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

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M. EST
MONDAY, DECEMBER 4, 1972

STATEMENT OF
ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES
BEFORE THE
SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN GOVERNMENT
OF THE JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES
ON OPPORTUNITIES TO IMPROVE EFFECTIVENESS AND REDUCE
COSTS OF HOUSING SUBSIDY PROGRAMS ADMINISTERED BY
FEDERAL HOUSING ADMINISTRATION
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
AND FARMERS HOME ADMINISTRATION, DEPARTMENT OF AGRICULTURE

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MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

DURING THE PAST 3 YEARS, WE HAVE ISSUED OVER 100 REPORTS IN THE HOUSING AREA, INCLUDING REPORTS ON MODEL CITIES, LOW-RENT PUBLIC HOUSING, URBAN RENEWAL, AND MORTGAGE INSURANCE ACTIVITIES. THIS MORNING, I WILL DISCUSS THE RESULTS OF TWO REVIEWS WE RECENTLY MADE OF THE MANNER IN WHICH THE DEPARTMENTS OF HOUSING AND URBAN DEVELOPMENT (HUD) AND AGRICULTURE HAVE CARRIED OUT HOUSING SUBSIDY PROGRAMS. THE COMPLETE RESULTS OF BOTH REVIEWS WILL BE PUBLISHED IN REPORTS TO BE ISSUED WITHIN THE NEXT MONTH.

AS YOU KNOW, THESE SUBSIDY PROGRAMS WERE STARTED IN 1968 AND ARE DESIGNED TO ASSIST LOW- AND MODERATE-INCOME FAMILIES IN BECOMING HOMEOWNERS OR IN PAYING LOWER RENTS. FIRST, I WILL DISCUSS OUR WORK ON THE HOMEOWNERSHIP ASSISTANCE PROGRAMS. FOLLOWING THAT, I WILL PRESENT OUR VIEWS ON THE RENTAL ASSISTANCE PROGRAM.

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HOMEOWNERSHIP ASSISTANCE

THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT AND THE DEPARTMENT OF AGRICULTURE ARE AUTHORIZED BY SECTION 235 OF THE NATIONAL HOUSING ACT AND BY SECTION 502 OF THE HOUSING ACT OF 1949, AS AMENDED BY THE HOUSING ACT OF 1968, TO ASSIST LOW- AND MODERATE-INCOME FAMILIES, THROUGH MORTGAGE INSURANCE AND INTEREST SUBSIDIES, TO BECOME HOMEOWNERS. THE PURCHASE OF EITHER NEW OR EXISTING HOUSES CAN BE SUBSIDIZED UNDER THESE PROGRAMS. THE PRESIDENT'S SECOND ANNUAL REPORT ON HOUSING GOALS (APRIL 1970) ESTIMATED THAT ABOUT 2.8 MILLION FAMILIES WILL HAVE RECEIVED SUCH ASSISTANCE BY 1978. THE ESTIMATED COST TO HUD WILL BE IN A RANGE FROM \$10 BILLION TO \$37 BILLION. AS OF JUNE 30, 1972, HUD HAD EXPENDED ABOUT \$379 MILLION FOR HOMEOWNERSHIP ASSISTANCE PAYMENTS. NO ESTIMATE WAS AVAILABLE AS TO AGRICULTURE'S EVENTUAL TOTAL COST. HOWEVER, AS OF JUNE 30, 1972, AGRICULTURE ESTIMATED THAT ITS SUBSIDY PROGRAM HAD COST \$37 MILLION.

BECAUSE OF THE MAGNITUDE OF FEDERAL FUNDS INVOLVED, THE GENERAL ACCOUNTING OFFICE REVIEWED MAJOR ASPECTS OF BOTH PROGRAMS TO DETERMINE WHETHER OPPORTUNITIES EXIST FOR HUD AND AGRICULTURE TO IMPROVE PROGRAM EFFECTIVENESS AND REDUCE COSTS. WE REVIEWED THE ALLOCATION OF PROGRAM RESOURCES, QUALITY OF HOUSING PROVIDED, MORTGAGE DEFAULT RATES, HOUSING OPTIONS PROVIDED, AND METHOD OF FINANCING THE PROGRAMS. ALSO, WE CONSIDERED RECENT COMPREHENSIVE INTERNAL AUDITS OF THE SECTION 235 AND SECTION 502 PROGRAMS BY HUD AND AGRICULTURE.

OUR REVIEW WAS GENERALLY CONFINED TO HUD AND AGRICULTURE ACTIVITIES IN NINE STATES WHERE ABOUT 38 PERCENT OF THE SECTION 235 LOANS AND ABOUT 29 PERCENT OF THE SECTION 502 LOANS WERE MADE. THE COMPLETE RESULTS OF OUR REVIEW WILL BE PUBLISHED IN A SOON TO BE RELEASED REPORT.

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OUR FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS IN THIS AREA OF HOUSING ASSISTANCE ARE AS FOLLOWS.

NEED TO IMPROVE ALLOCATION OF PROGRAM RESOURCES

HUD AND AGRICULTURE DID NOT ALLOCATE PROGRAM RESOURCES TO INSURE THAT ELIGIBLE FAMILIES HAD THE SAME OPPORTUNITY TO PARTICIPATE IN THE HOMEOWNER-SHIP ASSISTANCE PROGRAMS REGARDLESS OF WHERE THEY LIVED.

THE NEED FOR SUBSIDIZED HOUSING HAS NOT BEEN ADEQUATELY IDENTIFIED BY EITHER HUD OR AGRICULTURE. HUD HEADQUARTERS ESTIMATED THE NEED FOR SUBSIDIZED HOUSING; HOWEVER, THIS ESTIMATE VARIED SIGNIFICANTLY FROM THE NEED ESTIMATED BY HUD FIELD OFFICES AND THE DIFFERENCES WERE NOT RECONCILED TO ARRIVE AT REASONABLY RELIABLE DATA. NEITHER AGRICULTURE HEADQUARTERS NOR ITS FIELD OFFICES HAD DEVELOPED ESTIMATES OF RURAL SUBSIDIZED HOUSING NEEDS AS A BASIS FOR ALLOCATING PROGRAM RESOURCES.

AN AREA'S CAPACITY TO PRODUCE HOUSING HAS BEEN A MAJOR FACTOR INFLUENCING THE DISTRIBUTION OF HUD PROGRAM RESOURCES AT BOTH THE NATIONAL AND LOCAL LEVELS. ALLOCATION OF AGRICULTURE PROGRAM RESOURCES AT THE NATIONAL LEVEL HAS BEEN BASED PRIMARILY ON PRIOR YEARS' PRODUCTION ACTIVITY AND DISTRIBUTION AT THE LOCAL LEVEL HAS BEEN PRIMARILY ON A FIRST-COME, FIRST-SERVED BASIS. AGRICULTURE MAKES SUBSIDIZED AND UNSUBSIDIZED HOUSING LOANS; HOWEVER, IT DOES NOT DETERMINE THE SPECIFIC NEEDS OF LOW-INCOME FAMILIES AS A BASIS FOR AN EQUITABLE ALLOCATION OF FUNDS FOR SUBSIDIZED HOUSING.

TO ILLUSTRATE THE RESULTS OF THE ABOVE ALLOCATION PROCESSES, ABOUT 11 PERCENT OF THE HOUSING UNITS PROVIDED BY HUD THROUGH DECEMBER 1971 WERE LOCATED IN THE NORTHEASTERN STATES WHICH WOULD HAVE RECEIVED ABOUT 32 PERCENT OF THE HOUSING UNITS HAD THEY BEEN ALLOCATED ON THE BASIS OF HUD-

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ESTIMATED NEEDS. SIMILARLY, FOR AGRICULTURE, ABOUT 10 PERCENT OF ITS HOUSING UNITS WERE LOCATED IN THE NORTHEASTERN SECTION OF THE NATION WHICH HAD ABOUT 18 PERCENT OF THE NATION'S RURAL POPULATION. ABOUT 58 PERCENT OF THE AGRICULTURE HOUSING UNITS WERE LOCATED IN THE SOUTH WHICH HAD ABOUT 41 PERCENT OF THE TOTAL RURAL POPULATION.

SIMILAR DISPARITIES EXISTED AT THE LOCAL LEVEL, WITH SOME SMALL CITIES AND COUNTIES RECEIVING NO UNITS, WHILE SOME METROPOLITAN AREAS IN THE SAME STATE RECEIVED UP TO 190 PERCENT OF ESTIMATED NEEDS.

WE ARE RECOMMENDING THAT HUD AND AGRICULTURE PROVIDE REASONABLE ASSURANCE THAT RESOURCES UNDER SECTIONS 235 AND 502 PROGRAMS ARE ALLOCATED PRIMARILY IN PROPORTION TO IDENTIFIED NEEDS. WE ARE RECOMMENDING ALSO THAT AGRICULTURE MAKE SEPARATE ALLOCATIONS FOR SUBSIDIZED AND UNSUBSIDIZED HOUSING LOANS IN ACCORDANCE WITH NEED.

IN COMMENTING ON OUR FINDINGS, HUD STATED THAT NEED FACTORS WERE GIVEN GREATER WEIGHT IN THE FISCAL YEAR 1972 ALLOCATION FORMULA. HOWEVER, THERE ARE A NUMBER OF STATES THAT HAVE NOT RECEIVED THEIR PROPORTIONATE SHARE OF THE TOTAL SUBSIDIZED HOUSING UNITS PROVIDED BY HUD. WE BELIEVE THAT HUD MUST FIRST IDENTIFY THE TRUE NEED FOR SUBSIDIZED HOUSING AND MAKE EVERY EFFORT TO ALLOCATE PROGRAM RESOURCES IN ACCORDANCE WITH THE IDENTIFIED NEED.

HUD STATED ALSO THAT STATUTORY MORTGAGE INSURANCE LIMITATIONS, RESTRICTIVE INCOME LIMITS, INCREASING LAND COSTS AND TAXES, AND THE CONSERVATIVE ATTITUDES OF SOME BANKING INSTITUTIONS CONTRIBUTED TO THE DISPARITY BETWEEN THE ESTIMATED NEED FOR SUBSIDIZED HOUSING IN THE NORTHEASTERN STATES AND THE HOUSING UNITS ACTUALLY PROVIDED.

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HUD AGREED THAT FIELD OFFICES SHOULD TAKE A MORE ACTIVE ROLE IN DETERMINING AREAS' NEEDS FOR SUBSIDIZED HOUSING AND THAT PRIORITY SHOULD BE GIVEN TO THE DEVELOPMENT OF THE AREAS.

AGRICULTURE STATED THAT THE ALLOCATION OF RURAL HOUSING FUNDS MADE TO STATES TAKES INTO CONSIDERATION FACTORS SUCH AS NUMBER OF RURAL HOMES, CONDITION OF HOMES, INCOME OF RURAL FAMILIES, AVERAGE COST OF NEW HOMES AND HISTORICAL LENDING PATTERNS, AND THAT FUNDS WERE DISTRIBUTED TO STATES IN ACCORDANCE WITH NEED. AGRICULTURE STATED ALSO THAT THE STATES WILL BE INSTRUCTED TO CHANNEL AT LEAST 50 PERCENT OF THE ALLOCATION OF RURAL HOUSING SECTION 502 FUNDS INTO HOUSING FOR LOW-INCOME FAMILIES.

ALTHOUGH THE CITED FACTORS WERE TAKEN INTO CONSIDERATION WHEN SECTION 502 FUNDS WERE DISTRIBUTED, WE NOTED THAT HISTORICAL LENDING PATTERNS (PRIOR PRODUCTION) HAVE BEEN A MAJOR FACTOR INFLUENCING SUCH DISTRIBUTION. FOR EXAMPLE, THE INITIAL DISTRIBUTION OF FISCAL YEAR 1971 FUNDS WAS BASED PRIMARILY ON FISCAL YEAR 1970 DISTRIBUTION.

AGRICULTURE ADVISED US THAT FOR FISCAL YEAR 1973 IT RANKED THE STATES FOR EACH OF THE FIVE FACTORS MENTIONED ABOVE AND THEN ADJUSTED THE RANKING BASED ON "HISTORICAL LENDING PATTERNS" IN ORDER TO DECIDE WHETHER A STATE SHOULD RECEIVE A GREATER OR LESSER PROPORTION OF THE TOTAL PROGRAM RESOURCES THAN IT DID THE PREVIOUS YEAR. WE BELIEVE THAT THIS PROCEDURE, EMPHASIZING HISTORICAL LENDING PATTERNS, CONTINUES TO GIVE UNDUE WEIGHT TO PRIOR PRODUCTION OF HOUSING INSTEAD OF CURRENT NEEDS FOR HOUSING.

ALSO, WE DO NOT BELIEVE THAT AN ARBITRARY 50 PERCENT ALLOCATION WOULD ACHIEVE THE OBJECTIVE OF OUR RECOMMENDATION. WE BELIEVE THAT ALLOCATIONS FOR SUBSIDIZED LOANS SHOULD BE MADE ON THE BASIS OF SPECIFIC DETERMINATIONS OF NEED RATHER THAN ON AN ARBITRARY PERCENTAGE.

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CONDITION OF HOUSING

OUR NEXT FINDING DEALS WITH THE CONDITION OF THE HOUSING BEING INSURED UNDER THE SECTIONS 235 AND 502 PROGRAMS.

HOUSES WITH SIGNIFICANT DEFECTS WERE SOLD UNDER THE HOMEOWNERSHIP ASSISTANCE PROGRAMS. BECAUSE MANY OF THE HOUSING DEFECTS CONCERN THE SAFETY AND HEALTH OF THE OCCUPANTS, THE OBJECTIVE OF PROVIDING LOW- AND MODERATE-INCOME FAMILIES WITH DECENT, SAFE, AND SANITARY HOUSING WAS NOT MET IN MANY CASES. ALSO, THE FAMILIES THAT OBTAINED SUCH HOUSES COULD BE FACED WITH UNEXPECTED FINANCIAL HARDSHIPS IN CORRECTING THE DEFECTS OR COULD GIVE UP THE HOUSES BECAUSE OF DISSATISFACTION.

A REPORT BY THE STAFF OF THE HOUSE COMMITTEE ON BANKING AND CURRENCY IN DECEMBER 1970 DISCLOSED THAT HOUSES WITH SERIOUS DEFECTS WERE PROVIDED TO LOW- AND MODERATE-INCOME FAMILIES UNDER THE SECTION 235 PROGRAM. AS A RESULT OF THE COMMITTEE STAFF REPORT, THE HUD OFFICE OF AUDIT MADE A NATION-WIDE REVIEW OF HUD'S ADMINISTRATION OF THE SECTION 235 PROGRAM WHICH INCLUDED THE PHYSICAL INSPECTION OF 1,281 PROPERTIES SELECTED ON THE BASIS OF A STATISTICAL RANDOM SAMPLE. HUD AUDITORS FOUND THAT ABOUT 24 PERCENT OF THE NEW HOUSES AND ABOUT 39 PERCENT OF THE EXISTING HOUSES HAD SIGNIFICANT DEFECTS.

WE REVIEWED THE HUD AUDITORS' SAMPLING TECHNIQUES AND VERIFIED THEIR INSPECTION RESULTS BY INSPECTING WITH THEM, OR BY REINSPECTING, A SELECTED NUMBER OF HOUSES IN THEIR SAMPLE. ON THE BASIS OF OUR REVIEW OF THE HUD AUDIT WORK, WE BELIEVE THAT THE RESULTS OF THE INSPECTIONS CAN BE PROJECTED NATIONWIDE. SUCH A PROJECTION INDICATES THAT ABOUT 18,900 NEW HOUSES AND ABOUT 15,800 EXISTING HOUSES PROVIDED BY THE SECTION 235 PROGRAM AS OF NOVEMBER 30, 1970, HAD DEFECTS.

HUD INSPECTION PROCEDURES, WHICH ARE SUPPOSED TO PREVENT DEFECTIVE HOUSES FROM BEING INSURED, WERE INADEQUATE BECAUSE (1) APPRAISERS HAD NOT BEEN ADEQUATELY TRAINED TO MAKE INSPECTIONS, (2) THE EMPHASIS ON PROVIDING HOUSES HAD PLACED AN UNUSUALLY HEAVY WORKLOAD ON APPRAISERS, (3) APPRAISERS WERE NOT ADEQUATELY SUPERVISED, AND (4) FIELD OFFICE PERSONNEL DID NOT ADJUST THEIR THINKING AND ATTITUDES TO ENCOMPASS THE CONSUMER-ORIENTED NEEDS OF THE NEW PROGRAM.

WE INSPECTED 121 HOUSES IN EIGHT STATES UNDER THE AGRICULTURE ADMINISTERED SECTIONS 235 AND 502 PROGRAMS AND FOUND THAT OVER 50 PERCENT HAD DEFECTS SIMILAR TO THOSE FOUND IN THE HUD SECTION 235 PROGRAM. AGRICULTURE OFFICIALS ADVISED US THAT HOUSES WITH DEFECTS HAVE BEEN PROVIDED BECAUSE THE HOUSES WERE INSPECTED BY COUNTY SUPERVISORS WHO WERE NOT QUALIFIED AS HOUSING INSPECTORS.

HUD AND AGRICULTURE HAVE TAKEN CERTAIN CORRECTIVE ACTIONS AND PLANNED TO TAKE OTHERS. AT THE TIME OF OUR REVIEW, IT WAS TOO EARLY TO TEST THE ADEQUACY OF THESE ACTIONS.

PURCHASERS OF NEW HOUSES UNDER SECTIONS 235 AND 502 ARE PROTECTED AGAINST DEFECTS BY HOMEOWNER SERVICE POLICIES WHICH REQUIRE BUILDERS TO CORRECT DEFECTS DISCLOSED DURING THE FIRST YEAR AFTER PURCHASE.

THIS TYPE OF PROTECTION WAS NOT AVAILABLE TO PURCHASERS OF EXISTING SECTION 235 HOUSING UNTIL DECEMBER 31, 1970, WHEN THE NATIONAL HOUSING ACT WAS AMENDED TO PERMIT HUD TO CORRECT DEFECTS WHICH SERIOUSLY AFFECT THE USE AND LIVABILITY OF ANY EXISTING HOUSE PROVIDED UNDER SECTION 235. ALSO, HUD NOW REQUIRES A SELLER OF AN EXISTING HOUSE TO CERTIFY THE PRESENT CONDITION OF THE HOUSE, AND IF HE IS NOT THE MOST RECENT OCCUPANT, DEPOSIT 5 PERCENT OF THE SALE PROCEEDS IN ESCROW FOR 1 YEAR TO ASSURE REIMBURSEMENT TO HUD, SHOULD REPAIRS BE NEEDED.

SIMILAR PROTECTION FOR PURCHASERS OF EXISTING HOUSING UNDER SECTION 502 IS NOT AVAILABLE.

BECAUSE LOW-INCOME FAMILIES ARE OFTEN UNABLE TO DETECT HOUSING DEFECTS AND HAVE THEM CORRECTED, WE ARE RECOMMENDING THAT HUD AND AGRICULTURE REINSPECT ALL HOUSES WITHIN 1 YEAR AFTER PURCHASE TO INSURE THAT DEFECTS COVERED BY BUILDER SERVICE POLICIES AND SELLER CERTIFICATIONS HAVE BEEN IDENTIFIED AND CORRECTED.

WE ARE ALSO RECOMMENDING THAT THE SECRETARY OF AGRICULTURE IMPLEMENT PROCEDURES OR SEEK LEGISLATION, IF CONSIDERED NECESSARY, TO INSURE THAT AGRICULTURE AND/OR THE PURCHASER OF EXISTING HOUSING HAS RECOURSE TO THE SELLER TO COVER THE COST OF REPAIRING DEFECTS THAT EXISTED AT THE TIME OF SALE.

IN COMMENTING ON OUR RECOMMENDATION TO REINSPECT HOUSES, HUD POINTED OUT THE INCREASED WORKLOAD THAT WOULD BE IMPOSED BY SUCH A REQUIREMENT AND, SINCE ITS BUDGET WOULD NOT COVER THE ADDITIONAL STAFF NEEDED, IT MIGHT HAVE TO USE PRIVATE FEE INSPECTORS. AGRICULTURE STATED THAT, IF APPROPRIATIONS PERMIT, IT WOULD PUT INTO EFFECT A REQUIREMENT FOR REINSPECTION OF ALL HOUSES DURING THE ELEVENTH MONTH OF THE 1-YEAR WARRANTY PERIOD.

AGRICULTURE STATED THAT IT WOULD STUDY OUR RECOMMENDATION THAT PURCHASERS OF EXISTING HOUSING UNDER THE SECTION 502 PROGRAM BE PROTECTED BY A RIGHT OF RECOURSE TO THE SELLER.

HOUSING OPTIONS

OUR NEXT FINDING DEALS WITH THE NEED FOR DEFINING THE HOUSING FEATURES (OPTIONS) AVAILABLE UNDER THE SECTION 235 AND SECTION 502 PROGRAMS.

HUD AND AGRICULTURE DID NOT PROVIDE THEIR FIELD OFFICES WITH ADEQUATE GUIDELINES DEFINING THE TYPE OF HOUSING ELIGIBLE UNDER HOMEOWNERSHIP ASSISTANCE PROGRAMS FOR LOW- AND MODERATE-INCOME FAMILIES. AS A RESULT, SOME FAMILIES COULD BUY HOMES WITH OPTIONS SUCH AS AIR CONDITIONING, FIRE-PLACES, OR EXTRA BEDROOMS, WHILE OTHER FAMILIES IN THE SAME GENERAL AREA WERE UNABLE TO OBTAIN THESE OPTIONS. BECAUSE OF THESE INCONSISTENCIES, NEITHER AGENCY COULD INSURE THAT ALL ELIGIBLE FAMILIES WERE OFFERED THE SAME OPPORTUNITY TO RECEIVE THE EXTENT OF ASSISTANCE INTENDED BY THE CONGRESS NOR COULD THE TWO AGENCIES INSURE THAT PROGRAM COSTS ARE MINIMIZED SO THAT THE MAXIMUM NUMBER OF FAMILIES ARE ASSISTED WITH THE AVAILABLE FUNDS.

WE ARE RECOMMENDING THAT HUD AND AGRICULTURE (1) CLEARLY DEFINE THE TYPE OF HOUSING OPTIONS THAT WILL BE MADE AVAILABLE UNDER HOMEOWNERSHIP ASSISTANCE PROGRAMS IN THE VARIOUS AREAS OF THE NATION AND (2) JOINTLY DETERMINE WHAT HOUSING OPTIONS ARE APPROPRIATE FOR INCLUSION IN HOUSES BEING PROVIDED IN COMMUNITIES SERVED BY BOTH DEPARTMENTS.

HUD REFERRED TO GUIDELINES THAT IT ISSUED SUBSEQUENT TO THE PERIOD COVERED BY OUR REVIEW WHICH CLARIFY PREVIOUS INSTRUCTIONS REGARDING MORTGAGE CEILINGS. WE BELIEVE THAT THESE GUIDELINES COULD MEET THE OBJECTIVE OF OUR FIRST RECOMMENDATION; HOWEVER, AT THE TIME OF OUR REVIEW IT WAS TOO EARLY TO MAKE THAT DETERMINATION.

AGRICULTURE RECOGNIZED THAT SIGNIFICANT VARIATIONS EXIST BETWEEN COUNTIES WITH RESPECT TO THE TYPE OF CONSTRUCTION AND THE HOUSING OPTIONS MADE AVAILABLE TO LOW-INCOME PURCHASERS. IN JUNE 1972, IT INSTRUCTED STATE DIRECTORS TO RECONCILE DIFFERENCES AND ISSUE GUIDELINES TO ASSURE A CONSISTENT APPLICATION OF THE POLICY OF FINANCING ADEQUATE BUT MODEST HOUSING. WE

BELIEVE THAT IMPLEMENTATION OF THESE INSTRUCTIONS COULD MEET THE OBJECTIVES OF OUR FIRST RECOMMENDATION; HOWEVER, IT IS TOO EARLY TO MAKE THAT DETERMINATION.

HUD DID NOT COMMENT ON OUR SECOND RECOMMENDATION. AGRICULTURE STATED THAT THERE WOULD BE LITTLE ADVANTAGE TO ESTABLISHING A JOINT HUD/AGRICULTURE LIST OF HOUSING OPTIONS BECAUSE HUD AND AGRICULTURE SERVE DIFFERENT MARKETS. WE AGREE THAT HUD AND AGRICULTURE GENERALLY DO SERVE DIFFERENT MARKETS; HOWEVER, UNDER SECTION 235 AND 502 PROGRAMS, HOUSES ARE SOMETIMES PROVIDED IN THE SAME MARKET AREA. UNDER THESE CIRCUMSTANCES, WE BELIEVE THAT HUD AND AGRICULTURE SHOULD AGREE ON WHAT OPTIONS SHOULD BE MADE AVAILABLE UNDER BOTH PROGRAMS.

MORTGAGE DEFAULTS

WE ALSO REVIEWED THE MORTGAGE DEFAULTS RATES ON THE SECTION 235 AND SECTION 502 PROGRAMS.

PRELIMINARY INFORMATION INDICATES THAT MORTGAGE DEFAULTS COULD BECOME A MAJOR PROBLEM FOR THE SECTION 235 PROGRAM. THE NUMBER OF DEFAULTS IN THE SECTION 502 PROGRAM HAS BEEN LOW TO DATE; HOWEVER, AGRICULTURE OFFICIALS ANTICIPATE THAT INCREASED PROGRAM ACTIVITY WILL RESULT IN A MARKED INCREASE IN THE DEFAULT RATE. A HIGH DEFAULT RATE WOULD REDUCE PROGRAM EFFECTIVENESS AND COULD RESULT IN SIGNIFICANT COSTS TO MANAGE AND DISPOSE OF ACQUIRED PROPERTIES. WE BELIEVE HUD AND AGRICULTURE SHOULD TAKE PRECAUTIONARY STEPS TO ANALYZE ANTICIPATED DEFAULT PATTERNS AND IDENTIFY POSSIBLE WAYS OF KEEPING THE RATE DOWN.

WE EXAMINED THE INITIAL DEFAULT EXPERIENCE AT 10 HUD FIELD OFFICES AND FOUND A RANGE FROM A LOW OF ABOUT 2.2 PERCENT IN ONE OFFICE TO 20.1 PERCENT IN ANOTHER. ALTHOUGH A PRECISE DEFAULT RATE FOR THE SECTION 235 PROGRAM

HAS NOT BEEN DEVELOPED, THE PATTERN OF DEFAULTS THUS FAR CLOSELY PARALLELS HUD'S EXPERIENCE ON ANOTHER MORTGAGE INSURANCE PROGRAM FOR LOW- AND MODERATE-INCOME FAMILIES WHICH SHOWS A DEFAULT RATE OF ABOUT 11 PERCENT AFTER 9 YEARS.

AT JUNE 30, 1972, HUD HAD INCURRED AN AVERAGE LOSS OF ABOUT \$3,835 TO MANAGE AND DISPOSE OF EACH ACQUIRED SECTION 235 PROPERTY, FOR A TOTAL LOSS OF ABOUT \$15.2 MILLION. DATA PROVIDED BY HUD'S ACTUARIES INDICATES THAT THE AVERAGE LOSS WILL BE EVEN HIGHER IN THE FUTURE. HOWEVER, IF THE AVERAGE LOSS WAS TO REMAIN THE SAME, AND THE DEFAULT RATE REACHES 10 PERCENT ON THE 1.4 MILLION PROPERTIES TO BE INSURED THROUGH FISCAL YEAR 1978, HUD WOULD EVENTUALLY INCUR LOSSES OF ABOUT \$532 MILLION TO MANAGE AND DISPOSE OF ACQUIRED SECTION 235 PROPERTIES.

AT THE TIME OF OUR REVIEW THE NUMBER OF ACQUIRED SECTION 502 PROPERTIES WAS INCREASING. ONLY 251 PROPERTIES HAD BEEN ACQUIRED BY AGRICULTURE THROUGH 1969, THE FIRST 19 YEARS OF THE BASIC SECTION 502 PROGRAM. AN ADDITIONAL 184 PROPERTIES WERE ACQUIRED IN THE NEXT YEAR.

HUD HAS ESTABLISHED A PROCEDURE FOR CONTINUOUS REVIEW OF THE REASONS FOR DEFAULT AND RECENTLY INITIATED A COUNSELING PROGRAM FOR SECTION 235 APPLICANTS IN SOME OF ITS FIELD OFFICES. ALSO, AGRICULTURE INFORMED US THAT ITS REGULATIONS PROVIDE FOR A CASE-BY-CASE EVALUATION OF DELINQUENCIES AND THE REASONS FOR THEM.

WE BELIEVE THAT THESE PROCEDURES ARE NOT ADEQUATE TO OBTAIN A USEFUL ANALYSIS OF ALL SIGNIFICANT FACTORS RELATING TO DEFAULTS. WE ARE RECOMMENDING, THEREFORE, THAT HUD AND AGRICULTURE REQUIRE IN-DEPTH STUDIES TO DETERMINE THE MAJOR REASONS FOR DEFAULTS AND USE THE RESULTS TO DEVELOP GUIDELINES FOR SCREENING AND COUNSELING PROGRAM APPLICANTS.

METHOD OF FINANCING

OUR LAST OBSERVATION CONCERNS THE METHOD OF FINANCING HUD'S HOMEOWNER-SHIP PROGRAM. WE ESTIMATE THAT THE PRESENT VALUE OF THE SAVINGS ON THE SECTION 235 PROGRAM COULD AMOUNT TO ABOUT \$1 BILLION IF LOANS WERE FINANCED DIRECTLY BY THE GOVERNMENT RATHER THAN BY PRIVATE LENDERS BECAUSE OF THE LOWER INTEREST COST AT WHICH THE GOVERNMENT COULD BORROW FUNDS.

IN A PREVIOUS GAO REPORT TO THE CONGRESS IN JULY 1971, WE RECOMMENDED THAT THE CONGRESS CONSIDER AMENDING THE LEGISLATION PERTAINING TO THE SECTION 502 PROGRAM TO REQUIRE DIRECT FEDERAL FINANCING, AND WE ARE NOW RECOMMENDING THAT THE CONGRESS CONSIDER SIMILAR LEGISLATION FOR THE SECTION 235 PROGRAM.

COMMENTS REGARDING THE METHOD OF FINANCING THE SECTION 235 PROGRAM WERE OBTAINED FROM THE DEPARTMENT OF THE TREASURY AND THE OFFICE OF MANAGEMENT AND BUDGET (OMB), AS WELL AS HUD.

HUD AND TREASURY COMMENTED THAT DIRECT FEDERAL FINANCING OF THE SECTION 235 PROGRAM WOULD RESULT IN A LARGER FEDERAL BUDGET AND INCREASED CASH FLOW FROM THE TREASURY. HUD ESTIMATED THE AMOUNT TO BE ABOUT \$3.5 BILLION FOR FISCAL YEAR 1973. WE AGREE THAT THE BUDGET FOR THE SECTION 235 PROGRAM WOULD BE INCREASED IF DIRECT FEDERAL FINANCING IS APPROVED.

WE ALSO AGREE THAT DIRECT FEDERAL FINANCING WOULD INITIALLY RESULT IN INCREASED CASH FLOWS FROM THE TREASURY. HOWEVER, THIS IS ONLY TRUE DURING THE EARLY YEARS. BECAUSE OF THE MORE FAVORABLE INTEREST RATES FOR GOVERNMENT BORROWING, THE DIRECT METHOD OF FINANCING FOR THE SECTION 235 PROGRAM WILL RESULT IN A NET COST REDUCTION OF ABOUT \$1 BILLION WITHOUT INCREASING THE COST OF HOUSING FOR LOW-INCOME FAMILY PURCHASERS.

HUD STATED THAT SUBSTANTIAL STAFF INCREASES WOULD BE REQUIRED TO PROCESS LOAN APPLICATIONS AND TO ESTABLISH AND MAINTAIN ACCOUNTING RECORDS AND REPORTS. OUR REVIEW INDICATED THAT MOST MORTGAGEES INVOLVED IN THE SECTION 235 PROGRAM WOULD BE WILLING TO PERFORM THESE SERVICES AT NO INCREASE IN COST OVER THAT INCURRED UNDER THE PRESENT METHOD OF FINANCING. IN THESE CIRCUMSTANCES, SUBSTANTIAL STAFF INCREASES WOULD NOT BE NEEDED.

OMB EXPRESSED THE VIEW THAT THE GOVERNMENT SHOULD NOT SEEK A MAJOR ROLE AS A DIRECT LENDER WHEN THE PRIVATE ECONOMY CAN PERFORM THIS FUNCTION EFFECTIVELY. WE BELIEVE THAT THIS IS A FUNDAMENTAL QUESTION TO BE CONSIDERED BY THE CONGRESS IN DETERMINING WHETHER TO APPROVE DIRECT FEDERAL FINANCING OF THE SECTION 235 PROGRAM.

RENTAL ASSISTANCE

NOW LET US TURN OUR ATTENTION TO THE RENTAL ASSISTANCE PROGRAM.

PROVIDING ADEQUATE RENTAL HOUSING FOR LOW- AND MODERATE-INCOME FAMILIES IS ONE OF THE MAJOR ISSUES FACING THE NATION TODAY. TO INCREASE THE NUMBER OF RENTAL HOUSING UNITS AVAILABLE TO THESE FAMILIES, A MORTGAGE INSURANCE PROGRAM WAS AUTHORIZED BY SECTION 236 OF THE NATIONAL HOUSING ACT. UNDER THE PROGRAM, HUD PROVIDES FINANCIAL ASSISTANCE BY PAYING THE MORTGAGE INSURANCE PREMIUMS AND A PORTION OF THE INTEREST COSTS. HUD INTEREST SUBSIDY PAYMENTS MAKE POSSIBLE LOWER RENTS TO THE TENANTS.

BY 1978, AN ESTIMATED 1.3 MILLION UNITS OF RENTAL HOUSING ARE TO BE PROVIDED BY THE SECTION 236 PROGRAM. THE HUD INTEREST SUBSIDY PAYMENTS UNDER THIS PROGRAM COULD RANGE FROM \$20 BILLION TO \$49 BILLION.

BECAUSE OF THE MAGNITUDE OF THE FEDERAL FUNDS INVOLVED, WE EXAMINED THE ADMINISTRATION AND OPERATION OF THE SECTION 236 HOUSING PROGRAM. WE

REVIEWED THE PROCEDURES AND PRACTICES FOLLOWED BY HUD IN ALLOCATING PROGRAM RESOURCES, APPRAISING LAND SELECTED FOR PROJECTS, AND ASSISTING AND MONITORING PROJECT MANAGEMENT. WE REVIEWED ALSO THE METHOD OF FINANCING THE PROGRAM, THE QUALITY OF PROJECT CONSTRUCTION, AND THE VARIOUS PROGRAM INCENTIVES TO DETERMINE WHETHER THEY WERE SUFFICIENT TO BRING ENOUGH PRIVATE CAPITAL INTO THE PROGRAM TO MEET SECTION 236 OBJECTIVES. ALSO, WE CONSIDERED A RECENT COMPREHENSIVE INTERNAL AUDIT OF THE SECTION 236 PROGRAM BY HUD.

OUR REVIEW WAS GENERALLY CONFINED TO HUD ACTIVITIES IN FOUR STATES-- GEORGIA, TEXAS, CALIFORNIA, AND NEW YORK. THE COMPLETE RESULTS OF OUR REVIEW WILL BE PUBLISHED IN A SOON TO BE RELEASED REPORT.

OUR TENTATIVE FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS IN THIS AREA OF HOUSING ASSISTANCE ARE AS FOLLOWS.

NEED TO IMPROVE ALLOCATION OF PROGRAM RESOURCES

I PREVIOUSLY DISCUSSED THE NEED FOR IMPROVING PROCEDURES IN THE ALLOCATION OF SECTION 235 PROGRAM RESOURCES AND OUR RECOMMENDATION THAT HUD PROVIDE A BETTER IDENTIFICATION OF THE NEED FOR SUBSIDIZED HOUSING IN SPECIFIC AREAS AND COMMUNITIES AND ASSURE THAT SECTION 235 RESOURCES ARE ALLOCATED PRIMARILY IN PROPORTION TO IDENTIFIED NEEDS.

BECAUSE THE SAME GENERAL DEFICIENCIES WERE OBSERVED IN THE ALLOCATION OF SECTION 236 PROGRAM RESOURCES, WE ARE RECOMMENDING THAT HUD PROVIDE A BETTER IDENTIFICATION OF HOUSING NEEDS AND ASSURE THAT SECTION 236 RESOURCES ARE ALLOCATED PRIMARILY IN PROPORTION TO IDENTIFIED NEEDS.

IN COMMENTING ON OUR FINDING, HUD STATED THAT THE ALLOCATION SYSTEM HAS CONTINUALLY BEEN REFINED TO MAKE IT MORE OBJECTIVE, EQUITABLE, AND ACCURATE AND THAT THE SYSTEM PROVIDES MAXIMUM EQUITY AMONG THE HUD FIELD OFFICES.

HUD STATED ALSO THAT IT DOES NOT INITIATE HOUSING PRODUCTION AND DOES NOT ATTEMPT TO FORCE HOUSING IN ANY AREA. HOWEVER, THERE ARE A NUMBER OF STATES AND HOUSING MARKET AREAS WHICH HAVE NOT RECEIVED THEIR PROPORTIONATE SHARE OF THE TOTAL SUBSIDIZED HOUSING UNITS PROVIDED BY HUD. AS IN THE CASE OF THE SECTION 235 PROGRAM, WE BELIEVE THAT HUD MUST FIRST ADEQUATELY IDENTIFY THE NEED IN ALL AREAS AND THEN MAKE EVERY EFFORT TO ALLOCATE PROGRAM RESOURCES IN ACCORDANCE WITH THE IDENTIFIED NEED.

HUD STATED THAT IT HAS BEEN INFORMING INDUSTRY AND COMMUNITIES ON THE BENEFITS OF THE SECTION 236 PROGRAM AND IS CONSIDERING ADDITIONAL MEANS TO STIMULATE PRODUCTIVITY WHERE IT IS MOST APPROPRIATE.

ACTION TAKEN TO STRENGTHEN LAND APPRAISAL PROCEDURES

OUR NEXT POINT DEALS WITH THE LAND APPRAISALS THAT WERE BEING MADE BY HUD FOR SECTION 236 PROJECTS. BECAUSE HUD DID NOT GIVE ADEQUATE CONSIDERATION TO PURCHASE PRICE OR OPTION PRICE DATA, ITS APPRAISALS OF LAND TO ESTABLISH SECTION 236 MORTGAGE LOAN AMOUNTS MAY HAVE UNDULY INCREASED MORTGAGE LOANS, RESULTING IN HIGHER INTEREST SUBSIDY COSTS TO THE GOVERNMENT, AND PROBABLY HIGHER RENTS TO PROJECT TENANTS.

IN DETERMINING THE AMOUNT OF AN INSURED MORTGAGE LOAN FOR MULTIFAMILY HOUSING, SUCH AS A SECTION 236 PROJECT, HUD ESTIMATES THE REPLACEMENT COST OF THE PROJECT, INCLUDING THE FAIR MARKET VALUE OF THE IMPROVED LAND. FOR A PROFIT-MOTIVATED PROJECT OWNER, THE INSURED MORTGAGE LOAN AMOUNT IS GENERALLY LIMITED TO 90 PERCENT OF A PROJECT'S ESTIMATED REPLACEMENT COST, AND FOR NONPROFIT PROJECT OWNERS THE INSURED MORTGAGE LOAN AMOUNT MAY EQUAL 100 PERCENT OF REPLACEMENT COST.

AT THE TIME OF OUR REVIEW, HUD DETERMINED THE VALUE OF A PROPOSED PROJECT SITE BY MEASURING IT AGAINST COMPARABLE SITES (USUALLY FIVE) WHICH

HAD BEEN RECENTLY SOLD OR OFFERED FOR SALE AND WHICH HAD ELEMENTS OF UTILITY AND DESIRABILITY SIMILAR TO THE PROPOSED SITE. TO BRING THE OTHER SITES AND THEIR PRICES INTO PROPER PERSPECTIVE WITH THE SITE BEING APPRAISED, HUD ADJUSTED THE PRICES OF THE COMPARABLE SITES TO COMPENSATE FOR LOCATION, TIME, ZONING, SIZE, AND OFF-SITE IMPROVEMENT DIFFERENCES.

WE EXAMINED THE LAND VALUATION ASSIGNED TO 68 RECENTLY COMPLETED SECTION 236 PROJECTS ADMINISTERED BY HUD FIELD OFFICES IN ATLANTA, DALLAS, AND LOS ANGELES. EACH OF THE FIELD OFFICES USED THE AFOREMENTIONED HUD PROCEDURES IN VALUING LAND FOR MORTGAGE LOAN PURPOSES AND GENERALLY HAD NOT CONSIDERED THE ACTUAL COST TO THE OWNER AS ONE OF THE VALUATION CRITERIA. PROJECT LAND WAS VALUED BY HUD ABOVE ITS COST TO THE OWNER FOR 47 OF THE 68 PROJECTS. FOR 12 OF THE 47 PROJECTS, HUD VALUED THE LAND AT 125 PERCENT OR MORE OF THE OWNER'S COST, AND THE VALUATIONS HAD BEEN MADE WITHIN 24 MONTHS OF THE OWNER'S ACQUISITION OF THE LAND. FIVE OF THESE HUD VALUATIONS INVOLVED LAND WHICH THE PROJECT SPONSORS DID NOT YET OWN--THEY ONLY HAD PURCHASE OPTIONS. A TABLE SHOWING THE VARIATIONS BETWEEN THE OWNER'S COST AND HUD'S VALUATION FOR THESE 12 PROJECTS IS PROVIDED IN APPENDIX I OF THIS STATEMENT.

WHEN HUD ASSIGNS A VALUE TO PROJECT LAND IN EXCESS OF ITS COST TO THE PROJECT OWNER, THE OWNER REALIZES A GAIN WHICH, IN THE CASE OF A PROFIT-MOTIVATED OWNER, CAN BE USED TO MEET EQUITY INVESTMENT REQUIREMENT. WE ESTIMATE THAT THE DIFFERENCE BETWEEN HUD'S VALUATION AND THE COST OF LAND FOR THE 12 PROJECTS COULD INCREASE HUD'S INTEREST REDUCTION PAYMENTS BY ABOUT \$2 MILLION OVER THE LIFE OF THE 12 MORTGAGE LOANS.

IN APRIL 1972, HUD ISSUED REVISED GUIDELINES TO ITS FIELD OFFICES WHICH, IN PART, PRESCRIBE NEW PROCEDURES FOR LAND APPRAISALS. THE REVISED GUIDELINES

STATE THAT LAND VALUES ARE NOT TO BE BASED SOLELY ON THE SALE PRICE OF COMPARABLE SITES AND THAT VARIANCES BETWEEN THE HUD APPRAISAL AND THE OWNER'S COST MUST BE FULLY JUSTIFIED.

WE BELIEVE THESE GUIDELINES, IF PROPERLY IMPLEMENTED, SHOULD IMPROVE HUD'S LAND APPRAISAL TECHNIQUES AND HELP ASSURE THAT A REASONABLE VALUE IS GIVEN TO PROJECT LAND FOR MORTGAGE LOAN PURPOSES. HOWEVER, WE ARE RECOMMENDING THAT HUD INITIATE A FIELD MONITORING SYSTEM TO PERIODICALLY REVIEW THE FIELD OFFICES' LAND VALUATION PRACTICES.

IN COMMENTING ON OUR FINDING, HUD STATED THAT THERE SHOULD BE LITTLE CONCERN FOR THE POSSIBILITY OF WINDFALL PROFITS ON LAND IF ITS LAND APPRAISAL PROCEDURES, WHICH ARE BASED ON SOUND APPRAISAL PRINCIPLES AND PRACTICES, ARE FOLLOWED. HUD AGREED THAT THE FIELD OFFICES' COMPLIANCE WITH THE APPRAISAL GUIDELINES NEED TO BE MONITORED.

METHOD OF FINANCING

OUR NEXT FINDING ON THE SECTION 236 PROGRAM CONCERNS THE METHOD OF FINANCING THE PROGRAM.

SIZABLE SAVINGS COULD BE ACHIEVED IF SECTION 236 MORTGAGE LOANS WERE FINANCED BY THE GOVERNMENT RATHER THAN BY PRIVATE LENDERS BECAUSE OF THE GOVERNMENT'S MORE FAVORABLE INTEREST COST. WE ESTIMATE THAT FOR THE HOUSING PLANNED TO BE PROVIDED BY THE SECTION 236 PROGRAM DURING FISCAL YEARS 1973-1978, THE PRESENT VALUE OF THE SAVINGS COULD AMOUNT TO ABOUT \$1.2 BILLION. GOVERNMENT FINANCING OF SECTION 236 LOANS WOULD, OF COURSE, REQUIRE A LARGER ANNUAL BUDGET OUTLAY--ESTIMATED AT ABOUT \$3 BILLION ANNUALLY DURING THE 6-YEAR PERIOD 1973-1978--THAN WOULD BE REQUIRED BY THE PRESENT METHOD OF FINANCING THE PROGRAM.

AS FOR THE SECTION 235 HOMEOWNERSHIP ASSISTANCE PROGRAM, WE ARE RECOMMENDING THAT THE CONGRESS CONSIDER LEGISLATION WHICH WOULD PERMIT THE SECTION 236 PROGRAM TO BE FINANCED BY BORROWINGS FROM THE TREASURY. IN THIS REGARD, WE RECOGNIZE THAT THERE ARE FACTORS OTHER THAN COSTS, SUCH AS THE IMPACT ON THE FEDERAL BUDGET, WHICH MUST BE CONSIDERED IN DETERMINING WHICH METHOD OF FINANCING IS MOST APPROPRIATE FOR A PARTICULAR MORTGAGE CREDIT PROGRAM. HOWEVER, WE BELIEVE THAT THE CONGRESS SHOULD BE MADE AWARE OF THE SUBSTANTIAL SAVINGS THAT COULD BE ACHIEVED BY THE GOVERNMENT AS A RESULT OF AN ALTERNATIVE METHOD OF FINANCING THE SECTION 236 PROGRAM, SO THAT THE CONGRESS MAY TAKE SUCH ACTION AS IT DEEMS APPROPRIATE.

THE DEPARTMENT OF TREASURY, THE OFFICE OF MANAGEMENT AND BUDGET, AND HUD TOOK THE SAME POSITION REGARDING THE FINANCING OF THE 236 PROGRAM AS EXPRESSED IN THEIR COMMENTS ON OUR RECOMMENDATION FOR THE SECTION 235 PROGRAM.

INCENTIVES TO INVESTORS

WE EXAMINED THE INCENTIVES BEING PROVIDED TO INVESTORS. INCENTIVES PROVIDED TO PROFIT-MOTIVATED ORGANIZATIONS TO INVEST IN SECTION 236 PROJECTS ARE SUFFICIENT TO INITIALLY ATTRACT A SUBSTANTIAL NUMBER OF PROSPECTIVE SPONSORS BUT DO NOT APPEAR ADEQUATE TO ENCOURAGE LONG-TERM OWNERSHIP OF PROJECTS. SUCH INCENTIVES INCLUDE LOW INITIAL INVESTMENT, INCOME TAX SHELTERS, AND OPPORTUNITY TO PROFIT FROM PARTICIPATION IN OTHER PHASES OF PROJECT DEVELOPMENT AND OPERATION. THE INCENTIVES ARE AVAILABLE TO PROJECT OWNERS REGARDLESS OF HOW WELL OR HOW POORLY THEY MANAGE A PROJECT.

TO OBTAIN A HUD-INSURED MORTGAGE LOAN, A PROFIT-MOTIVATED OWNER OF A SECTION 236 PROJECT IS REQUIRED TO HAVE AT LEAST A 10 PERCENT INVESTMENT IN THE PROJECT, BASED ON THE PROJECT'S ESTIMATED REPLACEMENT COST.

A PROJECT OWNER'S CASH INVESTMENT IN A PROJECT, HOWEVER, MAY BE SUBSTANTIALLY LESS THAN 10 PERCENT OF THE PROJECT'S REPLACEMENT COST BECAUSE OF INCREASED LAND VALUATION AND CERTAIN ALLOWANCES WHICH HUD PERMITS PROJECT OWNERS TO USE TO MEET THE INVESTMENT REQUIREMENT. FOR EXAMPLE, IF THE PROJECT OWNER IS ALSO THE GENERAL CONTRACTOR FOR THE PROJECT, HUD PERMITS THE OWNER TO USE THE BUILDER-SPONSOR PROFIT AND RISK ALLOWANCE--AN AMOUNT EQUAL TO 10 PERCENT OF THE ESTIMATED CONSTRUCTION COST WHICH IS INCLUDED IN THE PROJECT'S REPLACEMENT COST--TO MEET THE INVESTMENT REQUIREMENT.

INCENTIVES TO INVEST IN FEDERALLY SUBSIDIZED MULTIFAMILY HOUSING HAVE BEEN PROVIDED IN THE FORM OF TAX SHELTERS THAT MAY BE USED TO REDUCE FEDERAL INCOME TAX LIABILITIES. SOME OF THE TAX INCENTIVES INCLUDE ACCELERATED DEPRECIATION, MORE LIBERAL PROVISIONS FOR THE RECAPTURE OF ACCELERATED DEPRECIATION IN EVENT OF SALE, 5-YEAR WRITE-OFF OF REHABILITATION COSTS, DEFERMENT OF TAXABLE GAIN WHEN IT IS REINVESTED IN OTHER SUBSIDIZED HOUSING, AND ALLOWANCE OF A FAIR MARKET VALUE RATHER THAN DEPRECIATED COST AS A DEDUCTIBLE ITEM WHEN HOUSING IS DONATED TO QUALIFIED CHARITABLE ORGANIZATIONS.

THE OWNER OF A SECTION 236 PROJECT MAY ALSO PROFIT FROM PARTICIPATION IN OTHER PHASES OF THE CONSTRUCTION AND MANAGEMENT OF A PROJECT. THE PROJECT OWNER CAN HAVE FINANCIAL INTEREST IN AN ARCHITECTURE FIRM WHICH DESIGNS THE PROJECT AND IN FIRMS WHICH DO WORK FOR THE GENERAL CONTRACTOR ON A SUBCONTRACT BASIS.

MANY PROJECT OWNERS ALSO OWN REAL ESTATE MANAGEMENT FIRMS WHICH CAN BE USED TO PROVIDE THE PROJECT WITH MANAGEMENT, CUSTODIAL, AND BOOKKEEPING SERVICES.

THERE APPEAR TO BE LITTLE INCENTIVES TO ENCOURAGE LONG-TERM OWNERSHIP OF PROJECTS. TAX SHELTERS DIMINISH RAPIDLY AFTER THE TENTH YEAR OF PROJECT

OWNERSHIP AND THE ALLOWED 6 PERCENT ANNUAL RETURN ON INVESTMENT MAY NOT BE SUFFICIENT TO KEEP SPONSORS FROM DISPOSING OF THEIR PROJECTS.

WE OBTAINED COMMENTS FROM TREASURY AND HUD ON THE EFFECTIVENESS OF PRESENT INCENTIVES. TREASURY STATED THAT IT IS NOT AT ALL CLEAR THAT THE VARIOUS TAX INCENTIVES ENCOURAGE PROJECT OWNERS TO SELL HOUSING PROJECTS. HOWEVER, HUD STATED THAT THE INCENTIVES HAVE INFLUENCED SIGNIFICANTLY THE MOTIVATION OF PROFIT-MOTIVATED OWNERS AND THAT THERE APPEARS TO BE LITTLE INCENTIVE TO CONTINUE OWNERSHIP AFTER THE INITIAL 10-YEAR PERIOD.

TREASURY AGREED THAT THERE ARE A NUMBER OF PROBLEMS ASSOCIATED WITH A SUBSIDY PROGRAM WHICH REQUIRES TAX INCENTIVES TO MAKE IT GO. HUD STATED THAT THE DEVELOPMENT OF INCENTIVES WHICH ENCOURAGE PROJECT RETENTION OR GOOD PROJECT MANAGEMENT SHOULD BE STRESSED RATHER THAN REDUCTION OR SHIFTING OF PRODUCTION INCENTIVES, SUCH AS USE OF THE BUILDER-SPONSOR PROFIT AND RISK ALLOWANCE TO MEET INVESTMENT REQUIREMENTS AND SPECIAL TAX PROVISIONS. HUD PLANS TO EXPLORE THIS POSSIBILITY IN-DEPTH.

OTHER PROGRAM OBSERVATIONS

OTHER SECTION 236 PROGRAM OBSERVATIONS THAT WE MADE DURING THE COURSE OF OUR REVIEW INCLUDE

- INSTANCES OF INCORRECT RENT CHARGES AND THE FAILURE OF PROJECT OWNERS TO TURN BACK RENT COLLECTIONS EXCEEDING BASE RENT TO HUD,
- THE QUALITY OF THE HOUSING UNITS INSPECTED WAS GENERALLY FOUND TO BE GOOD,
- HUD DID NOT HAVE ADEQUATE DATA WITH WHICH TO MAKE A COMPREHENSIVE ANALYSIS OF ESTIMATED OPERATIONS AND MAINTENANCE COSTS OF PROPOSED SECTION 236 PROJECTS, INCREASING THE POSSIBILITY OF APPROVING

PROJECTS WHICH ARE TOO COSTLY TO MEET THE NEEDS OF LOWER
INCOME FAMILIES, AND

--THE AMOUNTS ALLOWED BY THE DALLAS FIELD OFFICE FOR LEGAL AND
ORGANIZATIONAL FEES DURING THE DEVELOPMENT STAGE OF SECTION 236
PROJECTS WERE HIGHER THAN THE AMOUNTS SUGGESTED BY HUD GUIDELINES.

HUD HAS INDICATED THAT CORRECTIVE ACTION, WHERE APPROPRIATE, IS BEING
TAKEN REGARDING THESE MATTERS.

MR. CHAIRMAN, I HAVE ONE ADDITIONAL OBSERVATION TO MAKE REGARDING BOTH
THE SECTION 235 AND SECTION 236 PROGRAMS. ON NOVEMBER 22, 1972, GAO ISSUED
A REPORT TO THE CONGRESS ON THE OPPORTUNITY FOR REDUCING INTEREST COSTS
UNDER SECTIONS 235 AND 236 HOUSING PROGRAMS. IN THAT REPORT, WE POINT OUT
THAT BECAUSE HUD'S MONTHLY ASSISTANCE PAYMENTS INCLUDE THE MORTGAGE INSURANCE
PREMIUMS, HUD IS PAYING OUT FUNDS WHICH IT MUST SUBSEQUENTLY COLLECT FROM THE
MORTGAGEES. AS A RESULT, THE GOVERNMENT LOSES THE USE OF SUCH FUNDS FOR AN
AVERAGE OF 6 MONTHS. WE ESTIMATED, FOR THIS FISCAL YEAR ALONE, THAT THE
INTEREST COST TO THE GOVERNMENT ON SUCH MONTHLY PAYMENTS WOULD BE AT LEAST
\$1.6 MILLION.

IN OUR REPORT, WE RECOMMENDED THAT THE CONGRESS AUTHORIZE HUD TO WAIVE
THE MORTGAGE INSURANCE PREMIUM FOR THE SECTIONS 235 AND 236 HOUSING PROGRAMS
SIMILAR TO THE WAIVER OF PREMIUMS NOW PROVIDED FOR IN THE SECTION 221(D)(3)
RENTAL HOUSING PROGRAM.

IN ADDITION TO THE ABOVE OBSERVATIONS CONCERNING THE SUBSIDIZED HOUSING
PROGRAMS, WE WOULD LIKE TO RESPOND TO THE CHAIRMAN'S REQUEST FOR INFORMATION
ON INSURANCE WRITTEN AND THE INCIDENCE OF DEFAULTS AND FORECLOSURES IN THE
PAST 3 YEARS UNDER THE VARIOUS HUD-INSURED MORTGAGE LOAN PROGRAMS AND THE

ESTIMATED COSTS TO THE FEDERAL GOVERNMENT OF SUCH FORECLOSURES. THIS INFORMATION IS PROVIDED IN APPENDIXES II THROUGH VII OF THIS STATEMENT.

THIS CONCLUDES MY PREPARED STATEMENT, MR. CHAIRMAN. WE SHALL BE PLEASED TO RESPOND TO ANY QUESTIONS THE MEMBERS OF THE SUBCOMMITTEE MAY HAVE.

BEST DOCUMENT AVAILABLE

APPENDIX I

VARIATIONS BETWEEN
OWNER'S COST AND HUD VALUATION
OF SECTION 236 PROJECT LAND

HUD field office	Cost ^a	Project land		Months between purchase or option agreement and HUD valuation
		Amount	Percentage of cost	
Atlanta	\$ 61,400	\$157,000	256	3
	22,503	75,000	333	17
	72,502	96,000	132	2
Dallas	\$149,750 ^b	\$311,500	208	7
	116,320 ^b	250,000	215	6
	125,886 ^b	235,200	187	4
	116,520 ^b	223,700	192	8
	260,020 ^b	356,000	137	1
Los Angeles	\$317,400	\$415,800	131	17
	158,000	228,600	145	7
	271,407	341,000	126	17
	198,800	251,500	127	11

^aIncludes estimated cost of off-site improvements, demolition, and other related land improvements.

^bThe sponsors of these projects held purchase options at the time of the HUD appraisals.

BEST DOCUMENT AVAILABLE

TOTAL MORTGAGE INSURANCE WRITTEN FOR HOMEOWNERSHIP PROGRAMS
FISCAL YEARS 1970, 1971, AND 1972
AND CUMULATIVE THRU JUNE 30, 1972

APPENDIX I I

SECTION OR TITLE OF THE ACT	INSURANCE WRITTEN IN FISCAL YEAR						CUMULATIVE INSURANCE WRITTEN THRU JUNE 30, 1972	
	1970		1971		1972		NUMBER OF LOANS	AMOUNT (000 OMITTED)
	NUMBER OF LOANS	AMOUNT (000 OMITTED)	NUMBER OF LOANS	AMOUNT (000 OMITTED)	NUMBER OF LOANS	AMOUNT (000 OMITTED)		
SECTION 203	268,962	\$4,668,088	297,272	\$5,515,934	276,819	\$5,399,269	8,750,423	\$100,886,614
SECTION 221	53,087	734,998	86,913	1,385,403	87,690	1,509,664	539,327	6,948,986
SECTION 222	8,666	149,454	9,981	187,827	9,472	194,071	245,892	3,618,900
SECTION 223e	34,397	449,115	25,597	355,871	17,070	259,444	101,236	1,365,383
SECTION 235	49,622	757,274	140,548	2,499,456	135,122	2,501,612	330,070	5,825,938
TITLE VI (NOTE a)	-0-	-0-	-0-	-0-	-0-	-0-	628,835	3,663,998
SECTION 809	251	5,357	247	5,405	234	5,328	16,162	261,518
ALL OTHERS (NOTE b)	3,734	54,027	5,287	54,607	6,876	115,690	155,877	1,518,100
TOTAL	<u>418,719</u>	<u>\$6,818,313</u>	<u>565,845</u>	<u>\$10,004,503</u>	<u>533,283</u>	<u>\$9,985,078</u>	<u>10,767,822</u>	<u>\$124,089,437</u>

^aINCLUDES SECTIONS 603, 609, AND 611.

^bINCLUDES SECTIONS 8, 203k, 213, 220, 221(h), 225, 237, AND 903.

BEST DOCUMENT AVAILABLE

TOTAL PROPERTIES AND NOTES ACQUIRED UNDER HOMEOWNERSHIP PROGRAMS
FISCAL YEARS 1970, 1971, AND 1972
AND CUMULATIVE THRU JUNE 30, 1972

APPENDIX III

SECTION OR TITLE OF THE ACT	1970			1971			1972			PROPERTIES AND NOTES ACQUIRED THRU JUNE 30, 1972	
	NUMBER	AMOUNT (000 OMITTED)	NUMBER	AMOUNT (000 OMITTED)	NUMBER	AMOUNT (000 OMITTED)	NUMBER	AMOUNT (000 OMITTED)	NUMBER	AMOUNT (000 OMITTED)	
SECTION 203	19,177	\$310,247	20,128	\$346,801	22,797	\$438,732	331,810	\$4,720,060			
SECTION 221	4,957	73,233	7,133	115,821	12,099	220,969	51,821	752,931			
SECTION 222	982	15,781	743	11,818	589	10,032	21,582	303,192			
SECTION 223	920	12,066	3,134	47,352	4,432	73,478	8,509	133,125			
SECTION 235	282	4,091	3,679	60,094	13,164	233,156	17,128	297,377			
TITLE VI (NOTE a)	11	77	2	79	1	(15)	12,285	81,578			
SECTION 809	152	2,803	131	2,381	68	1,437	1,373	22,546			
ALL OTHERS (NOTE b)	212	3,704	290	4,031	247	5,257	24,739	278,783			
TOTAL	26,693	\$422,002	35,240	\$588,377	53,397	\$983,046	469,247	\$6,589,592			

^aINCLUDES SECTIONS 603, 609, 611

^bINCLUDES SECTIONS 8, 203k, 213, 220, 221(h), 225, 237, 903

BEST DOCUMENT AVAILABLE

APPENDIX IV

HOME PROPERTIES SOLD AND ASSIGNED NOTES LIQUIDATED
AS OF JUNE 30, 1972

SECTION OF THE ACT	PROPERTIES SOLD		ASSIGNED NOTES LIQUIDATED		TOTAL PROPERTIES AND ASSIGNED NOTES LIQUIDATED		AVERAGE LOSS PER CASE
	NUMBER	NET LOSS TO FUND (000 OMITTED)	NUMBER	NET LOSS TO FUND (000 OMITTED)	NUMBER	NET LOSS TO FUND (000 OMITTED)	
203	308,002	\$872,900	161	--	308,163	\$872,900	\$2,833
213	4,574	16,173	3	--	4,577	16,173	3,534
221	38,463	142,480	8	--	38,471	142,480	3,704
222	21,163	57,847	4	--	21,167	57,847	2,733
TITLE VI (NOTE a)	11,926	12,030	125	\$61	12,051	12,091	1,003
903	16,295	60,095	8	--	16,303	60,095	3,686
223(e)	2,736	17,703	--	--	2,736	17,703	6,470
235	3,974	15,245	1	--	3,975	15,245	3,835
237	52	317	--	--	52	317	6,096
OTHERS (NOTE b)	4,031	7,248	15	53	4,046	7,301	1,804

^aINCLUDES SECTIONS 603, 609, AND 611.

^bINCLUDES SECTIONS 2, 8, 203(k), 220, 233, 234, 809.

BEST DOCUMENT AVAILABLE

TOTAL MORTGAGE INSURANCE WRITTEN FOR MULTIFAMILY PROPERTIES
FISCAL YEARS 1970, 1971, AND 1972
AND CUMULATIVE THRU JUNE 30, 1972

APPENDIX V

SECTION OR TITLE OF THE ACT	TOTAL INSURANCE WRITTEN FOR FISCAL YEAR									CUMULATIVE INSURANCE WRITTEN THRU JUNE 30, 1972		
	1970			1971			1972			NUMBER OF LOANS	NUMBER OF UNITS	AMOUNT (000 OMITTED)
	NUMBER OF LOANS	NUMBER OF UNITS	AMOUNT (000 OMITTED)	NUMBER OF LOANS	NUMBER OF UNITS	AMOUNT (000 OMITTED)	NUMBER OF LOANS	NUMBER OF UNITS	AMOUNT (000 OMITTED)			
SECTION 207	78	11,347	\$ 86,068	266	42,052	\$285,648	187	30,681	\$332,535	2,466	321,069	\$ 3,566,267
SECTION 213	4	112	2,915	-0-	-0-	-0-	-0-	-0-	-0-	1,536	46,988	651,528
SECTION 220	11	1,030	25,062	20	2,639	57,854	11	3,833	93,085	363	66,910	1,242,592
SECTION 221	621	58,421	831,754	673	68,974	1,010,133	754	84,147	1,283,333	3,736	414,906	5,801,275
SECTION 236	473	59,987	901,804	985	104,907	1,740,744	1,043	111,323	1,843,621	2,509	277,502	4,504,050
TITLE VI (NOTE a)	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	7,103	472,791	3,463,560
TITLE VIII (NOTE b)	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	1,187	208,151	2,631,283
ALL OTHERS (NOTE c)	435	7,304	215,761	402	8,530	453,259	386	32,013	478,950	2,955	281,194	3,117,003
TOTAL	<u>1,622</u>	<u>138,201</u>	<u>\$2,063,364</u>	<u>2,346</u>	<u>227,102</u>	<u>\$3,547,638</u>	<u>2,381</u>	<u>261,997</u>	<u>\$4,031,524</u>	<u>21,855</u>	<u>2,089,511</u>	<u>\$24,977,558</u>

^aINCLUDES SECTIONS 608, 609, 610, AND 611.

^bINCLUDES SECTIONS 803 AND 810.

^cINCLUDES SECTIONS 220(h), 221 (h), 223(d), 231, 232, 233, 234, 241, 242, 908, 1002, 1101, 223(e), 235(j), and 213.

BEST DOCUMENT AVAILABLE

MULTIFAMILY PROPERTIES AND NOTES ACQUIRED UNDER TERMS OF INSURANCE CONTRACTS
 FISCAL YEARS 1970, 1971, AND 1972
 AND CUMULATIVE THRU JUNE 30, 1972

APPENDIX VI

TITLE OR SECTION OF THE ACT	PROPERTIES AND NOTES ACQUIRED									PROPERTIES AND NOTES ACQUIRED THRU JUNE 30, 1972		
	1970			1971			1972			NUMBER	UNITS	AMOUNT (NOTE a) (000 OMITTED)
	NUMBER	UNITS	AMOUNT (NOTE a) (000 OMITTED)	NUMBER	UNITS	AMOUNT (NOTE a) (000 OMITTED)	NUMBER	UNITS	AMOUNT (NOTE a) (000 OMITTED)			
SECTION 207	5	855	\$ 7,206	10	1,310	\$ 10,965	8	1,080	(2,011)	260	38,843	\$ 366,123
SECTION 213	-	-	(4,481)	-	-	(2,212)	1	169	480	80	8,746	125,192
SECTION 220	-	-	(5,233)	6	1,203	13,245	4	1,276	30,543	47	10,036	148,107
SECTION 221	29	1,929	18,322	62	6,081	76,212	94	10,627	134,524	245	26,552	299,798
SECTION 236	-	-	-	7	887	13,109	29	2,416	30,965	36	3,303	44,074
TITLE VI (NOTE b)	7	707	(1,894)	3	291	(3,171)	7	87	(3,242)	1,001	69,600	384,964
TITLE VIII (NOTE c)	-	-	(397)	-	-	(1,519)	1	70	717	66	9,878	96,152
ALL OTHERS (NOTE d)	6	387	(3,534)	26	2,924	25,250	23	1,708	9,708	192	23,422	258,428
TOTAL	47	3,878	\$9,989	114	12,696	\$131,877	167	17,433	\$201,684	1,927	190,380	\$1,722,838

^aFHA AS PART OF ITS OPERATION OF THE PROPERTIES ACQUIRED THROUGH FORECLOSURE OR ASSIGNMENT OF MORTGAGE NOTES COLLECTS RENTS AND PAYS OPERATING EXPENSES. FIGURES IN PARENTHESES ARE BALANCES BY WHICH RENT COLLECTIONS EXCEEDED OPERATING EXPENSES.

^bINCLUDES SECTIONS 608, 609, 610, 611.

^cINCLUDES SECTIONS 803 AND 810.

^dINCLUDES SECTIONS 220(h), 221(h), 223(d), 231, 232, 233, 234, 241, 242, 908, 1002, 1101, 223(e), 235(f), and 213.

BEST DOCUMENT AVAILABLE

MULTIFAMILY PROPERTIES SOLD AND ASSIGNED NOTES LIQUIDATED
AS OF JUNE 30, 1972

APPENDIX VII

SECTION OF THE ACT	PROPERTIES SOLD		ASSIGNED NOTES LIQUIDATED		TOTAL PROPERTIES AND NOTES ASSIGNED		AVERAGE LOSS PER UNIT
	UNITS	NET LOSS TO FUND	UNITS	NET LOSS TO FUND	UNITS	NET LOSS TO FUND	
207	16,577	13,849,975	2,998	283,518	19,575	14,133,493	722
213	4,531	17,265,593	1,016	3,226,346	5,547	10,491,939	1,891
231	6,533	16,751,543	575	(567,629)	7,108	16,183,914	2,277
221	2,807	2,032,249	-	-	2,807	2,032,249	724
608	45,213	70,627,505	5,301	1,511,476	50,514	72,138,981	1,428
TITLE VIII (NOTE a)	3,698	15,289,967	2,920	2,790,844	6,618	18,080,811	2,732
OTHER (NOTE b)	<u>4,912</u>	<u>817,548</u>	<u>910</u>	<u>364,254</u>	<u>5,822</u>	<u>1,181,802</u>	203
TOTALS	<u>84,271</u>	<u>\$126,634,380</u>	<u>13,720</u>	<u>\$7,608,809</u>	<u>97,991</u>	<u>\$134,243,189</u>	

^aINCLUDES SECTIONS 803, 810.

^bINCLUDES SECTIONS 232, 220, 234, 908, 213, and 609.

BEST DOCUMENT AVAILABLE