-82; 1990-95	1,079,921	42.4
Chester, PA	1,717	35.00	1991-95	876,130	0
Chicago, IL	40,119	46.38	1979-95	307,424	50.0
Detroit, IL	8,994	37.60	1979-95	3,033,732	87.9 ^c
District of Columbia	11,786	22.38	1979-95	2,052,093	15.7
Kansas City, MO	2,058	51.46	1991-95	774,500	47.6
Memphis, TN	7,089	59.36	1992-95	775,000	47.8 ^d
New Orleans, LA	13,414	48.21	1979-95	510,060	44.3
Philadelphia, PA	22,766	28.86	1979-95	2,249,738	50.0
Pittsburgh, PA	9,392	51.87	1993-95	186,000	31.6
Puerto Rico	57,800	53.00	1982-95	369,780	50.0
Springfield, IL	1,479	57.61	1979-81; 1991-95	75,000	19.8
TOTALS				\$ 12,365,012	\$ 487.1

Source: GAO's Presentation of data from HUD Office of Distressed and Troubled Housing Recovery & Office of Assisted Housing.

^aPublic Housing Management Assessment Program.

^bThe Office of Distressed and Troubled Housing Recovery (ODTHR) provides funding for items such as independent management assessments, computer equipment, organizational policy and procedures development, and technical assistance.

^cDetroit PHA received three HOPE VI grants: a \$500,000 planning grant for Parkside Homes; and implementations grants of \$39.9 million for Jeffries Homes and \$47.6 million for Parkside Homes.

^dMemphis PHA received two HOPE VI grants: planning and implementation grants of \$481,000 and \$47.3 million, respectively, for Le Moyne Gardens.

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