

February 1997

HOUSING AND URBAN DEVELOPMENT

Potential Implications of Legislation Proposing to Dismantle HUD





United States
General Accounting Office
Washington, D.C. 20548

**Resources, Community, and
Economic Development Division**

B-275718

February 21, 1997

The Honorable Alfonse D'Amato
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate

The Honorable Connie Mack
Chairman, Subcommittee on Housing
Opportunity and Community Development
Committee on Banking, Housing,
and Urban Affairs
United States Senate

The Honorable Lauch Faircloth
United States Senate

This report responds to your request that we examine the implications of one of the proposals to dismantle HUD—S. 1145, the Housing Opportunities and Empowerment Act. Specifically, the report (1) examines the bill's proposed changes in housing assistance, community development, and housing finance and the potential impact of these changes on the customers of these programs and (2) discusses the capacity of the states and other federal agencies to assume HUD's functions and the tasks to be accomplished in dismantling HUD within the 5 years specified in the bill.

We are sending copies of this report to the Secretaries of Housing and Urban Development, Health and Human Services, Agriculture, and the Treasury; the Directors of the Offices of Management and Budget and Personnel Management; the Attorney General; the Chairmen of the Federal Reserve Board and the Federal Trade Commission; the Administrator of the Environmental Protection Agency; the Chief Executive Officer of the Federal Home Loan Mortgage Corporation; and the President of the Federal National Mortgage Association. We will make copies available to others on request.

Please call me at (202) 512-7631 if you or your staff have any questions. Major contributors to this report are listed in appendix X.

Judy A. England-Joseph
Director, Housing and Community
Development Issues

Executive Summary

Purpose

Efforts to balance the federal budget by early in the next century will impose difficult choices about discretionary spending for the Department of Housing and Urban Development (HUD) and other federal departments and agencies. Most balanced budget plans include a freeze in discretionary spending at current levels to help reduce the deficit. Under such a freeze, spending would be nearly 20 percent lower by the year 2002 than if current levels were allowed to increase with inflation. Although budget constraints will test and challenge many agencies and programs, they can also prompt reforms of long-standing problems in programs' management and design.

HUD spent about \$29 billion in fiscal year 1995 to, among other things, make rental housing affordable, revitalize communities, and support homeownership. However, in recent years, several organizations, including GAO, have identified significant deficiencies in the Department's internal controls, information and financial management systems, organizational structure, and mix of staff and skills. Recognizing the need to address these concerns as well as to reduce discretionary spending, the administration, the Congress, and others have offered proposals to restructure HUD, privatize or transfer some of its functions, or dismantle the agency.

The Chairs of the Senate Committee on Banking, Housing, and Urban Affairs and its Subcommittee on Housing Opportunity and Community Development and Senator Faircloth asked GAO to examine the implications of one of the proposals introduced in the 104th Congress to dismantle HUD—S. 1145, the Housing Opportunities and Empowerment Act. This report (1) examines the bill's proposed changes in housing assistance, community development, and housing finance and the potential impact of these changes on the customers of these programs and (2) discusses the capacity of the states and other federal agencies to assume HUD's functions and the tasks to be accomplished in dismantling HUD within the 5 years specified in the bill. Projections of the bill's impact on the federal budget, developed by the Congressional Budget Office (CBO), will be published in a separate report. As agreed with the requesters' offices, this report assumes that the bill would cover the 5-year period from 1997 to 2002, rather than the period from 1995 to 2000 that is specified in S. 1145. To obtain information on these issues, GAO, among other things, visited six states and 11 federal agencies and surveyed representatives of 44 state community development agencies.

Background

Since HUD was created in 1965, it has grown to include some 240 programs and activities and hundreds of billions of dollars in financial commitments. Through its multiple social and financial roles, it directly or indirectly affects most Americans through its functions, which fall into four categories—housing assistance, community development, housing finance, and regulation. S. 1145 (and an identical bill, H.R. 2198) would dismantle HUD, transferring some of its functions to other federal agencies, the states, or the private sector and eliminating other functions altogether. To manage the transition, the bill would redesignate HUD as the Housing and Urban Development Programs Resolution Agency and make this temporary agency responsible for administering and concluding HUD's affairs within 5 years.

Under S. 1145, HUD's public housing and other rental housing assistance programs that provide subsidies for specific projects, referred to as project-based assistance, would be phased out and replaced with a flexible voucher system that would allow tenants to choose where they live. Tenants could use their vouchers to either rent or purchase any unit they could afford, but a household's receipt of vouchers would generally be limited to a lifetime maximum of 5 years. The program would be administered by the Department of Health and Human Services (HHS), but the states could choose to receive a block grant allocation to administer the vouchers on HHS' behalf or develop their own housing assistance programs. The funding for HUD's community development grants, as well as many of the Department's grant programs for housing and assistance to the homeless and people with special needs, would be combined—and greatly reduced—to form a grant program that would be administered by a new, independent agency. A shared-risk insurance program administered by the Department of the Treasury would replace the Federal Housing Administration's (FHA) single-family mortgage insurance program. Several other programs, including FHA's multifamily insurance program, would be terminated, as would the federal government's direct participation in the secondary mortgage market. Various other regulatory and enforcement activities would be transferred to other federal departments.

Results in Brief

The recent proposal to dismantle HUD—S. 1145—couples reduced federal funding with fundamental changes to the federal role in housing and community development. If enacted, such a bill could have far-reaching effects on renters, communities, and would-be home buyers. While the bill's plan to institute a voucher system to allow tenants to choose their residence could expand housing choices for renters in some areas, its

phaseout of assistance for specific projects could reduce the supply of affordable housing—and housing choices—in other areas, according to HUD and state officials. Nonetheless, rising costs make current levels of housing assistance increasingly difficult for the nation to afford in an era of declining federal discretionary budgets. Accordingly, budgetary constraints may well reduce federal housing programs and services, whether these programs are reformed or not. The bill's creation of a block grant for community development would give the states and localities more choice in spending federal funds, but the total federal funding for community development programs would be cut by about 40 percent. The current beneficiaries of federal programs targeted to their needs, such as the homeless, might receive less assistance in an open competition for funds at the local level. Also, small cities would see a significant reduction in the federal funding for their projects. Although some of the bill's other provisions are designed to reduce the federal government's risk in insuring loans and guaranteeing mortgage-backed securities, these same provisions would make purchasing a home more difficult, especially for low-income and first-time buyers.

Both the states and the federal agencies that would receive HUD's functions generally believed that they could assume additional programmatic and administrative responsibilities if they also received additional resources. However, several of the federal agencies cautioned that they did not seek to assume HUD's functions. HUD maintained that transferring its functions to other agencies would break up the network it has developed to implement its programs, would adversely affect the delivery of services to its clients, and would eliminate the focus on housing and community development it has provided as a cabinet-level department. The priority that other agencies would give to some of HUD's functions remains an open question. Finally, the bill's implementation would depend on the resolution agency's ability to transfer functions and administer—and in some cases resolve—complex financial commitments within the required 5-year period. Lessons learned from previous experiences in eliminating agencies, especially in dissolving the Resolution Trust Corporation, could assist the resolution agency.

Principal Findings

Bill Could Increase Choice in Housing and Community Development, but Aid to Some Vulnerable Populations Might Be Reduced

Replacing a mixed project-based and tenant-based housing assistance program with a voucher-only system could give renters more choice in deciding where they would live. The extent of their choice would, however, depend on a number of factors, including the amount of their rental subsidy compared with the costs of housing in any given market. Under S. 1145, currently assisted properties—1.3 million units of public housing and 1.4 million units of housing receiving section 8 project-based assistance—would be required to compete in the marketplace. During a 5-year transition period, the resolution agency would settle expiring long-term commitments to provide rental assistance through a process comparable to one that HUD has considered for reducing the government’s expenditures for these commitments. The resolution agency would also administer a block grant to operate and improve those public housing properties with an approved plan for becoming more competitive. But some of the public housing and other assisted properties might not become competitive. If tenants chose not to remain or if rental income was otherwise insufficient to cover operating costs, the properties might not remain viable, and their loss could decrease the supply of affordable housing. Any such loss could decrease the opportunities for recipients of voucher assistance to exercise choice in some housing markets, including tight markets such as those in San Francisco and New York City. However, for most households, according to both HUD and CBO, affordability is the main problem, not a shortage of housing. Additionally, under a tenant-based system, landlords would know that tenants could move and would, in principle, have more incentive to maintain their projects.

Combining the funding for HUD’s community development programs—currently about \$8 billion—into a block grant to be funded at \$5 billion in the first year, distributing it to the states and large metropolitan areas, and allowing these entities to decide how they would spend the funds—within federal guidelines—would give these entities more choice. But studies on local development issues have shown that communities often choose to invest in projects benefiting broad-based constituencies and reduce the funding targeted to low-income groups. For example, populations such as the homeless, who are guaranteed a measure of assistance under HUD’s McKinney Act programs, might not fare as well under a block grant that did not target some funds directly to them. Also, the bill’s reductions of almost 60 percent during the first year in the

grants to 3,000 small cities would mean that these cities would either receive smaller grants or fewer of them would receive grants. Either way, these communities might have to cut or scale back their community development activities.

Bill Would Reduce the Federal Role in Housing Finance

Under S. 1145, the federal government would provide partial mortgage insurance only for single family homes and would no longer insure multifamily dwellings. Borrowers would have to make a larger down payment to buy a home, and mortgage credit would be less readily available for some multifamily projects. The bill could reduce the federal government's exposure to loss (1) by lowering the percentage of a home mortgage loan that the federal government could insure from the current level of 100 percent to no more than 35 percent and (2) by no longer guaranteeing mortgage-backed securities. The federal government's actual losses would depend upon risk-sharing agreements negotiated between the Department of the Treasury and state housing finance agencies and/or private mortgage insurers. However, these changes, combined with a new provision limiting a loan to no more than 97 percent of the value of a home, might result in loan terms similar to those now offered by the private market. Consequently, some low-income families and first-time home buyers who would formerly have qualified for a federally insured loan might not do so under the bill's provisions. As a result, some would-be home buyers might have to delay purchasing a home while accumulating additional cash, purchase a home of lesser value, or in some cases never become homeowners. Eliminating FHA as a source of insurance for multifamily mortgages would eliminate a relatively small, but in some instances important, source of credit enhancement for developers of projects for lower-income renters, as well as for hospitals and nursing homes in certain locations.

States and Receiving Agencies Say They Would Need Resources to Implement Transferred Functions and Could Experience Some Difficulties

Officials in the six states GAO visited believed that their state could take on most of the bill's proposed responsibilities. In the housing assistance area, most officials said they would need funding for additional staff or automated systems to accomplish the tasks that this proposal would transfer to the states. However, almost 80 percent of the respondents to a GAO survey of state community development officials said their state could easily assume the community development responsibilities by dividing the grant among state agencies. State housing finance agencies, according to their association and one bond-rating agency, do not have the capital to participate in risk-sharing arrangements to insure single-family mortgages.

Most state and local officials GAO contacted said their state would be unlikely to supplement the federal funding provided in S. 1145, but the state's actual response might differ, depending on its resources and priorities. The states vary in their experience with programs such as those they might administer under S. 1145. Thirty-three states currently administer some federal tenant-based assistance, according to a 1994 housing industry survey. Forty-eight states share in administering HUD's Community Development Block Grant program, which somewhat resembles the bill's proposed block grant. Eight states currently provide single-family mortgage insurance.

Most of the federal agencies slated to receive responsibilities from HUD generally agreed that their missions were compatible with the new functions and that they could assume the responsibilities if they also received the necessary resources, but some agencies indicated that implementation might pose problems. HUD cited differences in missions, organizations, and operating procedures that it believed would impede the delivery of services to its clients and eliminate the advocacy for housing and community development issues provided by a cabinet-level department. The departments of Health and Human Services and Justice agreed with HUD that they do not have the appropriate field organizations—and, in the case of Justice—the investigative staff to carry out the fair housing program effectively. Treasury and the Environmental Protection Agency acknowledged that they are not experienced in dealing with HUD's traditional clients. HUD believes that the transfers could considerably weaken the impact of the programs. However, S. 1145 does allow for the transfer of some HUD program staff and resources to the receiving agencies. Given the complexity and uncertainty of the issues associated with transferring functions, GAO did not determine how many HUD staff might be transferred to receiving agencies.

Proposed Resolution Agency Would Face Difficult Tasks

Dismantling HUD and restructuring, transferring, or eliminating its programs would place significant responsibilities on the proposed resolution agency. During its 5-year term, the agency would need to administer—and in some cases resolve—over \$400 billion in loan insurance and approximately \$464 billion in mortgage-backed security guarantees. These commitments generally extend well beyond 5 years. In addition, the agency would need to administer nearly \$100 billion in section 8 project-based rental assistance contracts, the majority of which will expire during the next 5 years. Dismantling a department as large as HUD would be a significant undertaking. Lessons learned, particularly in

dissolving the Resolution Trust Corporation and in reorganizing smaller agencies, could be applicable if S. 1145 were enacted. For example, in previous work on dismantling and reorganizing agencies, GAO has found that useful actions include establishing an interagency task force to help transfer assets, personnel, and operations; developing a comprehensive strategy for addressing all financial commitments; and reviewing internal controls and information systems. These actions could facilitate the transition if it occurs. For example, reviewing internal controls and information systems could identify areas that require careful monitoring to prevent waste, fraud, and abuse in resolving HUD's financial commitments.

Agency Comments

GAO requested comments on a draft of this report from HUD, HHS, and the Office of Management and Budget (OMB). GAO also provided excerpts of the draft report pertaining to the proposed transfers of HUD functions to the departments of Agriculture, Justice, and the Treasury; the Environmental Protection Agency; the Federal Reserve Board; the Federal Trade Commission; the Office of Personnel Management; Freddie Mac; and Fannie Mae for their comments. HUD, HHS, the departments of Justice and of the Treasury, and OMB expressed their strong disagreement with S. 1145, and several of these agencies cited the need for a cabinet-level department to provide a focus for housing and community development issues. HUD also said that the report was deeply flawed in its methodology, content, and conclusions because it does not fully discuss (1) the harm to HUD's customers that HUD believes would result from dismantling the department, (2) the loss of a national housing and community development policy, and (3) the difficulties involved in transferring HUD's functions to other agencies and to other levels of government. After reviewing HUD's comments, GAO added information to the report to recognize possible additional consequences for home buyers and homeowners of the proposed changes to FHA. However, it is not possible to predict the exact impact of the bill on HUD's customers because the bill gives states and localities increased flexibility in making spending decisions. Neither GAO nor HUD can assess with any certainty what spending choices states and communities would make. GAO also added several references to HUD's position on the difficulties involved in transferring the Department's functions and the loss of a national housing and community development policy. The continued need for a cabinet-level department to address housing and community development issues is a policy question for the Congress and the administration to decide.

OMB said that issues related to the reorganization and administration of HUD's functions should be evaluated on their own merits, not as a strategy for reducing the deficit. OMB said that the administration believes that assigning HUD's functions to other agencies would counteract its reinvention goals. HHS said the proposal was not well advised and the planned transfers might result in little or no cost savings to the federal government. This report provides information on the potential positive and negative implications of S. 1145 and, as such, does not take a position on the bill. Projections of the bill's impact on the federal budget will be developed and published by CBO in a separate report. The Department of Justice stressed the extreme burden that transferring HUD's fair housing responsibilities would impose on it, especially the drain of resources from its primary mission of fair housing enforcement. Six of the remaining seven agencies provided clarifying language for the portions of the report that discuss their agency. GAO incorporated the comments, as appropriate, throughout the report. The agencies' written comments and GAO's detailed responses appear in appendixes III through IX. Additionally, GAO's responses to the agencies' broader comments are summarized at the end of chapters 1 through 4.

Contents

Executive Summary		2
Chapter 1		14
Introduction	HUD's Missions Have Evolved	14
	Despite Accomplishments, Problems Impede Efficiency and Effectiveness	16
	The Administration, the Congress, and Others Have Proposed Changes	17
	S. 1145 Would Introduce Sweeping Changes	18
	Objectives, Scope, and Methodology	22
	Agency Comments and Our Evaluation	23
Chapter 2		25
S. 1145 Could Increase Choice in Housing and Community Development, but Some Vulnerable Populations Might Receive Less Assistance	Impact of Proposed Changes in Rental Assistance, Would Depend on a Number of Factors	25
	Block Grants Would Give Some Communities More Choice but Could Decrease Aid for Vulnerable Populations	34
	Agency Comments and Our Evaluation	40
Chapter 3		41
The Federal Role in Housing Finance Would Be Reduced	HUD Insures Mortgages and Provides Liquidity to Lenders	41
	Federal Support for Housing Finance Would Be Reduced	45
	Home Mortgages Would Be Harder to Obtain for Some Home Buyers Under the Bill's Provisions	47
	Agency Comments and Our Evaluation	52

Chapter 4		53
States Have Varied Capacity and Receiving Agencies Generally Have Compatible Missions, but Implementation Could Pose Difficulties	States Are Willing to Assume a Greater Role but Have Varied Administrative and Fiscal Capacity	53
	Missions of Some Receiving Agencies May Be Compatible, but Program Delivery May Differ	59
	Agency Comments and Our Evaluation	63
<hr/>		
Chapter 5		65
The Proposed Resolution Agency Would Face Difficult Tasks	Resolution Agency Would Manage Transition for All Major Functions	65
	Lessons Learned From Prior Efforts to Abolish, Reorganize, or Transfer Federal Programs Could Ease Transition	71
	Conclusions	74
<hr/>		
Appendixes	Appendix I: Implications of S. 1145 on the Receiving Agencies	76
	Appendix II: Financial Commitments Inherited by the Resolution Agency	92
	Appendix III: Comments From the Department of Housing and Urban Development	99
	Appendix IV: Comments From the Department of Health and Human Services	107
	Appendix V: Comments From the Office of Management and Budget	109
	Appendix VI: Comments From the Department of the Treasury	112
	Appendix VII: Comments From the Environmental Protection Agency	114
	Appendix VIII: Comments From the Federal Reserve Board	119
	Appendix IX: Comments From the Department of Agriculture	120
	Appendix X: Major Contributors to This Report	122
<hr/>		
Related GAO Products		125

Tables	<p>Table 1.1: Shifts in Responsibility From HUD to Other Agencies Under S. 1145 21</p> <p>Table 5.1: HUD’s Financial Commitments as of Fiscal Year 1995 68</p>
Figures	<p>Figure 2.1: Distribution of HUD-Assisted Housing Units 26</p> <p>Figure 2.2: Provision of Rental Assistance Under S. 1145 29</p> <p>Figure 2.3: Fiscal Year 1997 Public Housing Funding Compared With the Funding Proposed in S. 1145 32</p> <p>Figure 2.4: Provision of Community Development Assistance Under S. 1145 36</p> <p>Figure 2.5: Comparison of Current Funding for Programs to Be Consolidated Under the Block Grant With Funding Under S. 1145 for Fiscal Years 1998-2002 37</p> <p>Figure 3.1: Share of Single-Family Mortgages—Home Purchase and Refinancings—Made During 1995 43</p> <p>Figure 3.2: Share of Single-Family and Multifamily Mortgage-Backed Securities Insured or Guaranteed as of September 30, 1995 45</p> <p>Figure 5.1: Responsibilities of the Resolution Agency Under S. 1145 for Housing Assistance, Community Development, Housing Finance, and Regulatory Functions 66</p>

Abbreviations

CDBG	Community Development Block Grant
EPA	Environmental Protection Agency
FDIC	Federal Deposit Insurance Corporation
FHA	Federal Housing Administration
FHMIFA	Federal Home Mortgage Insurance Fund Administration
FTC	Federal Trade Commission
GAO	General Accounting Office
HFA	Housing Finance Agency
HHS	Department of Health and Human Services
HMDA	Home Mortgage Disclosure Act
HUD	Department of Housing and Urban Development
NAPA	National Academy of Public Administration
OFHEO	Office of Federal Housing Enterprise Oversight
OMB	Office of Management and Budget
PHA	Public Housing Authority
RESPA	Real Estate Settlement Procedure Act
RHS	Rural Housing Service
RTC	Resolution Trust Corporation
USDA	Department of Agriculture
VA	Department of Veterans Affairs
VPA	Veterans Preference Act

Introduction

Created in 1965, the Department of Housing and Urban Development (HUD) carries out the federal government's missions, policies, and programs in housing and community development. Its activities are designed to implement a broad range of statutory mandates, from making housing affordable, to helping revitalize communities, to supporting homeownership. Since 1965, HUD has grown to include some 240 programs and activities and hundreds of billions of dollars in financial commitments. Its annual outlays for fiscal year 1995 were about \$29 billion. Studies performed by HUD's Office of Inspector General, the National Academy of Public Administration (NAPA), GAO, and others have documented inefficiencies in organization and deficiencies in management that impede the effectiveness of HUD's programs. Leaders in the administration and the Congress agree that HUD must, at a minimum, be restructured to better meet the nation's housing and community development needs. Some policymakers believe that HUD's problems are so great that they can be cured only by dismantling the agency and transferring or eliminating its functions. This report focuses on the two most recent proposals to dismantle HUD—S. 1145 and H.R. 2198. For convenience, we refer to both bills, which are identical, as S. 1145.¹

HUD's Missions Have Evolved

As a new cabinet-level department, HUD took over most, though not all, of the federal housing and community development functions that had been located in independent agencies. Its focus, as defined in the legislation that created it, was primarily urban—" . . . the sound development of the Nation's communities and metropolitan areas." HUD took over the rental assistance and low-income housing production functions of the Public Housing Administration and the Housing and Home Finance Agency, the mortgage insurance functions of the Federal Housing Administration (FHA), and the secondary market functions for government-insured and guaranteed loans. HUD did not, however, take over the housing programs administered by the Veterans Administration (VA) and the Rural Housing Service² or the economic development programs operated by the Department of Commerce. In addition, HUD does not control the tax policies that affect housing, such as the homeowner's deductions for mortgage interest and property taxes, and it does not oversee all of the financial institutions, such as banks, savings and loans, and mortgage companies, that participate in the nation's mortgage markets.

¹S. 1145 is cited as the Housing Opportunities and Empowerment Act.

²Formerly called the Farmers Home Administration.

Even though HUD has not assumed all of the nation's housing functions, it has primary responsibilities for programs in four areas—housing assistance, community development, housing finance, and regulatory issues.

- Housing Assistance: HUD provides (1) public housing assistance through allocations to public housing authorities and (2) private-market housing assistance through rental subsidies for properties, referred to as project-based assistance, or for tenants, known as tenant-based assistance. In contrast to entitlement programs, which provide benefits to all who qualify, the benefits of HUD's housing assistance programs are limited by budgetary constraints to only about one-fourth of those who are eligible.
- Community Development: Primarily through grants to states, large metropolitan areas called entitlement areas, small cities, towns, and counties, HUD provides funds for local economic development, housing development, and assistance to the homeless. The funding for some programs, such as those for the homeless, may also be distributed directly to nonprofit groups and organizations.
- Housing Finance: FHA insures lenders—including mortgage banks, commercial banks, savings banks, and savings and loan associations—against losses on mortgages for single-family properties, multifamily projects, and other facilities. The Government National Mortgage Association (Ginnie Mae), a government-owned corporation within HUD, guarantees investors the timely payment of principal and interest on securities issued by lenders of FHA-insured and VA- and Rural Housing Service-guaranteed loans.
- Regulatory Issues: HUD is responsible for regulating interstate land sales, home mortgage settlement services, manufactured housing, lead-based paint abatement, and home mortgage disclosures. The Office of Federal Housing Enterprise Oversight, an independent office within HUD, is responsible for regulating the safety and soundness of Fannie Mae and Freddie Mac. HUD also supports fair housing programs and is partially responsible for enforcing federal fair housing laws.

To carry out its many responsibilities, HUD was staffed by about 10,500 employees at the end of fiscal year 1996.

Despite Accomplishments, Problems Impede Efficiency and Effectiveness

Through its programs, HUD makes housing affordable for about 4.5 million lower-income tenants, helps to revitalize over 4,000 communities, and has insured mortgages for about 23 million homeowners. In addition, as a cabinet-level department, HUD has given visibility and priority to housing and community development issues and has built up networks for implementing its programs. In some instances, HUD's offices have pioneered the development of services. For example, FHA initiated home mortgages with very small down payments and reverse mortgages.³

Despite these accomplishments, HUD has, over the years, developed both administrative and programmatic problems. In 1994, GAO designated HUD as a high-risk agency because of four long-standing management deficiencies—weak internal controls; poorly integrated, ineffective, and generally unreliable information and financial management systems; an ineffective organization; and an insufficient mix of staff with the proper skills. Internal control weaknesses, such as not having the necessary data and management processes, contributed to the HUD scandals of 1989. Deficient information and financial management systems have not supported program managers' needs or provided adequate control over housing and community development programs. Organizational problems have included overlapping and ill-defined responsibilities and authorities between the Department's headquarters and field organizations and a fundamental lack of management accountability and responsibility. Not having enough staff with the proper skills has hampered the monitoring and oversight of programs and delayed the updating of procedures. While HUD has formulated approaches and initiated actions to address its departmentwide deficiencies, its efforts are far from reaching fruition and problems continue.⁴

In response to legislation and other initiatives, programs were created with missions that overlap or are linked only tangentially to primary missions within HUD. In December 1994, HUD's Inspector General recommended eliminating, consolidating, or restructuring many of HUD's 240 programs and activities, 91 of which, the Inspector General said, were questionably related to the Department's primary mission. We reported that several of the larger programs on this list seemed to contribute

³A reverse mortgage allows borrowers, who are 62 years of age and older, to convert the equity in their homes into a monthly stream of income or a line of credit. These mortgages are purchased by Fannie Mae.

⁴See High Risk Series: Department of Housing and Urban Development (GAO/HR-97-12, Feb. 1997).

directly to meeting the housing needs of low-income people.⁵ However, we estimated that 27 programs listed by the Inspector General could be reassessed to determine the need for them and their relative value in achieving HUD's mission. Other problems cited by the Inspector General included disproportionately high administrative costs, inflexible program requirements, and a multiplicity of programs with similar objectives that promote separate federal and local bureaucracies. Until the problems that we and the Inspector General identified are resolved, HUD's programs are likely to remain vulnerable to waste, fraud, and abuse.

Further exacerbating these concerns is the need to reduce discretionary spending governmentwide over the next several years to balance the budget by early in the next century. Most balanced budget plans include a freeze in discretionary spending at current nominal levels, meaning that by the year 2002, spending will be nearly 20 percent lower than it would be if it were allowed to increase with inflation.

The Administration, the Congress, and Others Have Proposed Changes

HUD's problems have led to studies and proposals for change, including the administration's reinvention plans, the National Academy of Public Administration's (NAPA) study,⁶ and several bills to reorganize or dismantle HUD. These proposals uniformly recognize the need to revise the delivery of housing and community development services. They also recognize that budgetary constraints dictate changes. However, the proposals differ in the role they envision for the federal government.

The administration's initial reinvention plans, introduced in December 1994, assume the need for a cabinet-level housing and community development agency and focus on restructuring and consolidating programs. Initially, the plans proposed to (1) remove public housing authorities from HUD's subsidy programs and make them compete in the private market; (2) consolidate 60 major categorical programs into three flexible, performance-based funds; and (3) transform FHA into a results-oriented, financially accountable credit-enhancement operation. In 1996, the administration updated its plans, retaining most of the provisions but revising the proposal for public housing. Under the current plans, HUD would continue to subsidize public housing but would consolidate and streamline programs to improve its delivery of services to low-income residents.

⁵Housing and Urban Development: HUD's Reinvention Blueprint Raises Budget Issues and Opportunities (GAO/T-RCED-95-196, July 13, 1995).

⁶Renewing HUD: A Long-Term Agenda for Effective Performance (July 1994).

The NAPA study, issued in July 1994, recommended that the Congress and HUD restructure the agency to consolidate its programs and reform its management. The study suggested that if HUD did not operate under a clear mandate and in an effective manner in 5 years, its existence should be reevaluated. In addition, the study recommended that HUD modify its operations and work from the bottom up rather than from the top down, supporting local initiatives consistent with its mission instead of imposing its own strategies on localities. For most programs, the study proposed a shift in decision-making authority from headquarters to the field and from the federal government to the state or local level. Finally, the study recommended that the Congress give HUD broad waiver and demonstration authority to allow the states to experiment with changes in their housing and community development programs.

Between February 1995 and August 1995, the 104th Congress introduced five bills in the House and Senate to dismantle HUD.⁷ These bills would move farther than the NAPA study in shifting power from the federal government to the states, and they would transfer some governmental responsibilities to the private sector. Furthermore, they would transfer the remaining federal responsibilities to other federal agencies and terminate HUD's existence. The two most recent bills—S. 1145 and H.R. 2198—are the subject of this report. For convenience, we refer to both bills, which are identical, as S. 1145.

S. 1145 Would Introduce Sweeping Changes

S. 1145 would dramatically change the federal role in housing and community development. To reduce the federal government's spending for housing and community development, the bill would shift many of HUD's operations to other federal agencies, provide block grants to the states, and rely more on the private sector. The bill seeks to give the recipients of housing assistance more choice in deciding where to live and communities more choice in deciding how to spend their community development funds; however, it would also reduce the federal funding for community development. In addition, it would increase the influence of the private market in federal housing assistance and housing finance. As the NAPA study and the administration's proposals recommended, the bill would increase decision-making at the state and local levels, bringing the administration of programs—and accountability for their results—closer to the persons affected by the decisions. Overall, the bill seeks to reduce

⁷S. 435, Feb. 16, 1995; H.R. 1098, Mar. 1, 1995; H.R. 1923, June 22, 1995; H.R. 2198, Aug. 4, 1995; and S. 1145, Aug. 10, 1995.

federal spending for housing and community development activities by consolidating and eliminating programs.

To accomplish its goals for housing assistance, S. 1145 would phase out HUD's public housing and rental housing assistance programs and replace them with a flexible, tenant-based voucher system, to be administered by the Department of Health and Human Services (HHS). Public housing properties and properties that formerly received section 8 project-based rental assistance would have to compete for tenants with other rental properties in the marketplace. Tenants could use their vouchers to either rent or purchase any unit they could afford, but a household's receipt of vouchers would generally be limited to a lifetime maximum of 5 years.⁸ The states could choose to receive a block grant allocation and administer vouchers on behalf of HHS or develop their own housing assistance program.

S. 1145 would consolidate HUD's community development programs, including many categorical ones, into a block grant for housing and community development, of which \$1 billion would be set aside for Indian housing, the elderly, people with disabilities, and people with AIDS. The grant would be administered by a new, independent agency, the Housing and Community Opportunities Agency. This change would give communities more choice in spending federal funds, but both large and small communities would have less money to spend. Under the housing and community development grant, entitlement areas would receive 80 percent of the total funding provided, while small cities would receive 20 percent. However, the total funding would be cut by about 40 percent as soon as the bill's provisions went into effect and would then be reduced even further over time.

S. 1145 would restrict the federal government's role in housing finance to covering losses on single-family mortgages, at a substantially reduced rate—down from 100 percent to a maximum of 35 percent. It would transfer the responsibility for operating the single-family mortgage insurance program to the Department of the Treasury, which would negotiate agreements for sharing the risk of insuring single-family mortgages with other mortgage insurers—the states and/or the private sector. Additionally, it would eliminate federal loan insurance for multifamily and certain other properties and terminate Ginnie Mae, leaving these areas for the states and private sector to cover.

⁸Indian Housing Authority programs are not included because Indian tribes would receive a housing block grant through another section of S. 1145.

Finally, S. 1145 would transfer HUD's regulatory functions to other federal agencies, designated in this report as receiving agencies. These agencies include the departments of the Treasury and Justice, the Environmental Protection Agency, and other independent agencies. To manage these changes, the bill would redesignate HUD as the Housing and Urban Development Programs Resolution Agency and make this agency responsible for administering and concluding HUD's affairs within 5 years.⁹ Among other things, the resolution agency would have to resolve, or provide for resolving, hundreds of billions of dollars in financial commitments and manage HUD's shutdown. Table 1.1 summarizes the organizational changes that would occur under S. 1145.

⁹S. 1145 was introduced on August 10, 1995, and calls for terminating the resolution agency on September 30, 2000. However, in this report, we assume that the 5-year period begins in 1997 and ends in 2002.

**Chapter 1
Introduction**

Table 1.1: Shifts in Responsibility From HUD to Other Agencies Under S. 1145

Function	Proposed action			Receiving agency
	Abolish	Change	Transfer	
Housing assistance		X	X	Federal Housing Voucher Agency ^a in HHS
Community development		X		An independent Housing and Community Opportunities Agency ^a
Housing finance				
Secondary mortgage market	X			Fannie Mae, Freddie Mac, or other private secondary mortgage market entities may assume function
Federal mortgage insurance—single-family		X	X	Federal Home Mortgage Insurance Fund Administration, ^a Department of the Treasury
Federal mortgage insurance—multifamily	X			No receiving agency contemplated in the bill
Regulatory				
Fair housing	X ^b		X	Department of Justice
Interstate land sales			X	Federal Trade Commission
Real estate settlement procedures			X	Board of Governors of the Federal Reserve System
National manufactured housing			X	Department of Agriculture
Lead-based paint			X	Environmental Protection Agency
Home mortgage disclosure			X	Department of the Treasury
Government-sponsored enterprise oversight	X ^c		X	Department of the Treasury

^aThese agencies would be created under S. 1145.

^bThe Fair Housing Initiatives Program would be abolished.

^cThe bill does not address all of HUD's responsibilities under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992. Specifically, the bill does not specify the disposition of HUD's responsibilities for ensuring that Fannie Mae and Freddie Mac fulfill their public purposes and serve the housing needs of the country. Under S. 1145, programs that are not transformed, transferred, or continued would expire.

The changes that would occur under S. 1145 in housing assistance, community development, and housing finance are discussed in more detail in chapters 2 and 3 of this report. Chapter 4 discusses the capacity of the

states and the receiving agencies to assume HUD's former responsibilities. Chapter 5 discusses the resolution agency's responsibilities, including resolving HUD's financial commitments, and lessons learned from previous efforts to dismantle or reorganize federal agencies. The Congressional Budget Office (CBO) will provide its estimate of the bill's impact on the federal budget in a separate report. Appendixes I and II provide details on the receiving agencies' responsibilities and the resolution agency's financial commitments, respectively.

Objectives, Scope, and Methodology

The Chairs of the Senate Committee on Banking, Housing, and Urban Affairs and its Subcommittee on Housing Opportunity and Community Development and Senator Faircloth asked GAO to examine the implications of one of the proposals to dismantle HUD—S. 1145, the Housing Opportunities and Empowerment Act. Specifically, the requesters asked GAO to (1) examine the bill's proposed changes in housing assistance, community development, and housing finance and the potential impact of these changes on the customers of these programs and (2) discuss the capacity of the states and other federal agencies to assume HUD's functions and the tasks to be accomplished in dismantling HUD within the 5 years specified in the bill. As agreed with the requesters' offices, this report assumes that the bill would cover the 5-year period from 1997 to 2002, rather than the period from 1995 to 2000 specified in S. 1145. The requesters also asked CBO to project the federal costs of implementing the bill's provisions. CBO's projections will be published in a separate report.

To examine the proposed changes, we reviewed the bill's provisions and examined major administrative and other legislative proposals introduced to change the federal role in housing and community development. We conducted a literature search and discussed S. 1145 with officials from the Office of Management and Budget (OMB), HUD, NAPA, interest groups and associations, and think tanks. To assess the impact of the proposed changes in housing assistance, community development, and housing finance on HUD's clients, we interviewed and gathered studies and position papers from senior HUD officials, think tanks, and interest groups representing HUD's clients, including tenant organizations, public housing authorities, lenders, major bond-rating agencies, government-sponsored enterprises, private mortgage insurers, state agencies, and local governments.

To examine the bill's implications for entities outside the federal government, we met with officials from national associations representing

state and local governments—including the National Governors’ Association, the National Council of State Housing Agencies, the Council of State Community Development Agencies, and the U.S. Conference of Mayors—and we conducted a survey of community development officials from the 47 states represented by the Council of State Community Development Agencies. We received responses to this survey from officials in 44 states.¹⁰ We reviewed existing literature on states’ fiscal capacity and visited officials in six states—Alabama, Illinois, Maryland, Massachusetts, Texas, and Washington—that we had selected because they differed from one another in their fiscal capacity, federal and state funding for housing assistance, experience in administering section 8 programs, experience with troubled public housing authorities, political philosophy, and geographic location. The findings resulting from our visits are not projectable to all 50 states. Because S. 1145 would not directly expand the role of local governments, we focused specifically on states’ capacity to take on expanded responsibilities. Changes in local responsibilities would depend largely on the states’ decisions.

To examine the bill’s implications for the receiving agencies and the resolution agency, we conducted interviews and collected documentation and studies from the federal agencies designated to receive HUD’s functions and from HUD. We also drew on our own prior and ongoing work on HUD and on reorganizing federal agencies. Specifically, we interviewed officials from OMB, the General Services Administration, and the Office of Personnel Management to gather the current guidance on reorganizing federal agencies. To better understand the functions that would be transferred, we interviewed HUD officials and reviewed HUD documents on the mission, staffing, and internal controls of each function. Using this information, we interviewed officials from the receiving agencies to obtain their views on the implications of transferring HUD’s functions to them. We interviewed officials from the departments of Agriculture, Health and Human Services, Justice, and the Treasury; the Environmental Protection Agency; the Federal Reserve Board of Governors; the Federal Trade Commission; the Federal National Mortgage Association (Fannie Mae); and the Federal Home Loan Mortgage Corporation (Freddie Mac).

Agency Comments and Our Evaluation

In commenting on a draft of the report, the Acting Secretary of HUD expressed concern that our methodology did not include adequate consultation with HUD’s customers. Over the course of this study, we

¹⁰We did not obtain completed surveys from Alaska, Colorado, Hawaii, Kentucky, New York, and Wyoming.

interviewed and/or collected documentation from organizations that represent a wide range of HUD's customers. Information obtained from this work is included in chapters 2 and 3. We also revised the methodology section of our report to reflect more clearly the range of organizations we interviewed.

S. 1145 Could Increase Choice in Housing and Community Development, but Some Vulnerable Populations Might Receive Less Assistance

S. 1145 would dramatically reduce the federal role in housing and community development and could have far-reaching effects on renters and communities. The bill’s plan to institute a voucher system could expand housing choices for renters in some areas, but its phaseout of project-based assistance could reduce the supply of affordable housing—and housing choices—in other areas. Similarly, the bill’s creation of a single block grant for community development would give the states and localities more choice in spending federal funds for projects in their communities, but some of HUD’s current clients, especially the homeless and very low-income families, might receive less assistance.

Impact of Proposed Changes in Rental Assistance, Would Depend on a Number of Factors

Replacing housing assistance with a voucher system would, in principle, give renters more choice in deciding where they would live. In fact, the extent of their choice would depend, in large part, on the amount of the subsidy provided compared with the cost of housing in the area. Under S. 1145, currently assisted properties would be required to compete in the marketplace. During a transition period, the resolution agency would settle long-term commitments to provide rental assistance and provide funds through a block grant to operate and improve public housing properties with an approved plan for becoming more competitive. However, if tenants chose not to remain and other renters were not attracted to the properties or if rental income was otherwise insufficient to cover operating costs, the properties would not remain viable, and their loss would decrease the supply of affordable housing. Reductions in the supply of affordable housing could decrease the opportunities for recipients of voucher assistance to exercise choice, particularly in housing markets where affordable housing was in short supply.

HUD Currently Provides Public Housing and Private-Market Housing Assistance

HUD provides two basic types of rental housing assistance: public housing and private-market housing assistance. Public housing is owned and operated by local government agencies known as public housing authorities (PHA). HUD provides funds to these authorities primarily to operate and make capital improvements to public housing projects. The private-market housing programs provide “project-based” and “tenant-based” rental assistance to owners of private rental housing. For project-based assistance,¹ eligible lower-income households must live in designated housing. HUD has contracted with the owners of this housing to provide rental payments for units in those properties for a certain time

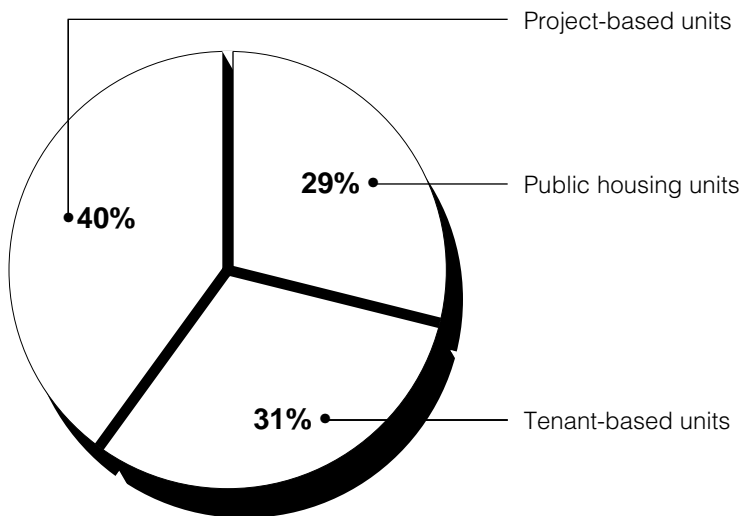
¹Project-based assistance programs include the rent supplement; section 221(d)(3) below-market interest rate; section 202 elderly; section 236; and section 8 new construction, substantial rehabilitation, and moderate rehabilitation programs and some smaller programs.

Chapter 2
S. 1145 Could Increase Choice in Housing
and Community Development, but Some
Vulnerable Populations Might Receive Less
Assistance

period. For tenant-based assistance (the section 8 certificate and housing voucher programs), assisted households may live in rental units of their choice as long as the units meet HUD's standards for rent and quality. Generally, HUD administers its private-market rental housing programs through housing owners or PHAS, depending on the program.

HUD spent about \$25 billion in fiscal year 1995 to provide rental housing assistance for about 4.5 million units. HUD targets rental assistance primarily toward households classified by law as having very low incomes. For households with four people, very low incomes are those that do not exceed 50 percent of the local area's median income. Because of its high costs, the public housing program was sharply curtailed in 1983, and section 8 project-based rental assistance was discontinued for new construction or substantial rehabilitation. Nevertheless, because of the pattern of past funding, most people who receive federal rental aid today receive project-based subsidies. As shown in figure 2.1, of the 4.5 million units assisted by HUD, about 29 percent are in public housing, about 40 percent receive project-based assistance, and about 31 percent receive tenant-based assistance, according to HUD.

Figure 2.1: Distribution of HUD-Assisted Housing Units



Source: HUD's Office of Policy Development and Research (Mar. 1996).

S. 1145 Would Replace Current Assistance With a Voucher System

Under the bill, all existing public housing and project-based rental housing assistance would be phased out and replaced with a tenant-based voucher system administered by the Department of Health and Human Services (HHS). During the 5-year transition phase, the resolution agency would take actions to ensure the continued viability of projects with project-based section 8 contracts that expire during the period and provide operating and capital grants to PHAS that have an approved plan for making their housing competitive. The grants would also fund the demolition of units that could not be made competitive. During the phaseout, tenants would start to receive vouchers that they could use to stay in their current apartment, move to another apartment, or purchase a home. Any section 8 assistance or public housing commitments still in effect at the termination of the resolution agency would be transferred to the voucher administrator in HHS. The bill limits the amount of assistance available during the 5-year transition period and then permanently limits the assistance to the amount necessary to (1) provide housing assistance to the same number of families as received assistance under any section 8 or public housing program during fiscal year 1997 and (2) cover administrative fees.² Under the bill, the subsidy is generally limited to the difference between 30 percent of a household's adjusted income and a rent ceiling known as the fair market rent.³

As shown in figure 2.2, the states could choose to develop their own rental assistance program, administer the federal program for their state, or allow HHS to carry out the program in their state. If a state chose to develop its own program, it would receive an annual grant and would have latitude in determining how the funds could be used. For example, the state could request to waive the requirement that the grants be used for voucher assistance and could, with HHS' approval, use the funds for affordable housing activities—such as constructing or rehabilitating units or providing homeownership assistance or housing counseling—as long as these activities were consistent with those of the state's general welfare assistance program. If the state chose to operate the voucher program, it could use the vouchers to assist low-income renters and homeowners. The state would also be able to determine the duration of the assistance and could assist individuals and families whose incomes did not exceed the median income for the area—a higher income level than HUD now targets. If HHS were to run the program for a state, it would enter into contracts

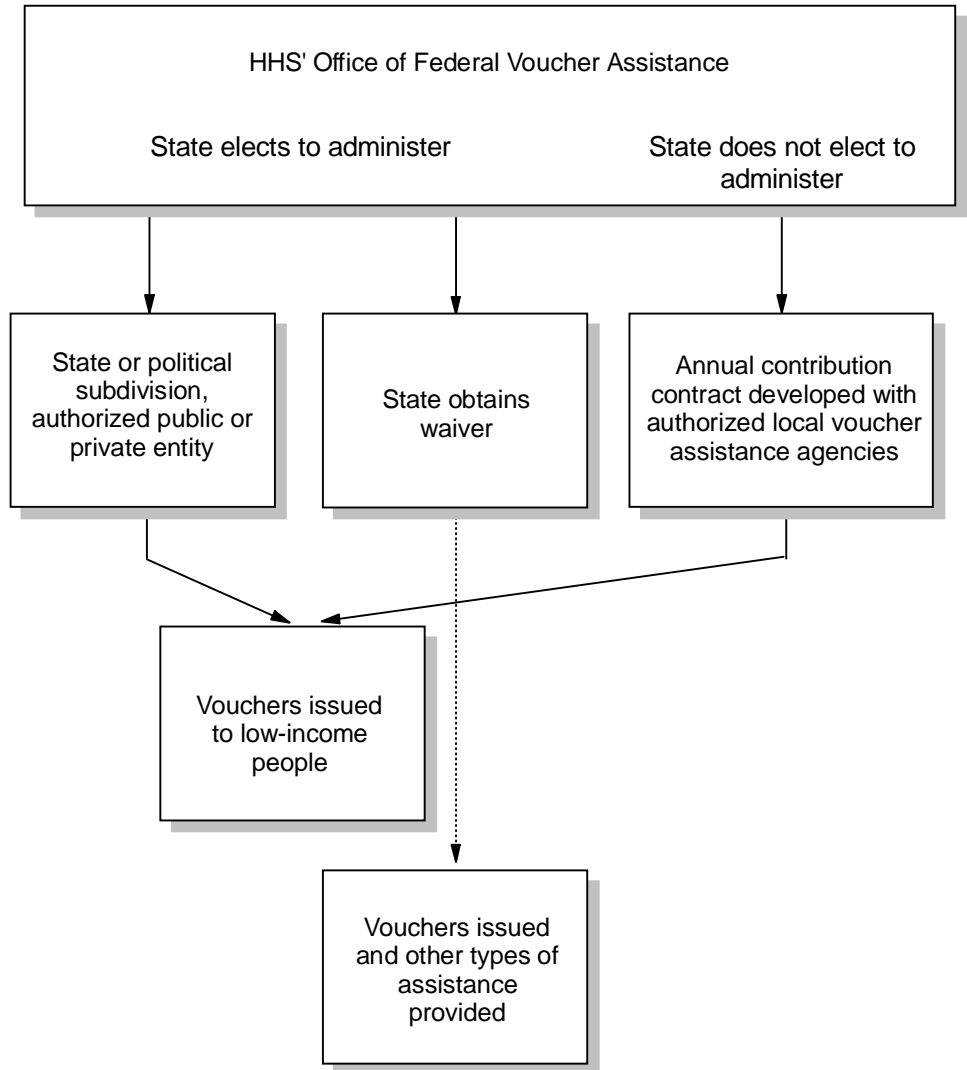
²Indian Housing Authority programs are not included because Indian tribes would receive a housing block grant through another section of S. 1145.

³Under S. 1145, the fair market rent would be the dollar amount that reflects the rent for a standard-quality unit of a particular size and type in a certain market area.

Chapter 2
S. 1145 Could Increase Choice in Housing
and Community Development, but Some
Vulnerable Populations Might Receive Less
Assistance

with local voucher assistance agencies to administer the assistance. The requirements would be similar to those of the state-run voucher program except that the assistance would be limited to 5 years—for all but the elderly and disabled—and monthly assistance payments would be limited to the difference between 30 percent of the household's adjusted income and the fair market rent.

Figure 2.2: Provision of Rental Assistance Under S. 1145



Elimination of Project-Based Assistance Could Affect the Supply of Affordable Housing

Under the bill, the over two-thirds of HUD’s assisted units that receive either public housing or project-based assistance would become unsubsidized units competing in the market. Without a subsidy for every unit, some of this housing—including 1.4 million units of project-based section 8 housing and 1.3 million units of public housing—might not remain viable.

Some Section 8 Properties
Might Not Remain Viable at
Market Rents

During the 5-year term of the resolution agency, section 8 contracts covering almost 1 million units will expire, while most of the remaining contracts will expire by 2006. For about three-fourths of its properties with project-based section 8 subsidies, HUD estimates that the rental subsidies exceed the market rents for comparable properties. As the contracts for the assisted projects expire and the tenants receive vouchers, the rents charged by landlords could rise or fall, depending on the local rental market. In general, the tenants could decide whether to move elsewhere or to stay in their units.

Over time, affordable housing units may be lost as owners who cannot operate at market rates default or as owners in tight housing markets raise their rents to levels that certificate holders cannot afford. In either case, tenants could be displaced. As a further complication, almost half of all the properties with section 8 project-based subsidies have mortgages insured by FHA, which would have to pay lenders' claims if the owners defaulted. Recognizing these possibilities, S. 1145 contains "mark-to-market" provisions that would, for contracts expiring during the 5-year transition period, give the resolution agency broad authority to take actions such as adjusting the FHA-insured mortgages to bring the properties' rental income and operating expenses into line and to decrease the likelihood of defaults on FHA-insured mortgages. These goals are similar to those proposed by HUD. The remaining section 8 properties, whose mortgages are not insured by FHA, also present complications, particularly for the states. Specifically, as the Republican Governors' Housing Task Force cautioned, if the federal government were to unilaterally not renew expiring section 8 contracts, it would jeopardize the ability of the states to meet their financing obligations. Such an action could have serious consequences for the states' future financing capacity. Consequently, the states believe they must be held harmless from the effects of any mark-to-market action on uninsured section 8 projects. According to HUD's data, just over half of all section 8 projects are not insured by FHA. Furthermore, over half of the units in uninsured section 8 projects are in projects whose contracts will expire after the year 2000. The financial impact of the losses that the federal government could incur are discussed in chapter 5.

Some Public Housing Might Not
Be Competitive

In converting the 1.3 million units of public housing to compete in the private market, the resolution agency, along with the PHAS, would face difficult decisions about which assets could be made viable in 5 years and which should be demolished. While the bill requires the planning to determine which projects would likely be viable, many PHAS might have

Chapter 2
S. 1145 Could Increase Choice in Housing
and Community Development, but Some
Vulnerable Populations Might Receive Less
Assistance

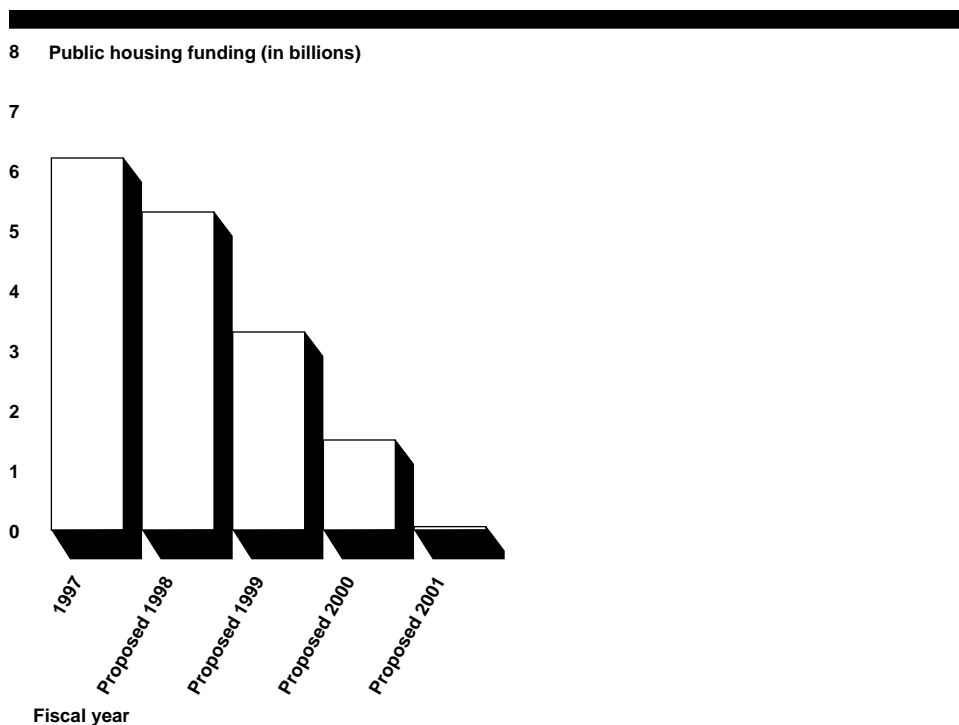
difficulty developing plans because public housing was not built to the private market's standards and its operation has not been guided by the market's forces, according to a recent HUD study.⁴ Thus, many PHAS might find that they lacked the information to analyze their housing stock, management practices, and local housing markets to determine the viability of their housing, and they might need to have contractors perform these studies. Since the bill does not provide funding specifically for the studies, it would have to come from the operating funds or modernization grants provided under the bill, potentially putting a further strain on PHAS' budgets.

In addition, the physical condition of public housing has deteriorated over time because operating subsidies and modernization funds have not kept pace with needs. For example, for fiscal year 1996, about 90 percent of public housing's operating needs were covered by the appropriation, leaving about 10 percent of the expenses unfunded by either subsidy or rent. Because of such shortfalls, routine maintenance is typically deferred. Since 1981, almost \$29 billion has been provided for modernizing public housing. However, a backlog estimated at between \$10 billion and \$20 billion still exists, and, despite recent progress in reducing the backlog, needs continue to accrue. As shown in figure 2.3, the bill provides total funding for operating subsidies and capital grants (modernization funds) of \$5.3 billion for fiscal year 1998, \$3.3 billion for fiscal year 1999, \$1.5 billion for fiscal year 2000, and \$56 million for fiscal year 2001. In comparison, for fiscal year 1997, a total of about \$6 billion was appropriated for public housing. Given this funding gap, the General Counsel for the Council of Large Public Housing Authorities and the President of the National Association of Housing and Redevelopment Officials said that they do not believe that the appropriations in the bill—even when considered in light of the proposed deregulation—would be sufficient for the bulk of public housing to become competitive. As we reported previously, the condition of the existing stock and its per-unit operating costs vary tremendously.⁵ While some projects with high operating costs would not be viable after renovation because their expenses would exceed their rental income, other projects with low operating expenses could, if they retained or attracted tenants, use their rental revenues to pay for rehabilitation.

⁴Public Housing in a Competitive Market: An Example of How It Would Fare, HUD Office of Policy Development and Research (Apr. 1996).

⁵Public Housing: Converting to Housing Certificates Raises Major Questions About Cost (GAO/RCED-95-195, June 20, 1995).

**Figure 2.3: Fiscal Year 1997 Public
 Housing Funding Compared With the
 Funding Proposed in S. 1145**



**Renters Could Choose to
 Move If Affordable
 Housing Were Available**

The impact of S. 1145 on tenants would depend on the local housing market. Where the supply of affordable housing was sufficient, the vouchers could provide housing choice. To the extent that current residents exercised their choice by moving out of very poor neighborhoods, a basic goal asserted by those who favor tenant-based subsidies would be met. CBO observed that “recipients of tenant-based housing assistance—except the elderly—were less likely than recipients of project-based aid to report dissatisfaction with their neighborhood or housing unit.”⁶ Additionally, HUD’s Inspector General recommended that actions be taken to decouple project-based subsidies from insured projects because they insulate the owners of projects from normal market forces and result in inferior projects and services for tenants. With tenant-based subsidies, landlords would know that tenants could move and would have more incentive to maintain their projects, according to CBO. However, both housing and community development officials in the six states we visited and HUD officials told us that substituting vouchers for all project-based assistance and public housing could reduce the supply of affordable housing and hamper households’ ability to find affordable

⁶The Challenges Facing Federal Rental Assistance Programs (Dec. 1994).

housing in some localities. Officials from five states mentioned that discontinuing project-based assistance would exacerbate the shortage of affordable housing. HUD agrees that housing markets nationwide are uneven, making an across-the-board approach to housing assistance unworkable. In areas such as New York, San Francisco, and areas of expanding growth where housing markets are tight, rebuilding units is the only practical way to retain affordable units and avoid displacing households, according to HUD.

However, CBO and HUD agree that the primary causes of severe housing problems across the country are not shortages of housing but lagging incomes and high housing costs. In fact, in 1993, about 6 million unsubsidized households had “worst-case” needs, according to HUD, meaning that they had incomes of less than 50 percent of their area’s median income and paid more than 50 percent of their incomes for housing or lived in substandard housing. For most of these households, affordability was their only housing problem. HUD and others have argued that certificates give low-income households the purchasing power they need to afford the housing that is available in the private market. A 1994 study by Abt Associates, Inc., performed for HUD, found that nearly 9 out of 10 households (excluding New York City) in HUD’s mainstream section 8 voucher and certificate programs were able to find rental housing by using their vouchers and certificates.⁷ As we reported previously,⁸ actual housing choice depends on many factors, including the characteristics of the current tenants and their inclination to move, the availability of affordable housing, the willingness of private landlords to accept tenants with housing certificates, and the extent to which laws prohibiting housing discrimination are followed and enforced. In a case study of the Baltimore housing authority, HUD found that massive movement out of public housing following a change to tenant-based vouchers would be unlikely. The president of the National Association of Housing and Redevelopment Officials, who is also the executive director of the Richmond housing authority, said he fears that 20 to 30 percent of the tenants in public housing would move. He said that he and other PHA directors are concerned that PHAs would be faced with partially occupied buildings and dwindling resources. Another factor that would influence choice is the level of subsidy to be provided through the certificate. The states that operated their own program could determine the amount of the subsidy for their state. In theory, if a state wanted to serve more clients, it could

⁷Section 8 Rental Voucher and Rental Certificate Utilization Study: Final Report (Oct. 1994).

⁸Public Housing: Converting to Housing Certificates Raises Major Questions About Cost (GAO/RCED-95-195, June 20, 1995).

provide smaller payments for each client. If it wanted to serve fewer people or stimulate other movements, it could provide larger payments.

Block Grants Would Give Some Communities More Choice but Could Decrease Aid for Vulnerable Populations

Combining the funding for HUD's community development programs into a single block grant, distributing it to the states and large metropolitan areas, and allowing these entities to decide how they would spend the funds—within federal guidelines—would give these entities more choice. But studies have shown that communities often choose to invest in projects benefiting higher-income groups. Populations such as the homeless, who are guaranteed a measure of assistance under HUD's categorical McKinney Act programs, might not fare as well under a block grant that did not target some funds directly to them, according to these studies.

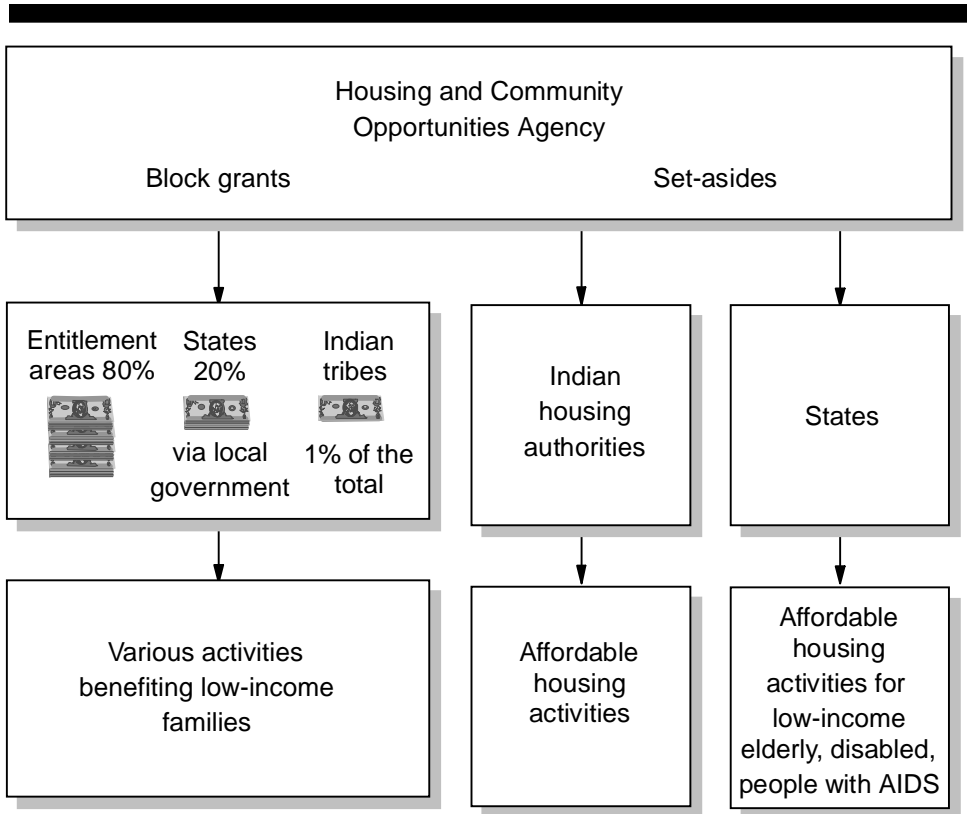
HUD Currently Assists Communities Through Many Grant Programs

Through a variety of programs, HUD provides flexible funding for local economic development, housing development, and assistance for the homeless to and through the states; entitlement areas (mostly cities with at least 50,000 people and urban counties); nonentitlement cities, towns, and counties; and other jurisdictions. HUD's primary community development program is the Community Development Block Grant (CDBG) program, for which \$4.6 billion was appropriated in fiscal year 1997 for grants to aid in the development of viable communities through activities such as housing rehabilitation, public works, public services, and economic development. Under CDBG, grants are distributed directly using a statutory formula to entitlement areas and to the 48 states that manage the program on behalf of nonentitlement communities (HUD manages the program for Hawaii and New York). Another major grant program is the HOME Investment Partnerships program, which was appropriated \$1.4 billion in fiscal year 1997 to provide grants to states and localities for a wide range of housing activities, including building or rehabilitating affordable housing, assisting first-time home buyers, and offering tenant-based rental assistance. HUD was appropriated \$823 million in fiscal year 1997 to assist the homeless through six McKinney Act programs—Shelter Plus Care, Supportive Housing, Emergency Shelter Grants, Section 8 Moderate Rehabilitation for Single-Room Occupancy Projects, Rural Homeless Housing Assistance, and Safe Havens. Some forms of assistance—such as that for the homeless—may go directly to nonprofit groups and organizations without going through governmental jurisdictions.

**S. 1145 Would Consolidate
and Reduce Grant Funding**

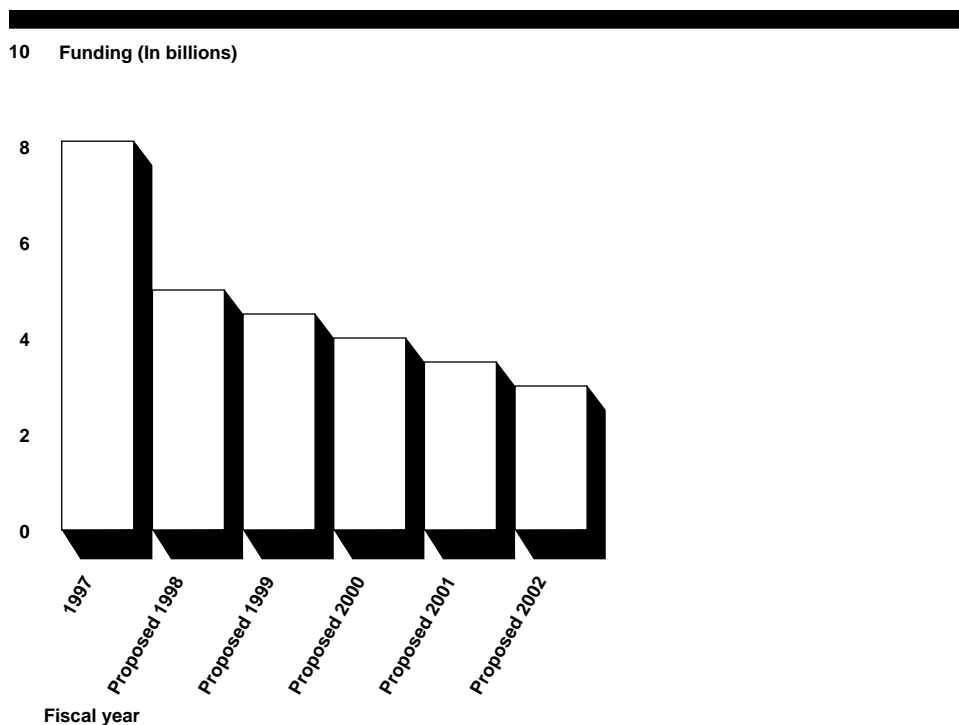
As shown in figure 2.4, HUD's multiple grant programs would be combined to form a grant that would be administered by an independent agency—the Housing and Community Opportunities Agency. S. 1145 would give the states and localities greater flexibility in determining the types of activities to fund. The grant funds could be used for community or neighborhood development, affordable housing, or relocation. The grant would be allocated to the states and entitlement areas in much the same way as CDBG funds are currently allocated. However, the entitlement areas would receive 80 percent of the funding and the states 20 percent. Currently, the split is 70 percent to the entitlement areas and 30 percent to the states under CDBG and 60 percent to participating jurisdictions and 40 percent to the states under the HOME program. In addition, S. 1145 would require that 90 percent of the funds be used annually to benefit low-income families—defined by the bill as those with incomes that do not exceed 80 percent of the area's median income. The CDBG program currently requires that 70 percent of the funds be used to benefit low- and moderate-income families over a 1- to 3-year period. Each year, the bill would set aside \$1 billion for a grant for housing for special populations—the elderly, people with disabilities, and people with AIDS. The set-aside would be allocated to the states on the basis of need as indicated by objective measures. Indian tribes would receive 1 percent of the total block grant, and, in addition, Indian housing authorities would receive an amount not to exceed the funding they received for housing in fiscal year 1995.

**Figure 2.4: Provision of Community
Development Assistance Under S.
1145**



As figure 2.5 shows, federal funding for the single block grant for community development and special populations proposed under S. 1145 would start at \$5 billion for fiscal year 1998 and decline over 5 years to \$3 billion, where it would be capped. The block grant would replace approximately \$8 billion in fiscal year 1997 funding for various programs supporting community development, housing, and the homeless.

**Figure 2.5: Comparison of Current
 Funding for Programs to Be
 Consolidated Under the Block Grant
 With Funding Under S. 1145 for Fiscal
 Years 1998-2002**



In addition, the new agency would inherit HUD’s outstanding commitments for loan guarantees made under the CDBG program. Under section 108 of the Housing and Community Development Act of 1974, communities and states that receive CDBG grants can apply for loans to obtain additional financing. HUD guarantees notes issued by grantees for up to five times their current year’s CDBG grant; current and future CDBG grant funds serve as the collateral for these loans. The proceeds from the notes can be used to finance community and economic development projects that are too large to be financed from the grantee’s annual grant. The financial impact of these guarantees is discussed in chapter 5.

**States and Localities
 Would Have Greater
 Flexibility in Setting
 Spending Priorities, but
 Service to the Poorest
 Clients Might Decline**

The consolidation of HUD’s programs for community development, housing development, and the homeless was supported, in general, by NAPA and by representatives from the Brookings Institution and the Hudson Institute, the National Association of Counties, the Association of Local Housing Finance Agencies, the National Community Development Association, and the U.S. Conference of Mayors. However, HUD, the organizations

Chapter 2
S. 1145 Could Increase Choice in Housing
and Community Development, but Some
Vulnerable Populations Might Receive Less
Assistance

representing state and local governments, and housing officials generally favored two or three block grants covering housing, community development, and assistance for the homeless. For example, in its reinvention plans, HUD has proposed to consolidate these programs into three block grants. The Deputy Director of the Office of Executive Services in the Community Planning and Development Division, who was otherwise critical of S. 1145's provisions, noted that a single block grant would be less costly to administer than separate programs. However, the president of the Progress and Freedom Foundation and a representative from the Brookings Institution cited drawbacks to block grants, such as difficulties in maintaining accountability for missions' objectives and funding and reductions in flexibility accompanying the addition of set-asides and restrictions on or cuts in funding.⁹

HUD, the National Council of State Housing Agencies, and program officials in all six of the states we visited said that state and local decisions under a consolidated block grant would result in less funding for affordable housing and/or the homeless. According to HUD, because the bill contains no specific requirements for serving either very low-income persons—those with incomes that do not exceed 50 percent of their area's median income—or the homeless and because activities for these populations do not enjoy wide support in some cities, consolidation could result in sharp funding reductions for these populations. According to an official from the U.S. Conference of Mayors, local governments face a great deal of political pressure to fund their police departments and environmental mandates, rather than housing, which has traditionally been a federal responsibility. Some Maryland state officials thought that few funds would be allocated for the homeless under a consolidated block grant, particularly in entitlement areas. These officials were concerned that without HUD's emphasis on providing a continuum of care, some areas would use their funds for emergency shelter rather than address the multiple needs of the homeless. However, the stakeholders representing state and local governments and housing officials expressed concern that additional set-asides or other restrictions would be added to the block grants, limiting state or local flexibility.

Several studies support the concern of some stakeholders that under a consolidated block grant, states and localities would reduce the funding targeted to very poor households. An analysis of the activities funded through HUD's HOME and CDBG programs in fiscal year 1992 by a sample of

⁹The Brookings Institution, the Hudson Institute, and the Progress and Freedom Foundation are research and public policy organizations.

Chapter 2
S. 1145 Could Increase Choice in Housing
and Community Development, but Some
Vulnerable Populations Might Receive Less
Assistance

cities indicated that the cities used their grants for purposes that were more closely aligned with their nonfederal spending than they did with other federal funding sources.¹⁰ According to the study, distributing more funds through block grants would likely lead to greater expenditures to benefit moderate- and middle-income households. Similarly, an analysis of the transfer of the CDBG Small Cities program from HUD to the states found that, overall, the states spent less money than the federal government on housing and community development activities for low- and moderate-income households and more on economic development and public works projects.¹¹ Finally, a Department of Agriculture bulletin on how rural areas would be affected by block grants noted that the “states have used block grants to spread development funds around to benefit more rural communities” and, as a result, have allocated less money for poor people and communities.¹²

Specific funding provisions in the bill, including the set-aside for housing for special populations and the 10-percent increase in funding for entitlement areas, could mean a further decline in the services provided elsewhere, as the states and localities made difficult choices among competing priorities. In our survey of community development officials, 98 percent (43 of the 44 state officials responding) believed the funding decreases would significantly affect their residents. In addition, because of the funding cuts and the increase in the proportion of funds for entitlement communities, the 3,000 nonmetropolitan areas would either receive smaller grants or fewer communities would receive grants. According to HUD, the grants could become too small to have much impact. In addition, HUD said that nonprofit organizations that rely on the CDBG and HOME programs for partial funding might have to terminate or sharply curtail their services. Nonprofit providers of assistance to the homeless would be the most vulnerable, according to HUD, since they would no longer have direct access to federal funds and the bill does not contain any set-asides for the homeless.

Despite their desire for flexibility, some local officials are concerned about creating additional block grants that flow through the states. According to representatives from the U.S. Conference of Mayors, the National Association for County Community and Economic Development, and the Council of Large Public Housing Authorities, urban areas often suffer

¹⁰Edward G. Goetz, “Potential Effects of Federal Policy Devolution on Local Housing Expenditures,” *Publius: The Journal of Federalism*, Vol. 25, No. 3 (Summer 1995).

¹¹Edward T. Jennings, Jr., et al., *From Nation to States: The Small Cities Community Development Block Grant Program* (Albany, NY: SUNY Press, 1986).

¹²Richard J. Reeder, “How Would Rural Areas Fare Under Block Grants?” *Agriculture Information Bulletin* No. 724-03 (Apr. 1996).

when the states are involved in administering programs. In Maryland, a panel of local officials from municipalities near Washington, D.C., explained that the CDBG nonentitlement program was better run by HUD than by the state, which took over the program's administration in 1987. Similarly, a representative of public housing authorities in Illinois told us that he would prefer to work directly with the federal government in operating housing assistance programs, rather than with the state government. Reasons cited by these local officials for preferring to work with the federal rather than the state government include (1) the influence of state politics on programs' administration and (2) the imposition of burdensome bureaucratic requirements by the state. These officials would prefer federal programs that channel funds directly to local areas.

Agency Comments and Our Evaluation

HUD said that our report does not fully discuss provisions of the bill that it believes would have harmful effects on the Department's low- and moderate-income customers and their communities in rural, suburban, and urban areas. The bill's call for eliminating public housing and replacing it with housing vouchers could have a significant impact on all communities, according to HUD. HUD pointed out that in a previous report we identified potential problems with a "one size fits all approach" to providing housing assistance because costs differ among areas. In addition, HUD noted that the impact on communities and on the poor of consolidating and cutting—by 40 percent—the funding for the Community Development Block Grant, the HOME program and the current programs for the homeless—would also be devastating. Neither we nor HUD can assess with any certainty what spending choices states and communities would make. However, on the basis of our extensive interviews with representatives of federal and state agencies and affected populations and of our analysis of relevant studies, we believe that the information presented in this chapter reasonably reflects the most likely effects of the bill on those presently served by HUD and its programs.

The Federal Role in Housing Finance Would Be Reduced

The federal role in housing finance would change dramatically under the provisions of S. 1145. Specifically, the federal government would provide partial mortgage insurance only for single-family homes, would no longer insure multifamily mortgages, and would no longer provide liquidity to certain lenders. Because of the limitations on the percentage of the value of the home that could be financed and the percentage of the losses that would be covered by insurance, some home buyers—particularly lower-income and first-time buyers—who would have qualified for federally insured loans without the changes envisioned in the bill could have difficulty obtaining a home mortgage or might never become homeowners. In addition, veterans and rural residents, as well as certain lower-income home buyers benefiting from other affordable homeownership programs—particularly those of state housing finance agencies (HFA)—could have more difficulty obtaining—or could pay higher costs to obtain—a home mortgage without FHA as a source of mortgage insurance and Ginnie Mae as a source of liquidity to lenders. Eliminating the federal role in insuring multifamily mortgages could particularly affect the availability of mortgages for affordable rental housing, and, in New York and New Jersey, for hospitals. Finally, risk-sharing as envisioned in the bill could diminish the federal role in stabilizing housing markets. Specifically, according to FHA, the loss of FHA’s ability to serve as a market stabilizer in economic downturns could mean greater losses in home equity value for low- and moderate-income homeowners and greater volatility in the economy.

Both FHA’s principal single-family mortgage insurance program and Ginnie Mae’s guarantee program have expected revenues that exceed their expected costs. The resulting surplus lowers the federal deficit. The budgetary implications of the bill’s housing finance proposals are described in appendix II.

HUD Insures Mortgages and Provides Liquidity to Lenders

HUD supports housing finance principally through FHA’s mortgage insurance program and Ginnie Mae’s program for providing liquidity to lenders of government-insured loans.

FHA Insures Mortgages

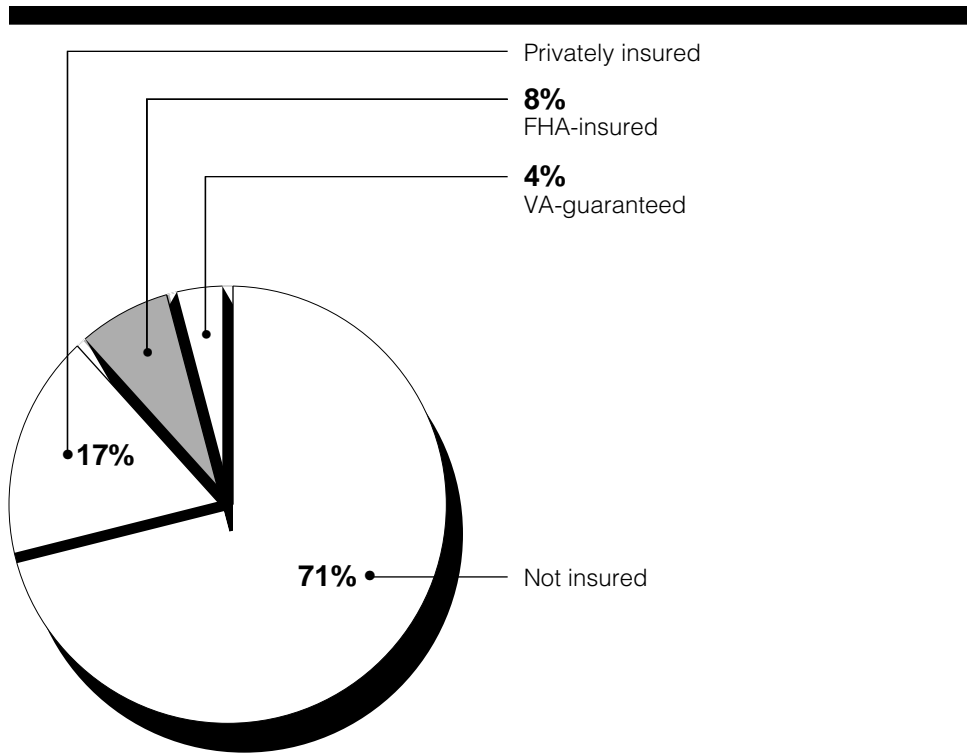
FHA was established under the National Housing Act of 1934 to improve housing standards and conditions, to provide an adequate home financing system by insuring home mortgages and providing credit, and to stabilize

the mortgage market. FHA insures private lenders against losses on mortgages financing homes, multifamily properties, and health care facilities and against losses on loans for property improvements and manufactured homes. In July 1996, FHA had insurance on 6,490,546 single-family loans totaling about \$364 billion. It had insurance on an additional 15,876 multifamily loans (totaling almost 2 million units) and 474,750 property improvement and manufactured housing loans, totaling about \$48 billion and \$6 billion, respectively. FHA also held 126,467 notes on properties with unpaid principal balances totaling \$8.4 billion and held 26,531 single-family and multifamily properties acquired at a cost of \$2.1 billion. According to Price Waterhouse's latest actuarial study, the Mutual Mortgage Insurance Fund—the insurance fund supporting FHA's principal single-family insurance program—had an economic net worth of over \$7 billion as of September 30, 1995.¹ That is, the current cash available to the fund, plus the net present value of all future cash inflows and outflows expected to result from outstanding mortgages in the fund, is about \$7 billion.

While serving a relatively small part of the entire single-family mortgage market, FHA is an important resource for certain market segments. Specifically, while FHA insured about 8 percent of the dollar amount of all mortgages made in 1995—both home purchase mortgages and refinancings—FHA-insured loans represented about 26 percent of the dollar amount of all insured loans made that year. (See fig. 3.1.) Borrowers of FHA-insured mortgages are more likely to have lower incomes, be first-time home buyers, or be minorities than are borrowers of privately insured loans. For example, while FHA insured about 15 percent of all mortgages used to purchase homes in 1994, it insured 20 percent of all home purchase mortgages made to low-income borrowers, 24 percent of those made to minorities, and 21 percent of those made to first-time home buyers. In addition, in 1994 FHA insured more home purchase mortgages in nine states than did private mortgage insurers or the Department of Veterans Affairs (VA).

¹FHA has four insurance funds. The Mutual Mortgage Insurance (MMI) fund provides mortgage insurance principally for 30-year fixed-rate single-family home mortgages and is required to be actuarially sound. The General Insurance (GI) fund provides mortgage insurance for multifamily properties, including nursing homes and hospitals, and is not required to be actuarially sound. The GI fund is dependent on budget appropriations to sustain operations. The Cooperative Management Housing Insurance (CMHI) fund and the Special Risk Insurance (SRI) fund have had very little activity in recent years and, according to HUD's Office of Inspector General, represent a comparatively small exposure to additional losses.

Figure 3.1: Share of Single-Family Mortgages—Home Purchase and Refinancings—Made During 1995



Source: U.S. Housing Market Conditions, HUD's Office of Policy Development and Research (May 1996).

In 1995, FHA's mortgage insurance on loans for multifamily properties helped finance the construction of 17,113 new rental units; the purchase or refinancing of 32,383 existing rental units; and the construction, substantial rehabilitation, and purchase or refinancing of 12,888 units of group housing and health care facilities. Combined, these multifamily activities represented over \$2.3 billion in mortgage insurance written in 1995.

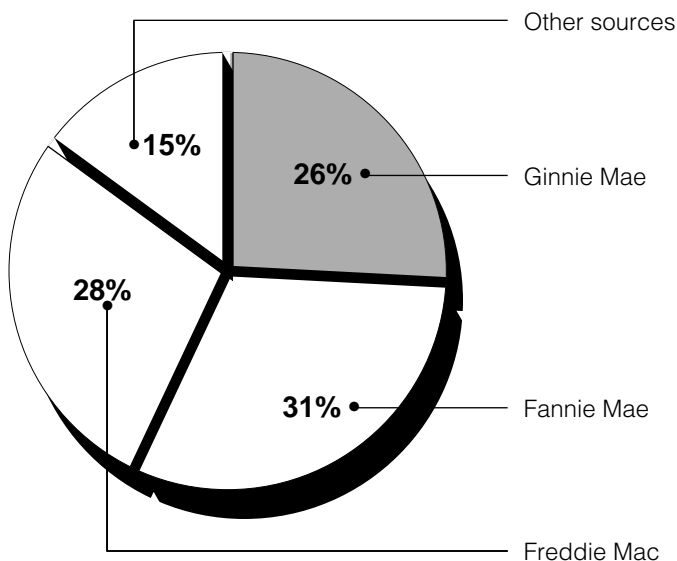
Ginnie Mae's Guarantees Raise Capital for Mortgage Loans

Ginnie Mae, a wholly owned government corporation, was established to expand affordable housing in America by providing liquidity to certain lenders through an efficient government-guaranteed secondary market for

federally insured or guaranteed loans. Its programs facilitate the financing of single-family, multifamily, and manufactured homes. Specifically, Ginnie Mae guarantees the timely payment of principal and interest on privately issued securities that are backed by pools of FHA-insured and VA- and Rural Housing Service (RHS)-guaranteed mortgages. In fact, according to Ginnie Mae, nearly all FHA-insured, VA-guaranteed, and RHS-guaranteed mortgages are in Ginnie Mae pools.² Ginnie Mae's mortgage-backed securities program provides a means of channeling funds from the nation's securities markets into local housing markets. According to Ginnie Mae, the U.S. government's full-faith-and-credit guaranty of these securities makes them widely accepted in sectors of the capital markets that would not otherwise be likely to supply funds to the mortgage market. Approximately 70 percent of the funds used to purchase Ginnie Mae-guaranteed securities come from nontraditional mortgage investors, including pension and retirement funds, life insurance companies, and individuals. The maturities on these guarantees are for up to 40 years. As shown in figure 3.2, as of September 30, 1995, Ginnie Mae-guaranteed securities represented 26 percent of all single-family and multifamily mortgages held in mortgage pools. At the end of fiscal year 1995, Ginnie Mae had outstanding guarantees of mortgage-backed securities totaling \$464 billion. Ginnie Mae's programs had negative net outlays—or profits—of \$464 million in fiscal year 1995.

²Fannie Mae, in partnership with the RHS, developed the market for RHS-guaranteed loans. According to Fannie Mae, it has provided more than \$787 million in financing to over 13,000 families since the beginning of this partnership.

Figure 3.2: Share of Single-Family and Multifamily Mortgage-Backed Securities Insured or Guaranteed as of September 30, 1995



Note: Excludes Rural Housing Service.

Source: Federal Reserve Bulletin (Nov. 1996).

Federal Support for Housing Finance Would Be Reduced

Under S. 1145, HUD would no longer insure multifamily mortgages or guarantee mortgage-backed securities, and the agency that would replace FHA would be limited in how it could insure mortgages. Specifically, the bill would abolish FHA and replace FHA's single-family mortgage insurance program with a program in which risk would be shared between qualified mortgage insurers and a Federal Home Mortgage Insurance Fund operated by a new agency—the Federal Home Mortgage Insurance Fund Administration (FHMIFA)—within the Department of the Treasury. Unlike FHA's mortgage insurance, this proposed new fund would not be backed by the full faith and credit of the United States. The new agency would be authorized to provide partial insurance on mortgages for families with incomes of 80 percent of their area's median income (125 percent for first-time home buyers and for homes purchased in economically distressed areas) and for refinancing a mortgage previously insured under a risk-sharing agreement.³ It would not be authorized to insure single-family mortgages for other prospective buyers or multifamily

³Refinancings would be limited to instances in which the amount of the original loan did not exceed 150 percent of the outstanding principal of the mortgage being refinanced.

mortgages. Furthermore, the federal government would no longer provide liquidity to lenders, as Ginnie Mae does now. Finally, low-income homeowners would be eligible to receive housing assistance vouchers for up to 60 months—or for longer if a state chose to design its own program.⁴ The bill also provides for the sale of FHA’s mortgage insurance interests and for the termination of Ginnie Mae.

Under the bill’s provisions, initial capital of \$100 million to \$500 million for the Federal Home Mortgage Insurance Fund would come from the sale of FHA’s mortgage insurance interests.⁵ FHMIFA would set standards for lenders and underwriting standards for borrowers. It would enter into risk-sharing agreements with qualified mortgage insurers. To be qualified, insurers would need a AA rating from a rating agency and could include state and local housing and housing finance agencies or private mortgage insurers in coordination with HFAS.⁶ Together, FHMIFA and a qualified mortgage insurer would insure no more than 35 percent of a loan, a lender would finance no more than 97 percent of a property’s value, and a borrower’s income could not exceed 80 percent of the area’s median income (or 125 percent of the median income for first-time home buyers or properties located in economically distressed areas). Premiums would remain at the levels currently authorized under FHA’s principal program for single-family mortgages, and premiums and losses would be shared as agreed between the fund and the qualified mortgage insurers.

Qualified mortgage insurers would underwrite loans and collect insurance premiums—retaining a portion for administrative expenses and passing the remainder on to the fund. An insurer would pay claims to lenders and dispose of foreclosed properties conveyed to the insurer and collect against borrowers assigned to the insurer. The resulting losses would be shared between the insurer and the fund. The total amount of the losses covered by the fund and the qualified mortgage insurer would be limited to 35 percent of the loan. Currently, FHA covers 100 percent of the losses on loans that it insures, while the maximum coverage on privately insured loans is 35 percent. According to the bill, FHMIFA and a qualified mortgage

⁴Upon the sale of a home for which the homeowner had received housing assistance vouchers, the homeowner would be required to return any additional assistance received as a result of not considering any amount of income imputed from the family’s equity in the house.

⁵FHA’s mortgage insurance interests include the assets, interests, debts, and obligations of the resolution administrator attributable to the residential mortgage insurance provided by the resolution administrator or the Secretary of HUD. These interests include rights to the payment of mortgage insurance premiums and properties and mortgages held by the administrator or the Secretary of HUD.

⁶According to Moody’s, insurance companies rated AA offer excellent financial security. Together with the AAA group, they constitute what are generally known as high-grade companies.

insurer would negotiate an agreement on how the risk would be shared. In addition, the qualified mortgage insurers and FHMIFA would agree on the portion of the premiums that the insurer could retain and the amount that the insurance fund would receive.

To provide liquidity to lenders of mortgages made under the proposed risk-sharing arrangement, as well as mortgages guaranteed by VA and RHS, the bill suggests that Fannie Mae, Freddie Mac, or private conduits might provide a means of channeling capital. The bill does not specify the conditions under which these entities would perform such a function.

The bill establishes transition provisions for selling FHA's mortgage insurance interests and administering any interests not sold, as well as for winding up Ginnie Mae's affairs. In essence, the bill would transfer these commitments to the resolution agency for their orderly sale and/or administration. Although the bill would transfer the administration of any unsold mortgage insurance interests to FHMIFA, it does not specify how Ginnie Mae's guarantees of mortgage-backed securities—with maturities of up to 40 years—would be administered beyond the 5-year term of the resolution agency. The bill does, however, specify that the resolution agency should provide the Congress with a plan for phasing out Ginnie Mae's guarantees. The specific tasks to be performed by the resolution agency, the limits it faces in doing so, and the implications of resolving these commitments are described in detail in chapter 5.

Home Mortgages Would Be Harder to Obtain for Some Home Buyers Under the Bill's Provisions

Given certain restrictions on the loans that could be insured under the bill's risk-sharing provisions and the elimination of Ginnie Mae, some home buyers would find it more difficult and, in some instances, more costly to obtain home mortgages. Particularly hard hit would be low-income and first-time home buyers. According to HUD, the bill's provisions "would strike a devastating blow to potential home buyers." HUD further notes that the proposal's requirements for serving only lower-income and first-time home buyers would freeze out many home buyers who currently pay FHA's higher premiums because they have no conventional-market alternative. Finally, HUD believes that lenders would be exposed to additional risk because of the reduction in coverage from 100 percent to 35 percent, which could result in credit rationing and higher prices in interest and fees. Some home buyers who would have qualified for FHA-insured loans might also qualify for mortgages offered by other mortgage market entities.

Some Borrowers Would
Need More Cash to
Purchase a Home

The bill's provision limiting a loan to no more than 97 percent of a property's value would likely increase the cash required of a borrower. As a result, some prospective borrowers would have to delay their purchase of a home or might, in some cases, never purchase a home. We reported in August 1996 that about 66 percent of the FHA-insured single-family loans made for the purchase of a home in 1995 did not meet three important guidelines used by private mortgage insurers.⁷ That is, about two-thirds of these home buyers might not have qualified for private mortgage insurance for the loan they received. An even greater proportion of first-time home buyers and low-income home buyers might not have qualified for a privately insured loan of the same amount. Specifically, about 77 percent of the first-time home buyers and 86 percent of the low-income home buyers who obtained FHA-insured mortgages in 1995 might not have qualified for privately insured loans. The bill's provision limiting a loan to 97 percent of a property's value is equal to the most liberal percentage allowed by private mortgage insurance companies today. On the basis of this ratio alone, about one-third of the borrowers who obtained FHA-insured mortgages in 1995 might not have qualified for private mortgage insurance for the loans they received.⁸ That is, these borrowers had loans for an amount that exceeded 97 percent of their property's value and, under the bill's provisions, would need either to contribute more cash toward the purchase of a home or purchase a home of lesser value.⁹ An April 1995 study conducted for the Mortgage Bankers Association—which represents most lenders of single-family mortgage loans—concluded that the majority of the customers served under FHA's principal single-family mortgage insurance fund would probably not have sufficient financial resources to qualify for private mortgage insurance if FHA were terminated. Furthermore, according to the study, low-income individuals would have particular difficulty in obtaining additional cash resources.¹⁰

⁷These guidelines included the most liberal private-sector guidelines for the amount of the loan as a percent of the property's value—known as the loan-to-value ratio—and the amount of the borrower's monthly total debt and housing debt payments as a percent of the borrower's monthly gross income—known as the total debt-to-income and housing-expense-to-income ratios. See *Homeownership: FHA's Role in Helping People Obtain Home Mortgages* (GAO/RCED-95-123, Aug. 13, 1996).

⁸This analysis excludes loans used for the purpose of refinancing an existing mortgage.

⁹Some FHA borrowers whom we have identified as not being able to qualify for private mortgage insurance on the loan they received might have been able to increase their down payment, thereby lowering their loan-to-value and total-debt-to-income ratios and qualifying for private mortgage insurance on a smaller loan.

¹⁰William M. Isaac and James A. Marino, *FHA Single-Family Mortgage Insurance: Its Relevance in Today's Market*, The Secura Group, prepared for the Mortgage Bankers Association of America (Apr. 25, 1995).

According to FHA lenders who participated in an October 1995 focus group sponsored by FHA, a reduction in FHA's insurance coverage would cause lenders to increase their prices to cover the perceived increase in risk. According to these lenders,

“this increase [in risk] will lead to an overall decline in FHA volume, as high-risk borrowers are either unable to meet stricter underwriting criteria imposed by lenders or are unable to afford insurance, and as the higher price of FHA insurance induces lower risk borrowers to choose conventional insurance, FHA will be less able to reach underserved areas and borrowers, as well as geographic areas suffering from economic downturns or hit by natural disasters, and the homeownership rate will fall.”

Also contributing to a likely increase in cost to borrowers would be the loss of the full-faith-and-credit backing of the U.S. government. Specifically, according to FHA, without this credit enhancement, investors would provide capital to lenders at a higher cost, increasing the cost of homeownership to borrowers. In addition, a more targeted insurance program, as envisioned in the bill, could concentrate risk in the newly envisioned fund, making it less able to survive economic downturns, according to FHA.

Finally, the changes in housing finance envisioned in the bill would also affect borrowers served through affordable housing programs who now rely on FHA's insurance. For example, FHA's mortgage insurance helps state HFAS raise capital for their single-family and multifamily mortgage programs. The credit enhancement provided by this insurance, backed by the full-faith-and-credit of the United States, makes the loans made by HFAS less risky. Without this enhancement, investors in securities issued by state HFAS would demand a higher return on their investments. These additional costs would be passed on to borrowers. In 1994, FHA insured over 55 percent of the loans made by state HFAS. With the added protection of mortgage insurance, these HFAS may offer more flexible terms than they could offer otherwise.

Capital for Some Mortgage Loans Might Be More Difficult to Raise

As mentioned earlier, the bill would eliminate Ginnie Mae—which today provides a channel for mortgage funds for nearly all government-insured and government-guaranteed loans. According to officials of Fannie Mae and Freddie Mac—organizations specifically mentioned in the bill as candidates for performing functions similar to those now performed by Ginnie Mae—they would immediately be able to purchase any new loans

that met their underwriting guidelines.¹¹ However, their qualifying ratios, particularly for total debt-to-income and loan-to-value, are the same as those used by private mortgage insurance companies. Consequently, under the bill's provisions for risk-sharing, coupled with the elimination of Ginnie Mae, only those borrowers who could meet the private-sector's existing qualifying ratios would be likely to obtain loans insured under the bill's provisions.¹² That is, Fannie Mae and Freddie Mac would be likely to immediately channel funds from the capital market to the housing market for borrowers who could meet today's standards for privately insured loans. As mentioned above, on the basis of our analysis of home purchasers who received FHA loans in 1995, up to two-thirds of the borrowers with FHA-insured loans would not meet these standards, and would, therefore, need to delay their purchase of a home, purchase a home of lesser value, or make a greater initial investment in their home.¹³ According to officials of Mortgage Insurance Companies of America, private mortgage insurers might be able to offer more flexible underwriting for loans in which they shared the risks as envisioned in the bill. Fannie Mae and Freddie Mac would, however, first need to better understand the risks associated with any changes to their underwriting and the price they would need to charge for purchasing such loans. For some borrowers, the provision of vouchers might increase the affordability of the home they currently owned or wished to purchase.

The loss of Ginnie Mae could also affect the availability of mortgages for veterans and rural home buyers. Currently, lenders of loans guaranteed by VA and the Rural Housing Service may retain 44 basis points (0.44 percent of the loan amount) for servicing loans when they are pooled into securities that are guaranteed by Ginnie Mae. But when these loans are securitized by Fannie Mae or Freddie Mac, the lenders might retain fewer basis points. This difference in servicing fees creates an incentive for lenders that originate government-insured and government-guaranteed loans to utilize Ginnie Mae's services and explains why nearly all such loans are held in securities guaranteed by Ginnie Mae. Consequently, some veterans and moderate-income rural home buyers might find a home mortgage more difficult to obtain. Ultimately, the terms of the mortgages made under the risk-sharing provisions of the bill would need to be established before the secondary market agencies could determine the risk and pricing for purchasing and securitizing such loans.

¹¹Many mortgages made to low- and moderate-income home buyers are purchased by Fannie Mae and Freddie Mac. For 1997, 42 percent of Fannie Mae's and Freddie Mac's mortgage purchases are required to be for mortgages issued to families with low and moderate incomes.

¹²Fannie Mae and Freddie Mac may purchase loans that exceed these guidelines.

¹³Both Fannie Mae and Freddie Mac have affordable loan programs and arrangements with certain lenders under which some of these borrowers may qualify for a mortgage.

Financing for Multifamily Projects Would Be More Difficult to Obtain

FHA's role in facilitating the financing of multifamily projects is more limited than it once was, but it is still significant for multifamily projects for lower-income renters, as well as for hospitals and nursing homes in certain locations. Eliminating FHA as a source of insurance for multifamily mortgages would eliminate a relatively small, but in some instances important, source of credit enhancement for developers of such projects.

FHA's role in insuring mortgages for unassisted multifamily projects has generally increased in the last few years, after a period of decline. Specifically, FHA insured twice the dollar amount in mortgages for constructing new rental units in 1995 as it did in 1992, as well as almost twice the dollar amount in mortgages for congregate housing, nursing homes, assisted living, and board-and-care facilities. The dollar amount of the mortgages for purchasing or refinancing existing rental units has fluctuated during the last few years but has exceeded the amount for 1992. While the extent to which FHA's share of the entire market has changed in recent years is unclear, FHA's Office of Multifamily Housing Programs wrote in its Business Strategic Plan of October 1994 that FHA's share of the multifamily mortgage lending market had fallen from over 30 percent during the early 1980s to 2.2 percent in 1992. However, the renters served by projects financed with FHA-insured loans generally had lower incomes than renters in general, according to FHA. Although FHA's multifamily insurance program for hospitals is concentrated in just two states—New York and New Jersey—it may serve as a significant source of credit enhancement for financing hospitals in these two states. Some of FHA's multifamily mortgage programs have been profitable. Specifically, according to a May 1995 analysis prepared by Abt Associates, Inc., FHA's insurance on loans for hospitals and for refinancing multifamily loans had a positive net cash flow for those loans endorsed between 1987 and 1994. Finally, FHA sees its role in pioneering and providing credit enhancement for multifamily mortgages serving the lower end of the market as critical, and the agency is working to better meet the needs of underserved renters and areas.

For multifamily projects as for single-family residences—but to a lesser extent—some state HFAS—including those in Louisiana, Missouri, and Ohio—rely on FHA's mortgage insurance for financing. In addition, in recent years some state HFAS have entered into risk-sharing arrangements with FHA for financing multifamily projects. Without FHA, these HFAS would need to seek another form of credit enhancement to finance such projects.

Agency Comments and Our Evaluation

HUD believes that we do not give sufficient emphasis to the bill's impact on homeownership. According to HUD, eliminating the federal backing for mortgage insurance would eliminate clients now served by FHA, but we cannot say how many prospective borrowers would be unable to obtain a home mortgage under the bill's provisions. While our analysis of the types of loans received by FHA borrowers recognizes the percentage of such borrowers who did not meet the most liberal underwriting guidelines, we cannot say with certainty that all of these borrowers could not qualify for other mortgages. In addition, because the bill does not specify the terms for sharing risk with qualified mortgage insurers, we cannot determine how many borrowers would be affected. In this regard, we share HUD's concern that mortgages insured under the risk-sharing provisions might be those products already offered on the private market. In fact, we recognize in the report that the restriction on loan-to-value ratio alone replicates a feature of products already offered by the private market. We have also added information to the report, in response to HUD's comments, to recognize the impact on the cost to borrowers of the envisioned fund's not being backed by the full-faith-and-credit of the U.S. government, and we have expanded our description of FHA's role in the multifamily mortgage market. Finally, in response to comments from Fannie Mae and Freddie Mac that our report does not recognize the extent to which these agencies serve low- and moderate-income families, we added information on their efforts and noted that the agencies may purchase loans whose terms exceed their underwriting guidelines.

States Have Varied Capacity and Receiving Agencies Generally Have Compatible Missions, but Implementation Could Pose Difficulties

Many states already have some experience in administering housing and community development programs. Most officials in the six states we visited believed they could take on additional programmatic and administrative responsibilities and welcomed the prospect of greater involvement in deciding how to spend federal funds. Although the state government officials responding to our survey generally indicated that their state would not be likely to supplement the federal block grant, past experience with block grants in the early 1980s showed that the states used a variety of approaches to help offset federal funding reductions. Similarly, a majority of the federal agencies that would receive HUD's functions generally indicated that they could assume the additional responsibilities if they received adequate resources; however, they said implementation would pose problems. S. 1145 does not explicitly expand the role of localities in administering housing and community development programs; rather, changes in the role of localities would depend largely on the states.

States Are Willing to Assume a Greater Role but Have Varied Administrative and Fiscal Capacity

The states vary in their experience with programs such as they might administer under S. 1145. Officials responsible for current housing, community development, and welfare programs in the six states that we visited generally believed that their state could develop the capacity to take on most additional administrative responsibilities associated with an increased role in these programs. In the housing assistance area, most said that they would need funding for additional staff and automated systems. However, 79 percent of the respondents to our survey of community development officials in 47 states said their state could easily assume the community development responsibilities by dividing the grant among state agencies. The one area in which the states would not be able to fully participate is risk-sharing to insure single-family mortgages, according to the National Council of State Housing Agencies. Although studies show that some states have greater fiscal capacity than others, most of the state officials we contacted did not believe that their state government would be likely to contribute additional funding for housing and community development activities.

State Officials Have Varied Experience Administering Housing and Community Development Programs

Many states have experience administering housing assistance through existing programs. In 1994, 33 states, the District of Columbia, and Puerto Rico had HFAS that administered tenant-based rental assistance through either the section 8 certificate or voucher program or the HOME program, according to a survey conducted by the National Council of State Housing

**Chapter 4
States Have Varied Capacity and Receiving
Agencies Generally Have Compatible
Missions, but Implementation Could Pose
Difficulties**

Agencies. Some states—such as Massachusetts and Maryland—already administer rental assistance programs that they designed and fund. In addition, the states are generally already equipped with a network of local public housing authorities (PHA) that operate public housing, many of which also administer section 8 certificates and vouchers. However, the PHAs currently receive their funding directly from the federal government and are not supportive of proposals that involve the states, according to three PHA associations. Also, the PHAs typically interact directly with HUD and may have only a limited ongoing relationship with the state.

Officials responsible for housing, community development, and welfare programs in five of the six states we visited indicated that if S. 1145 were implemented, their state would probably opt for a state-designed program that would include a tenant-based rental assistance component, such as vouchers, and would use the existing PHA infrastructure along with other local agencies for delivering rental assistance to residents. In the other state, Illinois, officials from the governor's office and the housing and community development departments were uncertain whether the state would want to administer the program. The officials said that they support tenant-based assistance but have found, in administering approximately 400 rental units as HUD has shifted from project- to tenant-based assistance, the state's administrative costs have risen because the tenants are more scattered and more travel is required to conduct inspections. However, the state's director of social services thought that his department should design and administer the program so that the state could use housing assistance as a tool to help welfare recipients become self-sufficient.

Forty-eight states and Puerto Rico have experience working with the existing CDBG program—a role somewhat similar to the one they would play in administering the nonentitlement portion of the community development and special populations block grant proposed in S. 1145. However, the states vary in the number of years they have worked with the CDBG program. In 1982, the states were given the chance to take over the administration of the nonentitlement portion of the CDBG program. While most states were eager to take over this role, Hawaii and New York continue to rely on HUD to administer the program for their state. In 1994, 37 states and the Virgin Islands participated in the HOME program. Many states also have experience administering programs for the homeless, the elderly, and people with AIDS.

**Chapter 4
States Have Varied Capacity and Receiving
Agencies Generally Have Compatible
Missions, but Implementation Could Pose
Difficulties**

Prior experience in administering housing and community development programs or other block grants may help the states take on additional responsibilities for administering block grants for housing and community development. During a review of the nine block grants created by the Omnibus Budget Reconciliation Act of 1981, we found that when a state had operated categorical programs in a particular program area, the transition to block grants in that area was smoother because the state could rely on its existing management and service delivery systems.¹ The states also consolidated offices or took other steps to coordinate related programs when assuming responsibility for the 1981 block grants. The transition to new block grants was not as smooth in program areas that had been funded almost entirely by the federal government.

Only eight states currently insure single-family mortgages—a responsibility S. 1145 would make available to the states through risk-sharing with the federal government. Most HFAS rely on FHA or the private market to insure their loans. For example, officials at the Illinois HFA said that their agency cannot insure its own mortgages because its enabling legislation requires it to use private insurance on its mortgages. Although few states currently insure mortgages, virtually all of them make direct loans to first-time home buyers using the proceeds from tax exempt bonds.

**States Believed They Could
Take on Additional
Housing and Community
Development
Responsibilities, but
Localities Said States
Lacked Experience in
Housing**

The states could take on additional housing responsibilities, according to the National Council of State Housing Agencies. Also, state officials responsible for housing, community development, and welfare in the six states we visited believed that the strength of their housing and community development departments, their capacity at the local level, and their interagency coordination would help them take on additional responsibilities for housing assistance. However, these officials believed they would need funds for additional staff and automated systems to assume the new responsibilities. Although state officials generally believed they could handle the expanded administrative responsibilities that could result from the implementation of S. 1145's housing assistance provisions, officials from localities in these states generally did not share this confidence. Local PHA directors and associations representing local governments in some of the states we visited did not believe that their state government had the administrative capacity or the experience with local housing problems needed to administer housing programs. In addition, to the extent that S. 1145 resulted in the transfer of responsibility

¹Block Grants: Characteristics, Experiences, and Lessons Learned (GAO/HEHS-95-74, Feb. 9, 1995).

**Chapter 4
States Have Varied Capacity and Receiving
Agencies Generally Have Compatible
Missions, but Implementation Could Pose
Difficulties**

for subsidized multifamily housing projects to the states, states with little or no experience in administering multifamily housing would not be well positioned to carry out these responsibilities, according to Moody's Investors' Service—one of the two major bond-rating agencies.

Assuming responsibility for administering the block grant for community development, affordable housing, and special populations by distributing the grant funds among existing state departments would be easy, according to 79 percent of those who responded to our survey of community development officials. Conversely, only 5 percent said that their state would be likely to create a new state agency to administer the proposed block grant. Seventy-two percent thought that the state would be unlikely to hire additional staff to administer the program. The states are more likely to shift staff between departments or offices, according to the officials surveyed.

Most state HFAS could not participate in risk-sharing because they would be unable to supply the capital needed to meet the rating requirement the proposal would establish for qualified mortgage insurers, according to officials from the National Council of State Housing Agencies and Moody's. Officials from the National Council said that some older HFAS—in New York, Florida, and Massachusetts, for example—do have significant reserves that they have been able to build over time. However, the newer HFAS have not had the time to develop reserves and the reserves that they do have are pledged against bond issues. In addition, the bond issues have come under tighter restrictions over time, which have restricted HFAS in building reserves.

**States Said They Would Be
Unlikely to Supplement
Federal Funds**

None of the officials we surveyed indicated that their state would be likely to provide additional funds for community development to compensate for the bill's proposed reductions. Almost all of these officials believed that their state would not provide additional funds because of its (1) inability or unwillingness to increase state tax rates and/or (2) balanced budget requirement. According to the Center for the Study of the States, the states are unlikely to raise their own taxes much to offset federal cutbacks, and the revenue from the existing taxes of most states will not grow enough to enable the states to make up for large reductions in federal aid.² For example, officials in Washington State said that because the state has a balanced budget requirement and an initiative that limits state spending

²Steven D. Gold, "The ABCs of Block Grants," *State Fiscal Brief of the Center for the Study of the States*, Nelson A. Rockefeller Institute of Government, No. 28 (Mar. 1995).

**Chapter 4
States Have Varied Capacity and Receiving
Agencies Generally Have Compatible
Missions, but Implementation Could Pose
Difficulties**

increases, the state would be precluded from providing additional funding for housing or community development. Balanced budget requirements exist in 49 states, according to the National Conference of State Legislatures.

Other limitations on the states' ability to provide additional funds cited by survey respondents included competition for state funds and the impact of other federal spending cuts. The Center for the Study of the States calculated that state spending for activities such as economic development and housing was cut back sharply during the early 1990s. According to 1996 testimony by a senior fellow at the Urban Institute before the House Budget Committee, if cutbacks in federal aid cause fiscal stress for states, programs that received a small share of the states' funds in the early 1990s would continue to lose out to spending for other activities, such as prisons.³ Federal spending cuts in areas such as welfare, job training, and education were cited by almost half of the survey respondents as moderately or greatly influencing their state's decision not to provide additional funds for community development.⁴ For example, officials in Massachusetts said they would have to wait and see how their state fared with welfare reform before determining how much more they could spend for housing and community development. However, this state differed from others we visited because officials believed that strong pressure from housing advocacy groups within the state could result in increased funding.

Although the state government officials responding to our survey generally indicated that their state would not be likely to supplement the federal block grant, the actual fiscal capacity of state governments appears to be more varied than the responses would suggest. Several recent studies indicate that while some states are weak in terms of their fiscal capacity, others are fairly strong. We reported in 1993, for instance, that the widespread disparities among the levels of public services that the states could afford reflected differences in their fiscal capacity.⁵ The six states we visited had varied levels of fiscal capacity, according to the 1993 report's ranking of states. Maryland and Massachusetts were ranked in the

³Steven D. Gold, "The Potential Impacts of Devolution on State Government Programs and Finances," The Urban Institute (Mar. 5, 1996).

⁴Only respondents who estimated that their state would probably or definitely not provide additional funds were asked this question. Those that were uncertain were not asked about the influence of the various factors on the state's decision.

⁵State and Local Finances: Some Jurisdictions Confronted by Short- and Long-Term Problems (GAO/HRD-94-1, Oct. 6, 1993).

Chapter 4
States Have Varied Capacity and Receiving
Agencies Generally Have Compatible
Missions, but Implementation Could Pose
Difficulties

top (strongest) quartile, Washington was in the second quartile, Illinois was in the third quartile, and Alabama and Texas were in the bottom (weakest) quartile. Furthermore, according to the National Governors' Association and the National Association of State Budget Officers, the states' revenues for 1995 exceeded projected levels. About half of the states enacted tax cuts in part because of moderate economic growth.⁶ In addition, experience with block grants in the early 1980s showed that the states used a variety of approaches to help offset federal funding reductions. For example, after nine block grants were created in the early 1980s, the states used carry-over funds from categorical programs, added state revenues, and transferred funds among programs to help make up for much of the reductions in federal funding.⁷ An April 1995 study on block grants concluded that ". . . critics who had predicted that states would be unable and/or unwilling to use their own funds to offset federal cuts were proven wrong."⁸ The study noted that spending for social services, which had seemed especially vulnerable, received surprisingly strong support.

However, some observers do not believe that the states would be willing or able to offset the reductions. The Center for the Study of the States concluded that even though fiscal conditions have improved in recent years, the states have limited financial reserves available. If the federal government sharply reduces its aid to the states, according to the Center, it should not be under the illusion that the states can easily afford to replace the lost funds.⁹ The Center's study on block grants noted that

". . . the anti-tax mood reflected currently in Washington is also prevalent in the states. If massive reductions in federal aid occur, many states would probably respond by increasing taxes somewhat, but not nearly . . . [enough] to replace the federal funding cuts."

⁶The Fiscal Survey of States, National Governors' Association and the National Association of State Budget Officers (Oct. 1995).

⁷See Block Grants: Characteristics, Experience, and Lessons Learned (GAO/HEHS-95-74, Feb. 9, 1995).

⁸Cheryl D. Hayes, Rethinking Block Grants: Toward Improved Intergovernmental Financing for Education and Other Children's Services, The Finance Project (Apr. 1995).

⁹Steven D. Gold, "The Impact of New Federal Policies on State Governments," State Fiscal Brief of the Center for the Study of the States, Nelson A. Rockefeller Institute of Government, No. 26 (Jan. 1995).

Missions of Some Receiving Agencies May Be Compatible, but Program Delivery May Differ

Officials from the federal agencies that would receive functions transferred under S. 1145 generally believed that their missions were compatible with those of the transferring functions; however, they expressed some concerns about whether their organizational structures, resources, and staff skills would meet the requirements of the transferring functions. HUD, in contrast, maintained that transferring its functions to other agencies would break up the network it has developed to implement its programs and could adversely affect the delivery of services to its clients. The priority that other agencies would give to some of HUD's regulatory functions is also unclear.

While Most Agencies See Their Missions as Broadly Compatible, Some Agencies Said the Transfers Would Create Difficulties

Most of the designated receiving agencies considered their missions to be very similar to HUD's, while HUD did not generally believe that its mission in each area was compatible with that of the respective receiving agency. Officials from the agencies that would receive seven of the nine functions to be transferred did not see compatibility of mission as a significant issue for their respective agency. HUD officials, however, considered only two missions—overseeing home mortgage disclosures and overseeing housing finance entities—to be compatible with the respective receiving agency's mission.

HHS considers its mission very similar to HUD's because both agencies are attempting to move people to self-sufficiency. HHS administers several programs primarily focused on providing services and assistance to low-income, needy children and families. About 20 percent of the beneficiaries of these programs also depend on HUD's housing assistance programs. Conversely, in HUD's view, HHS' entitlement programs differ fundamentally from HUD's housing assistance programs. HUD also disagreed that many of the same clients are served by both agencies, indicating that 67 percent of those in public housing obtain their income from sources other than public assistance.

Both the Department of the Treasury—slated to administer the mortgage insurance function—and HUD consider the proposed transfer a difficult fit. Treasury sees itself as the formulator and manager of the federal government's domestic and international tax and financial policies, while it sees HUD as a program agency primarily responsible for developing housing policy. Within HUD, FHA is responsible for improving housing standards, providing an adequate home financing system through its mortgage insurance program, and stabilizing the mortgage market. Although FHA's mortgage insurance program is a credit-related program,

**Chapter 4
States Have Varied Capacity and Receiving
Agencies Generally Have Compatible
Missions, but Implementation Could Pose
Difficulties**

FHA's core mission as a mortgage insurer is unrelated to Treasury's operation, according to both HUD and Treasury officials. Furthermore, both HUD and Treasury believe that the transfer would considerably weaken the influence of the program on its constituents because Treasury is not experienced in dealing with FHA's traditional clients: home buyers, tenants, mortgage lenders, realtors, builders, nonprofit developers, and state and local governments.

While both HUD and the Department of Justice see their roles in enforcing the Fair Housing Act as complementary, they believe that the act would be undermined if both their functions were combined under a single agency. Under the act, HUD is responsible for carrying out all of the functions relating to administrative enforcement of the act. Accordingly, HUD investigates, conciliates, or otherwise oversees the disposition of nearly 10,000 individual complaints annually. Justice's role is to litigate cases in federal court either when a case is referred from HUD after a formal charge has been issued and one of the parties elects to have the case heard in federal court or when Justice initiates a case of broader national significance. According to both Justice and HUD, this separation of duties between HUD and Justice currently works well, and both agencies were opposed to a previous proposal to transfer HUD's fair housing functions to Justice. HUD also expressed concern that its broader role in affirmatively furthering fair housing across other HUD programs and activities would be lost. Justice officials said they believe that even with a complete transfer of funding and personnel, the federal fair housing enforcement effort would suffer because the cost and disruption of the transfer would be significant and would drain resources away from Justice's mission of fair housing enforcement. Furthermore, both HUD and Justice believe the Fair Housing Assistance Program—a program through which HUD certifies states to resolve fair housing disputes—would not fit well at Justice because Justice is primarily an enforcement rather than an administrative agency.

**Agencies Said That Lack of
Organizational Structure,
Resources, and Housing
Expertise Could Hamper
Integration of HUD's
Functions**

Although many receiving agencies thought that they could integrate the transferred functions, they generally believed that the task would not be easy because they lack either an organizational structure or the resources needed for implementation. For example, HHS indicated that it carries out its functional responsibilities predominantly through grants-in-aid, which are administered in partnership with state and local governments, tribes, and private-sector grantees. HHS believes that in order to administer the voucher program, it might need to develop an extensive field structure,

Chapter 4
States Have Varied Capacity and Receiving
Agencies Generally Have Compatible
Missions, but Implementation Could Pose
Difficulties

because HUD's structure includes 52 state and 29 area offices, in contrast to HHS' 10 regional offices. Treasury believes that it would need staff with appropriate skills and experience with the housing industry to provide oversight and structure for the single-family insurance program. Treasury said that it does not have staff with similar types of knowledge, skills, or abilities—technical or otherwise—to continue the operations of a reconfigured FHA. Justice officials and HUD agreed that Justice—which is primarily a headquarters organization—would have trouble assimilating a field structure into its organization and carrying out HUD's administrative activities. According to the Attorney General's undated response to a similar proposal,

“The [Justice] Department does not have a comparable field office structure, and has no current capacity to handle the nearly 10,000 complaints received annually. . . . In order to carry out administrative responsibilities currently handled by HUD; the Department of Justice would have to duplicate the existing structure at HUD, with related disruption and start-up costs attached.”

S. 1145 would make some resources available to the receiving agencies. However, the level and location of the resources that would be made available is not certain. HUD had about 10,500 employees in its headquarters and field offices as of September 30, 1996. As discussed above, S. 1145, if enacted, would change many of the functions these employees currently perform. It would also affect the size of the workforce needed to carry out these functions. Efforts to assess this effect and its consequences for HUD need to consider the requirements of the current federal law. The Veterans Preference Act of 1944 (VPA) gives certain federal employees reemployment rights in some instances when functions are transferred from one federal agency to another or one federal agency is replaced by another. The act's provisions would appear to apply to the transfer of programs under S. 1145.¹⁰ If S. 1145 were enacted and VPA's provisions were found to be applicable, assessments would have to determine which existing HUD functions had been transferred elsewhere and whether the functions of particular HUD employees had been transferred.

Some functions, such as the administration of public housing, would at some point be discontinued, since public housing would be phased out under S. 1145. Other functions, such as the guarantee of home mortgages under FHA, would continue to be performed under S. 1145, but in a much

¹⁰See National Council of CSA Locals, American Federation of Government Employees (AFGE) *AFL-CIO v. Schweiker*, 526 F. Supp. 861.

Chapter 4
States Have Varied Capacity and Receiving
Agencies Generally Have Compatible
Missions, but Implementation Could Pose
Difficulties

different and more limited way. State governments and the private sector would have a much larger role under S. 1145 in administering a number of the restructured housing and community development programs and the federal government would have a smaller one. Under these circumstances, fewer federal employees would be needed to operate the programs. Even when S. 1145 would clearly transfer a function without change from HUD to another agency, the receiving agency might decide that it did not need as many employees to perform the function as HUD currently employs.

Given the complexity and uncertainty of the issues associated with transferring functions, we did not attempt to determine the impact of S. 1145 on the future employment of HUD's current workforce. If S. 1145 were not exempted from VPA's provisions, HUD's current functions would have to be compared with the restructured functions that other agencies would perform under the bill. Such an analysis was beyond the scope of this report. Appendix I provides more details on the functions to be transferred, as well as the agencies' missions, organizational compatibility, and staffing.

Primary concerns of HUD about the impact of transferring its functions to different agencies were the less extensive housing expertise at the new agencies and the disruption of networks that HUD has built up to help implement its programs. For example, HUD said that if HHS took over the housing assistance function, the linkages that HUD has created between housing and community development activities would end. In addition, HUD and EPA officials believe that if HUD's lead-based paint abatement functions were transferred to EPA, the nature of the relationships between the program's customers and clients would change because EPA does not manage housing and EPA's contacts are not as well developed as HUD's. Similarly, HUD noted that its responsibilities for enforcing the Real Estate Settlement Procedures Act involve traditional HUD constituents—home buyers, state regulatory agencies, and consumer trade groups. If these responsibilities were transferred to the Federal Reserve, new relationships would have to be established to maintain the same level of service. In addition, HUD said that under the Fair Housing Program, it receives many calls involving housing issues other than discrimination that it can effectively refer to other HUD offices or local networks. According to HUD, Justice has neither the familiarity with housing programs nor the knowledge of local communities and personalities that makes HUD's referral system effective.

Additionally, several federal, state, and local officials—including HUD officials—expressed concern that if HUD were abolished and its functions were transferred to other federal, state, and possibly local agencies, the federal focus on housing policy would be lost. Some of them indicated that the loss of a cabinet-level advocate for housing and community development issues—an advocate with a sole focus on these areas—could mean that these areas would not get adequate federal funding in the future. In previous testimony, we suggested that elevating the Environmental Protection Agency to the cabinet—“would affirm the prominence and permanence of the federal role in environmental protection.”¹¹ Conversely, dismantling HUD could diminish the “prominence and permanence” of the federal role in housing and community development.

Agency Comments and Our Evaluation

HUD, HHS, Justice, OMB, and Treasury expressed their strong disagreement with S. 1145 and several of these agencies cited the need for a cabinet-level department to provide a focus for housing and community development issues. HUD also said that the report is deeply flawed because it does not fully discuss either the difficulties involved in transferring HUD’s functions to other agencies and to other levels of government or the loss of a national housing and community development policy. We added several references to HUD’s position on the difficulties involved in transferring its functions and the loss of a national housing and community development policy. However, the continued need for a cabinet-level department to address housing and community development issues is a policy question for the Congress and the administration to decide.

OMB stated that “issues related to the reorganization and administration of HUD’s functions should be evaluated on their own merits, not as a strategy for reducing the deficit by seemingly arbitrary reductions in spending.” OMB said that the administration believes that assigning HUD’s functions to other agencies would be counterproductive relative to its reinvention goals. HHS said that the proposal is not well advised and the planned transfers might result in little or no cost savings to the federal government. This report provides information on the potential positive and negative implications of S. 1145 and, as such, does not take a position on the bill. Projections of the bill’s impact on the federal budget will be developed and published by CBO in a separate report. Justice stressed the extreme burden that transferring HUD’s Fair Housing Act responsibilities would create for their department, especially the drain of resources from its primary

¹¹Creation of a Department of the Environment, (GAO/T-RCED-93-6, Feb. 18, 1993).

Chapter 4
States Have Varied Capacity and Receiving
Agencies Generally Have Compatible
Missions, but Implementation Could Pose
Difficulties

mission of fair housing enforcement. The remaining six agencies provided clarifying language for the portions of the report that discuss their agencies. We incorporated the comments, as appropriate, throughout the report.

The Proposed Resolution Agency Would Face Difficult Tasks

The proposed HUD Programs Resolution Agency, as envisioned by S. 1145, would face a difficult task in restructuring, transferring, or eliminating HUD's programs. Over a 5-year period, the agency would need to address hundreds of millions of outstanding financial commitments, transfer nine HUD functions to receiving agencies and one function to a newly created agency, and terminate several programs. In carrying out these responsibilities, the resolution agency could learn from previous federal efforts to abolish, reorganize, or transfer federal programs and dispose of assets.

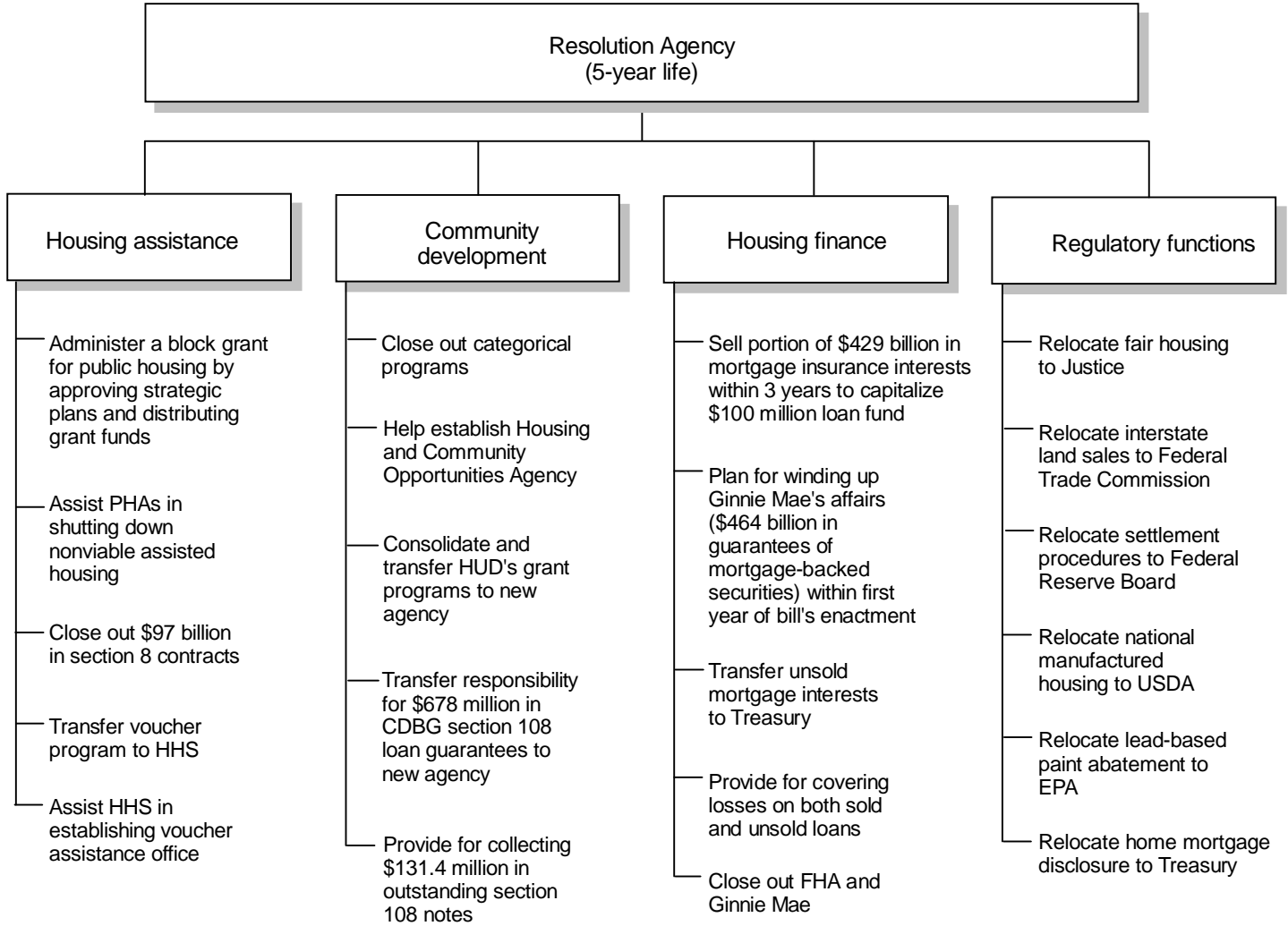
Resolution Agency Would Manage Transition for All Major Functions

S. 1145 directs the resolution agency to perform all of HUD's functions—excluding those abolished or transferred to other agencies by the bill—for a 5-year period. For the functions that would be abolished or transferred, the agency would oversee their transition. Thus, S. 1145 mandates that the resolution agency conduct a vast range of activities, such as distributing block grants, closing down entire programs, establishing a new agency, and transferring a number of programs to other agencies. More specifically, the agency's responsibilities would range from providing housing assistance through administering a block grant for public housing and settling expiring section 8 contracts to selling \$429 billion in mortgage insurance interests to raise at least \$100 million in capital within 3 years for an insurance fund.

Additionally, the bill imposes various planning requirements on the resolution agency, including developing an overall plan for winding up the affairs of the agency within 5 years and more specific plans for (1) settling the affairs of Ginnie Mae, (2) providing for the transition of assistance for public housing to voucher assistance, and (3) immediately marketing and selling FHA's mortgage insurance interests. The required planning would serve an important role in communicating to the Congress and the public how the resolution agency would interpret its mandates and how it would operate. Figure 5.1 details the responsibilities of the agency as mandated by S. 1145.

Chapter 5
The Proposed Resolution Agency Would
Face Difficult Tasks

Figure 5.1: Responsibilities of the Resolution Agency Under S. 1145 for Housing Assistance, Community Development, Housing Finance, and Regulatory Functions



As part of its 5-year effort to close out terminated programs and oversee the transition of other functions, the resolution agency would be responsible for ensuring that federal commitments made prior to the bill's enactment were maintained. In some cases, the resolution agency might need to plan for the administration of some of the commitments beyond its

own 5-year term. The commitments include contractual obligations, outstanding mortgage guarantees and insurance, and loans and properties held by HUD, as well as borrowings. Specifically, the commitments include over \$418 billion in loan insurance, approximately \$464 billion in mortgage-backed security guarantees, almost \$100 billion in section 8 project-based rental assistance contracts, over \$10 billion in notes and properties held by HUD, \$678 million in section 108 loan guarantees, \$46 billion in other contracted commitments, and \$15 billion in borrowings.

While most of the section 8 project-based assistance contracts will expire during the life of the resolution agency, most of the insurance, guarantees, and borrowings will outlive the term of the agency and would be transferred to other agencies. For example, the bill would transfer the administration of outstanding mortgage insurance obligations to Treasury's Federal Home Mortgage Insurance Fund. Likewise, the bill would transfer section 8 contracts whose terms extend beyond the life of the resolution agency to HHS. Finally, the bill does not specify how long-term guarantees of section 108 loans and of Ginnie Mae's mortgage-backed securities would be administered beyond the term of the resolution agency. The bill does, however, direct the resolution agency to provide the Congress with a plan for phasing out Ginnie Mae's guarantees.

Table 5.1 lists HUD's financial commitments as of the end of fiscal year 1995, as well as the agency that would receive responsibility for the commitments that outlive the resolution agency. For more detailed explanations of HUD's functions that involve financial commitments for the resolution agency, see appendix II.

Chapter 5
The Proposed Resolution Agency Would
Face Difficult Tasks

Table 5.1: HUD's Financial Commitments as of Fiscal Year 1995

Dollars in millions		
Title	Amount	Receiving agency^a
FHA single-family insured portfolio ^b	\$364,323 ^c	Treasury
FHA multifamily insured portfolio ^b	\$48,162 ^c	Treasury
FHA title I insured portfolio ^b	\$5,957 ^c	Treasury
FHA single-family note portfolio ^b	\$3,721 ^c	Treasury
FHA multifamily note portfolio ^b	\$4,125 ^c	Treasury
FHA title I note portfolio ^b	\$503 ^c	Treasury
FHA single-family property portfolio ^b	\$1,830 ^d	Treasury
FHA multifamily property portfolio ^b	\$312 ^d	Treasury
Ginnie Mae guarantee of mortgage-backed securities	\$464,000 ^e	^f
Section 8 contracts	\$96,958	HHS
CDBG, section 108 loan guarantees	\$678	^g
Section 235/236 and other contracted commitments	\$45,876 ^h	^g
Borrowings (governmental and intragovernmental)	\$15,271	^g
Total	\$1,051,716	

^aAgency responsible for the financial commitment after the resolution agency's 5-year term expires.

^bAs of July 1996.

^cUnpaid principal balance.

^dAcquisition cost.

^eThis figure is approximate.

^fTo be determined.

^gNot specified.

^hDoes not include CDBG contractual commitments, since the CDBG program would be transferred to a newly created Housing and Community Opportunities Agency.

Source: U.S. Department of Housing and Urban Development Report on Fiscal Year 1995 Financial Statements, HUD Office of Inspector General (96-FO-177-0003, Aug. 16, 1996), and Portfolio and Production Report, FHA Housing Comptroller (July 1996).

The resolution agency would face certain legal constraints on how it could settle HUD's commitments. For example, the bill recognizes that selling FHA's mortgage insurance interests or terminating Ginnie Mae would not relieve the federal government of commitments backed by the full faith

and credit of the United States. Generally, the bill provides that all grants, loans, contracts, agreements, and other obligations that have been issued before the transfer of functions shall continue in effect according to their terms until modified, terminated, superseded, set aside, or revoked in accordance with law. Consequently, because of the nature of some commitments, the federal government might continue to have a contingent liability regardless of how these commitments were resolved. For example, if the purchaser of an FHA mortgage insurance interest were required to pay claims but was ultimately unable to do so, the federal government would be responsible for meeting its original commitment to the holders of the affected FHA-insured mortgages.

In addition to the constraints described above, the federal government could be subject to unexpected losses, depending on how its commitments were resolved. For example, selling only the most profitable of FHA's mortgage insurance interests might have the net result of lowering the overall value of FHA's mortgage insurance interests. That is, even the most profitable insurance interest would likely be sold at a discount because private purchaser's—unlike FHA—need a return on their investment sufficient to cover any risk of default as well as tax expenses and a return to shareholders. The federal government might be left with only the unprofitable part of the insurance portfolio, supported by capital that—because of the discount at which insurance interests might be sold—would likely be valued at something less than its value before such a sale. For example, we estimate that for the single-family portfolio, loans originated before 1984 would have net positive cash flows for 1998 and the remaining years of the mortgage; therefore, only these loans would have value for potential investors unless the government gave these investors a portion of the up-front premium.¹ The remaining single-family portfolio—which we estimate to have net negative cash flows for 1998 and later years—would likely remain with the federal government. Even if the sale of FHA's single-family mortgage insurance interests included provisions that ensured that the federal government had no responsibility for covering lenders' losses, to the extent that these lenders experienced dramatic losses affecting their ability to pay investors in their Ginnie Mae-guaranteed securities, some or all of the loan losses could fall to the

¹These loans have net positive cash flows for 1998 and the remaining years because the expected annual premiums plus the proceeds from the sale of properties exceed the expected claims and administrative expenses. We assume that the mortgage insurance interest to be sold is the future stream of premium payments and that the purchaser would not be responsible for any partial refunds of up-front premiums that are due upon the prepayment of a mortgage. Loans insured between October 1984 and June 1991 do not have annual premiums. Also, in 1998, loans insured during fiscal years 1993, 1994, and 1995 would not have aged enough for the premiums plus the proceeds from the sale of properties to exceed the expected claims and administrative expenses.

federal government as it honored its full-faith-and-credit commitments on Ginnie Mae-guaranteed securities. Finally, while the section 108 loan guarantees are covered by future CDBG grants, the decline in funding for grantees specified in the bill would limit the ability of these grantees to repay lenders, potentially resulting in greater claims against the resolution agency or the agency designated to assume HUD's responsibility for guaranteeing these loans.

S. 1145 Does Not Address Some Programs

While S. 1145 generally addresses the major responsibilities within HUD—housing assistance, community development, and housing finance—certain programs within these areas would be terminated because the bill does not provide for their transformation or continuation. For example, within the community development area, because the bill does not address the Urban Empowerment Zones and Enterprise Communities program, HUD's involvement with the program would be terminated, leaving the resolution agency to close out technical assistance contracts and determine who would oversee the remainder of the urban part of this program. This program benefits communities by providing local governments and private nonprofit organizations with increased flexibility in meeting federal laws and regulations that might otherwise hinder their ability to implement comprehensive local plans for addressing the housing and economic problems of distressed neighborhoods. The loss of HUD's oversight of the urban portion of this program would diminish the federal role in helping localities initiate and maintain a comprehensive approach to revitalizing distressed neighborhoods. Other agencies involved in administering this program could continue it. Within the area of housing assistance, the Fair Housing Initiatives Program (section 561 of the Housing and Community Development Act of 1987) is not included as one of similar housing assistance functions to be transferred to the Department of Justice. This program funds public and private organizations for activities such as education outreach, enforcement activities, and the legal expenses incurred in prosecuting fair housing cases. Unlike the programs discussed above, these programs do not contain commitments that would need to be addressed by the resolution agency.

In the housing finance area, the bill does not address all of HUD's responsibilities under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992. Specifically, while S. 1145 does provide for transferring the responsibilities for regulating the safety and soundness of Fannie Mae and Freddie Mac now performed by HUD's Office of Federal

Housing Enterprise Oversight, it does not specify the disposition of HUD's responsibilities for ensuring that Fannie Mae and Freddie Mac fulfill their public purposes and serve the housing needs of the country. Among these responsibilities are establishing, monitoring, and enforcing goals for Fannie Mae's and Freddie Mac's purchase of mortgages financing housing for low-and moderate-income families; housing located in central cities, rural areas, and other underserved areas; and affordable housing for specially targeted families. According to HUD, assigning these responsibilities to the resolution agency would reduce their importance for Fannie Mae and Freddie Mac and signal the probable elimination of these agencies' public purpose goals. Ultimately, Fannie Mae and Freddie Mac would devote fewer resources and innovative products to these activities, according to HUD. Furthermore, if S. 1145 were implemented, HUD officials believe that this function should continue and be transferred to a cabinet-level agency.

Lessons Learned From Prior Efforts to Abolish, Reorganize, or Transfer Federal Programs Could Ease Transition

The proposed resolution agency could benefit from certain lessons learned from past efforts to abolish or reorganize federal agencies, transfer their programs, or dispose of their assets. While the previous efforts do not perfectly parallel the current plans for dismantling HUD, they do involve some of the same activities—such as transferring functions to other agencies and disposing of assets—and, thus, some of the lessons learned in the past might be applicable.² For example, we previously stressed the importance of creating an interagency transition task force to provide overall guidance on the transfer of assets, personnel, and operations to receiving agencies. We also highlighted the importance of establishing internal controls and developing an asset disposition plan when resolving financial commitments. Applying these lessons in consolidating, eliminating, and transferring federal housing and community development programs might help not only to reduce the risk of mismanagement, waste, fraud, and abuse within the programs but also to save money for the federal government by increasing the efficiency of the transition. Additionally, a number of officials we interviewed noted some special

²We previously examined a number of efforts to abolish, reorganize, or transfer federal programs and dispose of assets, including a proposal to abolish the Department of Commerce; efforts to reorganize and transfer programs at the Department of Energy, Federal Emergency Management Agency, Equal Employment Opportunity Commission, Federal Labor Relations Authority, International Development Cooperation Agency, Merit Systems Protection Board, and Office of the Special Counsel; and the disposition of assets by the Resolution Trust Corporation. See *Commerce Dismantlement: Observations on Proposed Implementation Mechanism* (GAO/T-GGD-95-233, Sept. 6, 1995), *Department of Energy: Observations on the Future of DOE* (GAO/T-RCED-96-224, July 23, 1996), *Implementation: The Missing Link in Planning Reorganizations* (GAO/GGD-81-57, Mar. 20, 1981), and *Resolution Trust Corporation: Management Improvements Reduce Risks but Transition Challenges Remain* (GAO/T-GGD-95-163, May 16, 1995).

considerations in abolishing HUD, including the possible elimination of staff positions and the wide dispersal of programs in the field with established support networks.

Resolution Agency Could Use Interagency Transition Task Force in Transferring Functions Between Agencies

A number of lessons learned from previous reorganizations would be applicable to the resolution agency's mandates to transfer some of HUD's personnel and programs and dispose of HUD's outstanding obligations. For example, as noted in our prior work, on the Resolution Trust Corporation Completion Act,³ the Congress required the establishment of an interagency transition task force to help transfer the Resolution Trust Corporation's (RTC) assets, personnel, and operations to the Federal Deposit Insurance Corporation (FDIC). The act assigned the task force—which included representatives of RTC and FDIC—specific duties, including examining both corporations' operations, evaluating their differences, recommending which of RTC's systems should be preserved for FDIC's use, and reporting its findings to the Congress. Some key elements for planning the transition included (1) "best practice reviews" conducted jointly by RTC and FDIC to identify differences in their respective operations and recommend practices for adoption by FDIC after RTC's dissolution, (2) information system reviews to assist the Secretary of the Treasury in recommending which of RTC's systems should be adopted by FDIC, and (3) implementation plans to identify the appropriate staffing and organizational structure for RTC's functions after their absorption by FDIC.⁴ The corporations also reviewed the legal and policy issues involved in transferring RTC's responsibilities and operations to FDIC and reviewed internal controls to ensure that vulnerabilities to waste, fraud, and abuse were minimized during and after the transition. Office of Management and Budget and Office of Personnel Management officials we interviewed emphasized the importance of incorporating some of these elements in the transfer of HUD's functions. They suggested that an interagency group should be established, that the receiving agencies would need to revise their organizational structures before the new programs were transferred, and that the entities should schedule at least 6 months for planning the transfers.

³GAO/T-GGD-95-163, May 16, 1995.

⁴While S. 1145 does not specifically recommend the establishment of an interagency transition task force or the use of best practice or information system reviews, it does mandate that the resolution administrator consult with officials from RTC, FDIC, and other federal agencies about selling FHA's assets.

Establishing Internal Controls and an Asset Disposition Plan Could Provide for the Orderly Resolution of Financial Commitments

Additional lessons can be gathered from the shutdown of RTC, which was tasked with disposing of about \$443 billion in financial assets, real estate, and other assets after the failure of numerous saving and loan institutions. Most importantly, internal controls were in place to monitor the disposition of assets. We previously testified that a successful transition between entities would include ensuring that sufficient controls were in place over the assets that would be sold during the remaining life of RTC, as well as over the assets transferred from RTC to FDIC.⁵ Since the resolution agency would also need to dispose of the assets received in the course of abolishing a program within HUD, it would need to develop an asset disposition plan with specific strategies. Currently, although S. 1145 specifies that the resolution agency should develop plans for disposing of some of HUD's assets—such as a plan for marketing and selling FHA's mortgage insurance interests—it does not recommend that the agency develop an overall strategy for inventorying, assessing, and disposing of all of HUD's assets. In our previous testimony on a proposal to dismantle the Department of Commerce, we noted a similar concern—that although the proposal contained a planning requirement, it did not specify a strategy for disposing of assets.⁶

We also previously reported on the importance of developing and managing credible information systems to maximize revenues from the sale of assets. We reported on a number of problems with RTC's information systems, including inaccurate and incomplete data, which contributed to our prior designation of RTC as a high-risk area.⁷ As discussed in chapter 1, HUD also has generally unreliable information and financial management systems. Dismantling and transferring HUD's programs without—at a minimum—reviewing and addressing, where possible, the current inadequacies within these systems and developing asset disposition plans could increase the risks of fraud, waste, and abuse in the management, transfer, and sale of HUD's assets.

Finally, lessons learned about closing out contracts following the transfer of agencies' functions could be applicable. We previously stressed the importance of ensuring the adequate management and oversight of asset management contracts continuing at FDIC after RTC's shutdown. We suggested that FDIC might benefit by evaluating its own contracts in conjunction with RTC's contracts to explore opportunities for combining,

⁵GAO/T-GGD-95-163, May 16, 1995.

⁶GAO/T-GGD-95-233, Sept. 6, 1995.

⁷High-Risk Series: Resolution Trust Corporation (GAO/HR-93-4, Dec. 1992).

canceling, or extending them. This same approach could be applied to any HUD contracts transferred to other agencies, such as the Housing and Community Opportunities Agency, whose creation is mandated by S. 1145.

HUD Presents Special Considerations

Officials from two organizations with prior experience in abolishing agencies or transferring functions between agencies—the Office of Personnel Management and the National Academy of Public Administration—observed that the proposal to dismantle HUD differs from previous efforts to abolish other federal agencies. For example, several officials stated that dismantling HUD would be more complicated because the Department has approximately 10,500 staff—many more than the two other federal agencies that were recently abolished, the Interstate Commerce Commission and the Bureau of Mines. While some of HUD’s staff would probably be transferred to receiving agencies, the staffing for programs scheduled to be phased out or terminated would be reduced over time. Thus, some of HUD’s positions would eventually be eliminated. Addressing the needs of HUD’s staff in these positions would create additional administrative responsibilities for the resolution agency, including the processing of employees’ grievances and appeals.

Conclusions

Some lessons learned in dismantling or reorganizing other federal agencies could benefit the proposed resolution agency in overseeing the dissolution of HUD and the transfer of some of its functions. The creation of an interagency task force, the development of an asset disposition strategy, and the review of agencies’ functions and contracts to identify opportunities for integration have proved valuable in the past and could facilitate the actions proposed in S. 1145. Finally, a review of HUD’s internal controls and information systems could identify areas requiring especially careful monitoring to prevent waste, fraud, and abuse, particularly in resolving HUD’s huge financial commitments.

Implications of S. 1145 on the Receiving Agencies

S. 1145 proposes actions involving 12 of the Department of Housing and Urban Development's (HUD) functions. Of these, nine would be transferred to other federal agencies, one would be transferred to a newly created agency, and two would be abolished. Of the 10 functions to be transferred, the following 4 would be changed significantly:

- Housing assistance programs, including both tenant-based and project-based rental assistance and public housing programs would be replaced by a voucher assistance program that would be administered by the Department of Health and Human Services (HHS).
- Community and special population assistance programs would be combined to form block grants to states and localities, which would be administered by a newly created, independent Housing and Community Opportunities Agency.
- The federal housing mortgage insurance authority of the Federal Housing Administration would be repealed and a Federal Home Mortgage Insurance Fund administered by a Federal Home Mortgage Insurance Fund Administration within the Department of the Treasury would be created.
- The Office of Federal Housing Enterprise Oversight, a regulatory function, would be transferred to Treasury and would become responsible for monitoring the safety and soundness of the Federal Home Mortgage Insurance Fund as well as for continuing to oversee housing finance institutions.

In addition, HUD's remaining regulatory functions would be transferred to other federal agencies but would remain essentially unchanged: Fair housing would be transferred to the Department of Justice; interstate land sales to the Federal Trade Commission (FTC); real estate settlement procedures to the Federal Reserve Board; national manufactured housing to the Department of Agriculture (USDA); lead-based paint abatement to the Environmental Protection Agency (EPA); and home mortgage disclosure to Treasury. Finally, the Government National Mortgage Association (Ginnie Mae) would be abolished and the resolution administrator would establish a plan for winding up its affairs. According to the bill, this plan may provide for Freddie Mac and Fannie Mae or other private secondary mortgage market entities to assume Ginnie Mae's secondary market functions.

Housing Assistance Function Would Become a Voucher Program Administered by HHS

The housing assistance function, which is administered by HUD's Office of Public and Indian Housing, has two primary goals. The first is to provide decent and safe shelter for low-income residents at rents they can afford. The second is to revitalize communities through reductions in the number of distressed public housing units, recovery partnerships with the worst-performing housing authorities, and the promotion of mixed-income developments. The community revitalization goal takes into account the large federal investment in the nation's public housing inventory, as well as the uneven nature of housing markets across the country. Since 1937, the federal government has invested some \$90 billion in the public housing inventory. Currently, a total of 3,225 housing authorities manage 1.3 million units.

Under S. 1145, the housing assistance function would be converted to a voucher program administered by HHS. HUD's Office of Public and Indian Housing, which currently has over 1,300 staff, would be abolished. With one exception—employees who develop fair market rents for the Section 8 Housing Assistance Program—S. 1145 does not specify that personnel currently assigned to the housing assistance function would be transferred to HHS. However, the bill would authorize the personnel connected with any transferred function be made available to the head of the receiving agency as directed by the Office of Management and Budget (OMB).

HHS Sees Housing Assistance Function as Being Compatible With Its Mission, While HUD Does Not

HHS officials believe that HHS' mission is similar to HUD's in that HHS is attempting to move people to self-sufficiency. In addition, while HHS primarily provides services and assistance to low-income, needy children and families, many of these same individuals depend on public housing assistance. Approximately 8 percent of the families assisted by HHS reside in public housing, 12 percent receive rental subsidies from HUD, and over 2 percent receive rental subsidies from other sources.

HUD believes that HHS should not receive the housing assistance function because HHS traditionally administers entitlement programs intended to provide income assistance to individuals and families.¹ The public housing program is a nonentitlement program developed to provide transitional housing for people needing decent, safe, and affordable shelter while working to improve their economic condition. Approximately 40 percent of the households residing in public housing remain there for 3 years or less, and 67 percent obtain their primary income from sources other than

¹Welfare assistance was changed from an entitlement program to a nonentitlement block grant program under the recently enacted Personal Responsibility and Work Opportunity Act of 1996.

public assistance. Hence, the populations served by HUD and HHS are not the same.

In addition, HUD believes that the housing assistance function, as envisioned under S. 1145, would focus exclusively on providing housing; the community revitalization element of the federal government's work would be lost, as well as the large federal investment in the nation's public housing inventory. HUD believes that an across-the-board approach to housing assistance would be doomed to failure because housing markets nationwide are uneven. In some locations, such as New York, San Francisco, and areas of expanding growth, housing markets are so tight that rebuilding units would be the only practical means of ensuring housing for residents.

HHS Believes an Extensive Field Structure Might Be Necessary

HHS' organizational structure might not be compatible with HUD's. Whereas HUD relies on an extensive field structure to deliver housing assistance, HHS does not have such a field structure. Instead, HHS administers its income assistance programs through grants administered in partnership with state and local governments, tribes, and private-sector grantees. HHS believes that to administer the voucher program, it might need to develop an extensive field structure. However, the flexibility provided to the states under the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, commonly known as welfare reform, would allow the states to coordinate the delivery of both kinds of assistance.

Community Development Function Would Be Transferred to Newly Created Agency

HUD's community development function is administered by the Department's Office of Community Planning and Development, which has about 850 employees. The goal of HUD's community development programs is to improve the lives of low-income Americans by providing decent and affordable housing, revitalizing neighborhoods and communities, stimulating economic growth, providing economic opportunities, and delivering needed services. This summary goal is broken down into a number of subsidiary goals, such as reducing the isolation of income groups within communities and geographical areas and making housing more affordable for very low-income families through the use of tenant-based rental assistance.

According to HUD, the sole purpose of the block grant proposed under section 202 of S. 1145 is to provide assistance to eligible states, entitlement areas, and Indian tribes to be used as they determine appropriate for

meeting their community and economic development and their affordable housing needs. According to HUD, although the bill stipulates that not less than 90 percent of the total assistance provided shall be used to support eligible activities benefiting low-income families, HUD believes that serving low- and moderate-income persons is no longer a central stated purpose of the legislation. Furthermore, according to HUD, most of the subsidiary goals established in the existing legislation, such as serving the homeless and very low-income persons, are not covered by the proposed block grant.

Under S. 1145, the administration of the proposed block grant program would be the sole function of the new Housing and Community Opportunities Agency. While the bill does not provide for transferring any HUD staff to this new agency, it gives the agency's director the authority to transfer program and support staff from HUD to fill positions established by the director. But fewer staff would be needed, presumably, to administer a single grant—especially one whose funding was decreasing. The major disadvantage of the proposed reorganization, according to HUD, is that it would impede the development of a comprehensive approach to urban revitalization, since the rest of HUD's programs would be dispersed among different agencies. HUD's experience shows that a fragmented approach to the development of cities is ineffective. The proposed block grant program would be isolated. Lacking a common plan, cities would have no incentive to coordinate urban development activities. HUD believes that although a number of programs that currently require a consolidated plan have been folded into the single block grant program, the consolidated plan would no longer be a unifying element for urban programs.

HUD officials do support some consolidation. In its reinvention plans, HUD has already proposed consolidating many of its programs into three flexible performance-based funds.

Housing Finance Functions Would Be Changed Substantially

HUD is responsible for three functions related to housing finance: providing mortgage insurance, providing liquidity to lenders, and overseeing the secondary mortgage market.

Federal Mortgage Insurance Would Be Transferred to Treasury

The Federal Housing Administration (FHA) was established under the National Housing Act of 1934 to improve housing standards and conditions, to provide an adequate home financing system by insuring home mortgages and extending credit, and to stabilize the mortgage

market. FHA insures private lenders against losses on mortgages financing homes, multifamily projects, and health care facilities and against losses on loans for property improvements and manufactured homes. FHA's overall goal is to help expand homeownership and make housing affordable for all Americans. FHA serves home buyers—particularly first-time and low-income, provides affordable rental housing to low- and moderate-income renters, and provides financing for a variety of health-care facilities needed by communities.

S. 1145 would abolish FHA and replace FHA's single-family insurance program with a Federal Home Mortgage Insurance Fund operated by the Federal Home Mortgage Insurance Fund Administration within Treasury. FHA's multifamily program would be terminated.

Treasury and HUD Do Not See Missions as Compatible

Treasury does not believe that its mission is consistent with FHA's. Treasury sees its role as the formulator and manager of the federal government's domestic and international tax and financial policies. Components of this role include formulating domestic and international economic and tax policy; setting fiscal policy; governing the fiscal operations of the government; maintaining foreign assets control; managing the public debt; performing certain law enforcement functions; managing the development of financial policy; and representing the United States on international monetary, trade, and investment issues.

In contrast, Treasury believes that HUD is principally a program agency with the primary role of developing housing policy. Moreover, Treasury believes that transferring the mortgage insurance function to Treasury would, at the very least, result in a difficult transition, since Treasury is not experienced in dealing with FHA's traditional clientele, and might even have a negative impact on homeownership. Treasury recognizes that the reconfigured mortgage insurance program would rely on private mortgage insurers to underwrite and service mortgage loans, but administering this program would require staff with the appropriate skills and experience in housing to provide oversight and structure. Treasury assumes that the private mortgage insurance industry would not be able to provide underwriting and other necessary services without close oversight and corrections from a sophisticated staff. Treasury believes that it does not have staff experienced in these areas, and S. 1145 does not provide for the direct transfer of FHA's approximately 5,000 employees. Treasury said that it does not have staff with similar types of knowledge, skills, or abilities—technical or otherwise—to continue the operations of a reconfigured FHA. Treasury also finds unclear how much cross-support is

presently provided among FHA's five components: single-family housing, multifamily housing, operations, comptroller (financial control), and hospital insurance.

HUD believes that a significant narrowing of FHA's purposes and goals would occur if S. 1145 were enacted. The newly created Federal Home Mortgage Insurance Fund in Treasury would not be supported by the full faith and credit of the U.S. government, and FHA's multifamily and health care programs would be eliminated altogether. According to HUD, "this new structure would strike a devastating blow to potential home buyers. Serving only below-median, first-time home buyers would freeze out many FHA-insured home buyers who pay FHA's higher premiums because they have no conventional market alternative."² Finally, lenders would be exposed to additional risk because the federal government would reduce its insurance coverage from 100 percent to 35 percent, resulting in credit rationing and higher interest rates and origination fees.

HUD further contends that except in so far as FHA's core mission as a mortgage insurer is credit related, that mission is unrelated to Treasury's operation. To the extent that the Low-Income Housing Tax Credit program has brought Treasury into the arena of providing affordable housing, HUD concedes that some experience may be claimed. However, that program is administered by the states, applies to multifamily housing only, and is overseen by Treasury only in terms of the credit's tax treatment. Furthermore, HUD believes that the influence on the program's constituents would be weakened considerably. Treasury is not experienced in dealing with FHA's traditional clients: home buyers, tenants, mortgage lenders, realtors, builders, nonprofit developers, and state and local governments.

HUD's Secondary Mortgage Market Function Would Be Abolished

Ginnie Mae, a wholly owned government corporation, was established to support expanded affordable housing in America by providing an efficient, government-guaranteed secondary market for federally insured or guaranteed loans. Ginnie Mae is responsible for providing federal subsidies to borrowers to make housing more affordable and for implementing a mortgage-backed securities program primarily for mortgages insured by FHA and the Department of Veterans Affairs (VA). Its programs help provide financing for single-family, multifamily, and manufactured homes.

²S.1145 provides partial insurance on mortgages for families with incomes of 80 percent of their area's median income (125 percent for first-time home buyers and for homes purchased in economically distressed areas).

S. 1145 would terminate Ginnie Mae and provide for Fannie Mae or Freddie Mac or other private secondary mortgage market entities approved by the Secretary of HUD to assume Ginnie Mae's secondary market functions. S. 1145 does not provide for transferring Ginnie Mae's personnel. Currently, Ginnie Mae has 72 employees, all of whom are located in Washington, D.C.

Ginnie Mae, Fannie Mae, and Freddie Mac agreed that they share missions in that the purpose of all three is to attract capital to the housing market. But they also agreed that their operations differ because Ginnie Mae's securities are backed by the full-faith-and-credit of the federal government, while Fannie Mae's and Freddie Mac's are not. In addition, according to Fannie Mae and Freddie Mac officials, neither could securitize all FHA mortgages at the price currently charged by Ginnie Mae. Ginnie Mae believes that its termination would weaken the government's ability to serve low- and moderate-income home buyers, especially FHA's and VA's customers. Ginnie Mae also believes that Fannie Mae and Freddie Mac principally serve the conventional market and thus the low- and moderate-income segment would, if pursued, be a small part of their business and would logically occupy less of their focus or mission. However, many home buyers whose loans are purchased or securitized by Fannie Mae and Freddie Mac have low or moderate incomes. Fannie Mae, for example, expects to meet or exceed its 1996 goal for purchasing loans made to low- and moderate-income families. For 1996, that goal is 40 percent, and for 1997, it is 42 percent (for both Fannie Mae and Freddie Mac).

Both Fannie Mae and Freddie Mac officials said that they would not expect a major change in their operations if Ginnie Mae were abolished, and both were unsure how much of Ginnie Mae's business they could absorb, but they agreed that their fees would likely be higher than those Ginnie Mae currently charges.

HUD's Regulatory Functions Would Be Transferred

Fair Housing

The Fair Housing Act prohibits discrimination in any housing activities relating to the sale or rental of dwellings, in the availability of residential

real estate-related transactions, or in the provision of services in connection with such transactions because of race, color, religion, sex, handicap, familial status, or national origin. The act makes the Secretary of HUD responsible for investigating complaints and ensuring compliance with fair housing practices. The Fair Housing Assistance Program provides financial and technical support to state and local fair housing agencies that administer laws certified by HUD as being “substantially equivalent” to the federal Fair Housing Act.

S. 1145 would transfer the fair housing function and the Fair Housing Assistance Program to the Department of Justice. Justice officials believe that transferring all fair housing enforcement activities to it would have legal ramifications. The Fair Housing Amendments Act of 1988 distinguishes between the roles of Justice and HUD in fair housing enforcement. The act gave HUD the authority to quickly resolve fair housing disputes by closing them through conciliation and administrative hearings presided over by administrative law judges. According to Justice, the act intended to have an efficient and cost-effective process in place at HUD and recognizes the close ties that HUD should maintain with the housing community. In contrast, the act foresees Justice’s role in enforcement actions involving individual fair housing claims as the litigator of those cases formally charged by HUD after conciliation has failed and only after either party to the charge elects to have the case heard in federal court. According to Justice and HUD officials, this separation of duties between HUD and Justice currently works well. Both agencies are opposed to both a previous proposal and this proposal to transfer HUD’s fair housing functions to Justice.

HUD believes that transferring the fair housing function to Justice would compromise the Congress’ intent to ensure that fair housing would be an integral part of federal housing policy. Also, the transfer would contravene decades of legal precedent ordering the Secretary of HUD to integrate fair housing concerns into the administration of HUD’s programs.

Transfer Would Pose Organizational and Staffing Issues

The Fair Housing Act and the Fair Housing Assistance Program are administered by 265 HUD employees.³ Of this total, 233 are located in HUD’s field offices. Most of the day-to-day intake, investigation, and conciliation, as well as the ongoing community-based technical assistance and customer service, occurs in these offices.

³According to HUD, the Office of Fair Housing and Equal Opportunity has 664 staff. About 265 of those staff handle complaint-related matters and the Fair Housing Assistance Program. The other staff are devoted to ensuring fair housing in all HUD-funded programs. These figures do not count the staff assigned by the Office of General Counsel or the Office of Administrative Law Judges.

Justice believes that it has neither the field organization nor the investigative staff to carry out the fair housing program effectively. One official told us that Justice is an agency of litigators, not investigators. To the extent that Justice is an investigative agency, its investigative function is, by and large, carried out by the Federal Bureau of Investigation. According to the Justice official, investigating every fair housing complaint, regardless of merit, as the act requires would not make productive use of the Bureau's scarce resources. Moreover, Justice has always focused on litigating large cases with a high impact, not on investigating and conciliating individual complaints. In addition, several officials cited general problems that arise when a litigating agency picks up an administrative agency's responsibilities. For example, under the Fair Housing Assistance Program, HUD monitors the state and local fair housing agencies that receive funds, certifies participating states, and revokes certifications when agencies are not performing adequately. Justice, according to some of its officials, is not set up to administer such programs.

HUD believes that Justice is neither familiar with housing programs, which generate large numbers of inquiries, nor well acquainted with local communities and key players, as is necessary for a referral system to function effectively. Furthermore, changes in this area would adversely affect recent improvements in customer service. Other customers of HUD's fair housing operation are state and local agencies enforcing state and local laws. Relationships with these entities have developed over several years and provide an important basis for sharing skills, knowledge, and resources.

HUD further contends that, depending on how Justice implemented the functions, a transfer could produce subtle differences as well. HUD's staff are carefully trained in intake and interview skills, frequently have skills in analyzing and handling difficult people, and are accustomed to handling many challenging inquiries. Justice, by contrast, has more lawyers handling the same functions, and to some inquirers, lawyers might be more intimidating than HUD's staff. Justice officials told us that if HUD's staff were transferred, the investigators would be difficult to place because their grade structure is higher than that of Justice's investigative staff.

Interstate Land Sales

HUD's function under the Interstate Land Sales Full Disclosure Act is to ensure that certain developers of subdivisions (1) provide adequate

disclosure to purchasers through the registration of their properties and (2) do not engage in any fraudulent or deceitful transaction, practice, or course of business in the sale of lots in their subdivisions. S. 1145 would transfer this function to FTC.

The mission of both HUD and FTC is to protect consumers; therefore, both agencies believe their missions are complementary. However, according to FTC staff, the methods and type of personnel used by the two agencies to handle consumer disclosure and fraud differ significantly. According to an FTC official, FTC does not (1) administer registrations of this type, (2) have an organization to handle individual complaints, or (3) have criminal enforcement authority. Furthermore, HUD believes that developers might not comply with the act unless steps were taken to ensure compliance through adequate reviews of registration and exemption requests.

**A Small Staff in Headquarters
Currently Administers the
Program**

Within HUD, the Interstate Land Sales and Real Estate Settlement Procedures Act (RESPA) Division of the Office of Consumer and Regulatory Affairs carries out the Department's responsibilities under the Interstate Land Sales Full Disclosure Act. Employees are directly assigned to the program, and no field staff enforce the act.

FTC officials said that if this function were transferred to FTC, it would probably be located in the Bureau of Consumer Protection, Division of Enforcement. However, FTC has undergone significant downsizing and is currently level-funded. FTC staff emphasized that the agency could not effectively perform the function unless the legislation transferring the program specifically allocated enough funds and full-time employees to cover the program's direct (e.g., salary costs for the transferred employees) and indirect costs (e.g., increased overhead and administrative costs that would be incurred in collecting and administering the fees and maintaining the registration files.) Section 144 of S. 1145 would allow (but would not require) OMB to make available to the receiving agency funds that were available to HUD in connection with the transferred function.

**Real Estate Settlement
Procedures**

RESPA requires lenders to provide applicants for home mortgages with timely good-faith estimates of the closing costs they will be expected to pay upon settlement. The purpose of RESPA is to eliminate the payment of unearned fees in connection with settlement services provided in mortgage transactions. Section 8 of RESPA prohibits kickbacks and referral fee arrangements. Specifically, it prohibits the giving or accepting of any fee, kickback, or thing of value for referrals of real estate settlement

service business involving mortgage loans. S. 1145 would transfer HUD's RESPA responsibilities to the Federal Reserve Board.

A Federal Reserve Board official indicated that S. 1145 does not represent the first attempt to transfer HUD's RESPA functions to the Board. Bills from both houses of Congress dealing with regulatory relief previously called for the transfer of HUD's regulatory requirements under RESPA to the Board.⁴ According to this official, the Federal Reserve Chairman spoke in opposition to the transfer, particularly of RESPA's section 8 provision.

According to HUD officials, the intended goal of RESPA might change if it were transferred to the Federal Reserve Board. The Board's focus is on the financial responsibilities of a central bank, not on mortgage settlement services. In addition, unlike the Board, RESPA covers not only financial institutions but also other lenders and other settlement providers, such as real estate agents and brokers, title agents and underwriters, and credit-reporting companies. The customers and clients of RESPA are among HUD's traditional constituents. New relationships and networks would have to be established by the Federal Reserve Board in order to continue the same level of service.

Minimal Number of HUD Employees Currently Perform in the Function

According to an associate division director of the Federal Reserve Board, the RESPA function, if transferred, would most likely be placed in the Board's Division of Consumer and Community Affairs. This division could accept the transfer, but it would have to request additional capacity from the Board. In addition, this official believed that a complete transfer of the function might not be the Board's preference; the Board might want to integrate the function into its current operations rather than administer the function as HUD currently does.

According to HUD, five employees are assigned to the RESPA function. In addition, six staff from HUD's Office of General Counsel spend at least 50 percent of their time on RESPA issues. Under section 144 of S. 1145, OMB can make available to the receiving agency funds that were available to HUD in connection with the transferred function.

⁴On March 30, 1995, H.R. 1362, the Financial Institutions Regulatory Relief Act of 1995, was introduced. Under this bill, rule-writing authority for all provisions of RESPA would have been transferred to the Board. Also on March 30, 1995, S. 650, the Economic Growth and Regulatory Paperwork Reduction Act of 1995, was introduced. As under the House bill, rule-writing authority for all provisions of RESPA would have been transferred to the Board.

National Manufactured Housing

The manufactured home (a dwelling that is not site-built) industry is the only segment of the American housing industry that is regulated by a national building code and a federally controlled enforcement system. The National Manufactured Housing Construction and Safety Standards Act of 1974 defines various criteria that HUD is to employ in establishing standards for activities such as conducting research and testing and evaluating relevant data on the construction and safety of manufactured homes. HUD's standards are considered mandatory and preemptive of all state laws. The standards cover such topics as fire safety, body/frame construction requirements, plumbing systems, and heating, cooling, and fuel-burning systems. S. 1145 would transfer HUD's manufactured housing function to USDA.

USDA officials said the manufactured housing program complements the core mission and objectives of the Department's Rural Housing Service (RHS), but USDA does not finance many manufactured homes. (Most housing assistance involves homes with foundations.) In the few instances when USDA is involved with manufactured housing, it follows HUD's building standards. Currently, USDA does not have the resources to set its own standards.

HUD believes that the influence of the program on its constituents (producers and home buyers) would probably diminish under USDA because RHS lacks technical expertise in manufactured housing. In addition, USDA might not be able to regulate manufactured housing in urban and suburban developments, where its use has recently increased. For example, Los Angeles changed its zoning laws to allow the use of manufactured housing to promote affordable homeownership and help stabilize troubled neighborhoods.

HUD Program Has Outside Support

According to HUD, 18 full-time permanent employees are assigned to its Manufactured Housing and Standards Division, which has the principal responsibility for administering the act's requirements. The staff include structural, electrical, and mechanical engineers, as well as management staff with relevant academic backgrounds. In addition, the program receives administrative support from the National Conference of States on Building Codes and Standards, as well as 36 state administering agencies and 25 private engineering and inspection agencies. State agencies, which currently share HUD's responsibility for enforcing this program's requirements, are predominantly located within housing-oriented departments within their state governments and their missions are, therefore, more likely to be compatible with HUD's than with USDA's.

RHS currently has about 130 staff in headquarters and 5,056 staff in its field offices. The staff are typically loan specialists who process and service loans and guarantees for residential housing and for community and business programs. RHS officials said that assuming the manufactured housing function's broad enforcement powers, such as the powers to issue subpoenas and use injunctive relief, should not be a problem for RHS. RHS employees are accustomed to ensuring that requirements are being met for their respective programs.

Lead-Based Paint Abatement

HUD is charged with providing safe and affordable housing and is focused on reducing childhood lead poisoning without disrupting the housing market. HUD provides technical guidance to housing authorities and health departments on detecting and controlling lead-based paint hazards in housing, provides grants to local governments to adopt housing-based strategies, and works to establish consensus among various housing interests. For example, according to HUD, it has worked to develop sound working relationships with the local housing and health departments that administer HUD's lead-based paint grant program and with the housing industry in general.

S. 1145 would transfer any portion of HUD's lead-based paint function that was not repealed by the bill to EPA. EPA's stated goal is to reduce lead exposures to the fullest extent practicable and to avoid high blood lead levels. The agency is particularly interested in reducing the risk of exposure to children. While EPA officials believe that EPA's and HUD's missions are complementary and that the agencies work closely together to help reduce childhood lead poisoning, they find HUD's mission to be broader. Whereas HUD performs risk assessments and oversees the management (i.e., abatement, interim controls) of lead-based paint in public housing, EPA does not believe it has the expertise, experience, or willingness to undertake these activities. However, EPA believes that it could easily assimilate other activities that the bill proposes to transfer, such as administering grants into its current structure.

Conversely, HUD said the mission of its lead-based paint program is not congruent with EPA's core mission. According to HUD, EPA is charged with setting standards for lead levels in paint, dust, and soil; conducting training; and accrediting laboratories. HUD also said that it has issued proposed regulations to incorporate lead-based paint requirements across all federally assisted housing programs at HUD. Without authority over the housing programs, EPA would be unable to effectively monitor these

A Transfer Would Pose
Organizational and Staffing
Issues

requirements, according to HUD. In addition, HUD questioned the level of priority that lead-based paint issues would receive at EPA.

HUD's Office of Lead-Based Paint Abatement and Poisoning Prevention relies primarily on its 25 full-time headquarters employees to operate the program. No field staff are assigned directly to the program. According to EPA officials, if HUD's lead-based paint program were transferred to EPA, the likely recipient would be the Chemical Management Division (CMD) within the Office of Pollution Prevention and Toxics. This division currently has 58 staff, the majority of whom work on lead and asbestos issues. If the entire function were transferred to EPA (with the 25 staff), the division would have to reorganize to accept HUD's staff. In addition, accepting and integrating HUD's Senior Executive Service and grade 15 positions into the division would be very difficult, given the division's grade structure.

Home Mortgage Disclosure

The Home Mortgage Disclosure Act (HMDA) was enacted to provide the public with information for determining whether financial institutions are serving the housing needs of their communities. Additionally, information collected under the act is used to assist regulatory agencies in identifying possible discriminatory lending patterns and enforcing antidiscrimination statutes. HUD's responsibilities under HMDA involve compiling submissions from mortgage companies on the applications these companies receive and on the home purchase and home improvement loans they originate or purchase. S. 1145 would transfer this function to Treasury.

Treasury currently collects HMDA data from national banks and thrifts. Specifically, the Office of the Comptroller of the Currency and the Office of Thrift Supervision collect and apply HMDA information in the context of compliance with the Community Reinvestment Act, the Equal Credit Opportunity Act, and the Fair Housing Act. However, Treasury does not regulate mortgage companies and lacks experience in the application of HMDA data for such entities. Accordingly, Treasury believes that transferring HUD's data collection responsibilities under HMDA to Treasury would be inconsistent with Treasury's existing mission. Treasury said it cannot predict what impact a transfer would have on the current users of HMDA data or on the affordable housing market. Treasury assumes that separating the collection from the application of the data for affordable housing purposes could have a significant adverse impact on low- and moderate-income home buyers and renters.

Conversely, according to the HUD official overseeing HUD's HMDA responsibilities, the goal of the function would complement Treasury's mission. He pointed out that Treasury already oversees the act's reporting requirements for other agencies that regulate financial institutions, including the Office of the Comptroller of the Currency and the Office of Thrift Supervision. He added that the transfer should have no effect on the program's customers.

HUD's responsibilities under HMDA are generally carried out by five contract employees who process the data submissions from about 1,000 lenders annually. The HMDA function is highly automated. Two HUD employees implement the Department's HMDA responsibilities part-time.

Oversight of Fannie Mae, Freddie Mac, and the Fund Would Be Transferred to Treasury

Title XIII of the Housing and Community Development Act of 1992, known as the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, established the Office of Federal Housing Enterprise Oversight (OFHEO) as an independent office within HUD. The primary function of OFHEO is to ensure the financial safety and soundness and the capital adequacy of Fannie Mae and Freddie Mac.

Under S. 1145, OFHEO would be transferred to Treasury, and the Director of OFHEO would monitor the safety and soundness of the newly created Federal Home Mortgage Insurance Fund. OFHEO believes that its program goal complements Treasury's core mission in that Treasury is broadly concerned with minimizing the federal government's borrowing needs and with maintaining the smooth functioning of the nation's financial markets.

Treasury's Office of the Comptroller of the Currency and Office of Thrift Supervision are the safety and soundness regulators for national banks and savings and loan associations. To the extent that OFHEO's mission is to oversee the safety and soundness of Fannie Mae and Freddie Mac, Treasury believes that this mission is consistent with one of its own roles.

However, OFHEO believes that the significant synergies created by its current relationship with other parts of HUD would be lost, while no important compensating benefits would be gained. HUD would save no money from OFHEO's departure; OFHEO is fully funded by assessments from its enterprises and reimburses HUD for any services it uses. OFHEO believes that it needs to be familiar and involved with broader national housing policy issues. Fannie Mae and Freddie Mac have a dominant influence on most aspects of housing finance. To properly evaluate the impact of safety

Appendix I
Implications of S. 1145 on the Receiving
Agencies

and soundness regulations on the broader issues, as well as the impact of other policy decisions on safety and soundness, OFHEO believes that it should remain a part of the department making these decisions.

In addition, OFHEO believes that its goal could conflict with Treasury's core mission if appropriate safety and soundness actions for Fannie Mae, Freddie Mac, or the federal home mortgage insurance fund were viewed, at certain times, as having an undesirable effect on the performance of the economy's housing sector, the economy as a whole, or other depository institutions.

According to OFHEO, S. 1145 does not require Treasury to make any significant organizational changes because OFHEO would retain its independent authority for internal management, budget, regulations, examinations, and enforcement actions. Treasury agrees. In addition, S. 1145 would transfer all 64 of OFHEO's permanent full-time employees to Treasury. However, if its mission were expanded to monitor the safety and soundness of the insurance fund as well as of Fannie Mae and Freddie Mac, OFHEO believes it would likely have to hire additional staff.

Financial Commitments Inherited by the Resolution Agency

FHA's Mortgage Insurance

FHA administers about 40 mortgage insurance programs, including programs for insuring single-family and multifamily mortgages, as well as loans for property improvements, cooperatives, condominiums, housing for the elderly and the handicapped, and hospitals. In July 1996, FHA had insurance on 6,490,546 single-family loans totaling about \$364 billion. It had insurance on an additional 15,876 multifamily loans and 474,750 property improvement and manufactured housing loans, totaling about \$48 billion and \$6 billion, respectively. FHA also held 126,467 notes with an unpaid principal balance totaling about \$8.3 billion and held 26,531 properties acquired at a cost of about \$2.1 billion. Overall, according to FHA's fiscal year 1995 financial statement, liabilities exceed assets by \$3.3 billion. According to Price Waterhouse's latest actuarial study, the Mutual Mortgage Insurance Fund—FHA's principal insurance fund for single-family housing—had an economic net worth of over \$7 billion as of September 30, 1995.¹ That is, the cash available to the fund, plus the net present value of all future cash inflows and outflows expected to result from the outstanding mortgages in the fund, was over \$7 billion.

The bill would require the resolution agency to sell FHA's mortgage insurance interests so that by the end of its third year, the agency would realize at least \$100 million—to be used to capitalize a newly created insurance fund in Treasury. These actions must be done in accordance with a plan to be prepared by the resolution agency within 6 months of the bill's enactment and submitted to the Office of Management and Budget (OMB) and the Congress. OMB must, in turn, certify that the portion of the plan concerning the sale of FHA's mortgage insurance interests will result in no net cost to the federal government. The resolution agency faces important limitations in accomplishing this sale, and the bill recognizes that the sale of FHA's insurance interests would not relieve the federal government of its original commitment of the full faith and credit of the United States to cover 100 percent of any losses that lenders might sustain from these loans. In addition, the bill would allow the resolution agency to target the most valuable or marketable insurance interests for sale during the first 3 years and would require the resolution agency to maximize the net present value return from the sale of these interests without incurring any net cost to the federal government. The bill would also require the

¹FHA has four insurance funds—the Mutual Mortgage Insurance (MMI), General Insurance (GI), Cooperative Management Housing Insurance (CMHI), and Special Risk Insurance (SRI) funds. The MMI fund provides mortgage insurance principally for 30-year fixed rate single-family home mortgages and is required to be actuarially sound. The GI fund provides mortgage insurance for multifamily properties, including nursing homes and hospitals, and is not required to be actuarially sound. In fact, the GI fund is dependent on budgetary appropriations to sustain operations. The CMHI and SRI funds have had very little activity in recent years and, according to HUD's Inspector General, represent a comparatively small exposure to additional losses.

resolution agency to protect investors in and lenders for mortgages insured by FHA and to minimize the risk of loss to the federal government (including Ginnie Mae) resulting from the nonpayment of insurance claims on defaulted mortgages insured by FHA.

While the single-family loans insured by FHA are backed by reserves and FHA's single-family portfolio has a positive net economic value, in total FHA had a negative net worth as of September 30, 1995. According to FHA officials, the resolution agency would be unlikely to realize the minimum \$100 million in initial capitalization from the sale of FHA's mortgage insurance interests. Such a sale would reduce the capital reserves of the existing fund without proportionally reducing the federal government's exposure to losses, according to FHA. Therefore, FHA might not be able to sell its mortgage insurance interests without incurring a net cost to the federal government. In contrast, officials from the Mortgage Insurance Companies of America believe that \$100 million could be realized from the sale of FHA's mortgage insurance interests. They note that potential customers include the reinsurance market, mortgage insurance companies, and other investors and syndicates. The value to purchasers would depend on the model they would use for estimating the value of the portfolio. Furthermore, the sale of FHA's insurance portfolio might allow some private mortgage insurers to better diversify their risk. Our analysis shows that the FHA-insured single-family mortgages made in 1983 and in earlier years would have net positive cash flows from 1998 through the end of their terms and would, therefore, be likely candidates for purchase by the private sector. While the present value of the net cash flows from this part of FHA's portfolio exceeds \$100 million, any private investor would likely require a discount in purchasing these cash flows because private investors—unlike FHA—need to earn profits sufficient to cover tax expenses and shareholders' returns while maintaining sufficient capital reserves.

Selling FHA's mortgage insurance interests would not relieve the federal government of its initial commitment to cover 100 percent of any losses sustained by lenders holding FHA-insured loans. As noted, FHA-insured single-family loans originated in 1983 and earlier would be likely candidates for sale if a purchaser were required to pay anticipated claims. However, if a purchaser were also required to refund any up-front premiums for prepaid loans,² FHA would likely need to pay the purchaser a fee to cover a portion of the up-front premium. The remaining years on the

²Loans insured between October 1984 through June 1991 do not have annual premiums. In 1998, loans insured during fiscal years 1993, 1994, and 1995 will not have aged to the point where annual premiums plus proceeds from the sale of properties exceed expected claims and administrative expenses.

insured single-family portfolio extend beyond the life of the resolution agency. The unpaid principal balance on the FHA-insured single-family loans originated in 1983 and earlier represents only about 5 percent of the entire single-family insured portfolio. The unsold portfolio would be transferred to Treasury. Yet any lender that held an FHA-insured mortgage would need to be protected, even when the loan's mortgage insurance interests had been sold. That is, the federal government would remain liable for any claims by a lender holding an FHA-insured loan if the entity that purchased the mortgage insurance interest proved unable to pay the claim. In effect, the sale of mortgage insurance interests might not relieve the federal government of all liability for future claims. To protect itself against the possibility of a purchaser's being unable to pay claims, the federal government could require that the purchaser meet certain conditions, including having a AAA rating and establishing an escrow account, according to officials of the Mortgage Insurance Companies of America.

Guarantees of Mortgage-Backed Securities

The Government National Mortgage Association (Ginnie Mae) guarantees the timely payment of principal and interest on privately issued securities that are backed by pools of FHA-insured and VA- and Rural Housing Service (RHS)-guaranteed mortgages. In fact, nearly all FHA-insured, VA-guaranteed, and RHS-guaranteed mortgages are in Ginnie Mae pools. The maturities on these guarantees are for up to 40 years. At the end of fiscal year 1995, Ginnie Mae had outstanding guarantees of mortgage-backed securities totaling \$464 billion. The program had negative net outlays of \$464 million in fiscal year 1995. The Mortgage-Backed Securities Program provides a means for channeling funds from the nation's securities markets into the housing market. The federal government's full-faith-and-credit guaranty of these securities makes them widely accepted in sectors of the capital markets that otherwise would not be likely to supply funds to the mortgage market. Approximately 70 percent of the funds used to purchase Ginnie Mae-guaranteed securities come from nontraditional mortgage investors, including pension and retirement funds, life insurance companies, and individuals.

The bill would terminate Ginnie Mae and require the resolution agency to establish a plan for winding up its affairs. Specifically, the bill would transfer Ginnie Mae's authority to the resolution agency, but only to the extent necessary to fulfill the outstanding obligations and settle the business of Ginnie Mae. According to the bill, the resolution agency's plan for winding up Ginnie Mae's affairs might provide for Fannie Mae, Freddie

Mac, or other private secondary mortgage market entities to assume Ginnie Mae's secondary market functions. The bill also specifies that the plan should include any recommendations for legislation that might be needed for terminating Ginnie Mae and should be submitted to the Congress within the first year of the bill's enactment.

Ginnie Mae's pledge to back investments with the full faith and credit of the United States would be an important restriction on any effort to resolve Ginnie Mae's outstanding guarantees. The bill recognizes these commitments in section 143, which provides that all agreements in effect prior to the transfer of a function shall continue in effect according to their terms until modified, terminated, superseded, set aside, or revoked in accordance with law. While the bill does not specify how these guarantees should be resolved, the resolution agency would need to administer them during its term and arrange for their continued administration beyond its term. In planning to wind up Ginnie Mae's functions, the resolution agency would also need to consider the impact of Ginnie Mae's termination on veterans and rural home buyers whose loans would no longer be securitized by Ginnie Mae.

Section 8 Contracts

To increase the supply of affordable housing, HUD provided contracts to developers that guaranteed for a certain time period the payment to landlords of a portion of the rent on units in those properties. These contracts were important considerations for the lenders that provided mortgages for the projects. In addition, many of the loans for these projects were insured by FHA. According to HUD's latest data, about 1.4 million units at about 20,400 multifamily properties receive section 8 project-based subsidies. Of these properties, 8,636 have FHA-insured mortgages whose unpaid principal balances total nearly \$18 billion. Over time, these properties' section 8 subsidies have increased dramatically, and today many of the section 8 contracts are about to expire. According to April 1996 data, contracts covering about 85 percent of the project-based section 8 units in the insured section 8 portfolio will expire by the end of 2002 and about 98 percent by the end of 2006. Without a continuation of the subsidy, many of the projects would not be economically viable. About half of the project-based section 8 units in the uninsured section 8 portfolio will expire after 2002. For FHA-insured properties with section 8 contracts, a reduction in the contract would lead to defaults and claims against FHA's insurance fund.

Recognizing that many properties could not cover expenses and borrowers might eventually default on their mortgages if the properties were forced to compete in the commercial market without their project-based section 8 subsidies, in May 1995 HUD proposed restructuring FHA-insured mortgages to bring income and expenses into line. This proposal—called “mark-to-market”—has undergone some changes since, and the fiscal year 1997 appropriation for HUD includes a demonstration program covering properties with contract rents that exceed 120 percent of their area’s fair market rents. Under this demonstration—for owners who agree to participate—HUD has the flexibility to use tools such as reinsurance, debt forgiveness, and second mortgages to decrease the escalating costs of section 8 rental assistance, prevent mortgage defaults, protect residents against dislocation, and resolve associated tax issues. Owners of projects with rents exceeding 120 percent of their area’s fair market rents who do not choose to participate in the demonstration would have their contract rents reduced to 120 percent of the fair market rents. Also, the appropriation requires HUD, if requested by the project owner, to renew for 1 year contracts with rents below 120 percent of the fair market rents.

As described in chapter 2, the bill envisions providing housing assistance to individuals through a voucher program, rather than through public housing, project-based assistance, and voucher and certificate programs, as HUD does today. Moving to a voucher-only program would require the resolution agency to resolve existing project-based section 8 contracts that expire during the 5-year transition period. In fact, the bill includes mark-to-market provisions that would authorize the resolution agency to take the actions necessary to ensure the financial viability of multifamily housing projects with project-based rental assistance contracts expiring before the end of the resolution agency’s term. Specifically, the mark-to-market provisions in the bill allow for remedies to make economically viable projects with section 8 assistance contracts—particularly those that have FHA-insured mortgages. The bill would also protect the validity of the section 8 assistance commitments made before the effective date of the bill; any section 8 assistance commitments still in effect upon the termination of the resolution agency would be transferred to the voucher administrator in HHS.

The resolution agency faces a challenge in reducing the costs of subsidies for multifamily housing projects with project-based assistance contracts while maintaining the federal government’s commitment to the projects’ owners. Furthermore, not renewing section 8 contracts or reducing the

federal subsidy could have financial consequences for the state housing finance agencies (HFA) that have provided financing for some of the projects. In fact, the 1997 appropriation specifically exempts state HFAS from the contract rent ceiling of 120 percent of the fair market rent. That is, section 8 contracts for projects with financing or insurance from state HFAS may be renewed at their current contract rents even if these rents exceed 120 percent of the fair market rents. While not placing any of its section 8 ratings under review, in July 1995 Moody's Investors Service disclosed to investors its concern that legislative proposals that negatively affect revenue streams of section 8 projects could adversely affect the financial feasibility of those projects. To induce projects' owners to voluntarily renegotiate their section 8 contracts, the resolution agency would need to provide a financial incentive, including debt forgiveness as well as a mechanism to offset or mitigate any tax consequences of debt forgiveness. For any section 8 contracts that expire after the termination of the resolution agency, the federal commitments would endure and be administered by the voucher administrator.

CDBG Section 108 Loan Guarantees

The bill would merge HUD's programs/grants for community revitalization, housing development, and assistance for the homeless into one block grant that would be administered by a newly created agency. The new agency would inherit HUD's outstanding commitments for loan guarantees made under one of the programs to be merged—the Community Development Block Grant (CDBG) program. Under CDBG, communities and states that receive grants can, under section 108 of the Housing and Community Development Act of 1974, apply for additional financing in the form of loans. HUD guarantees notes issued by grantees for up to five times their current year's CDBG grant and treats future CDBG grant funds as collateral for the loans. The proceeds from these notes can be used to finance community and economic development projects that are too large to be financed from the grantee's annual grant.

The amount of the outstanding section 108 loan guarantees as of September 30, 1995, was \$678 million. The maximum repayment period for these loans is 20 years. While the loan guarantees are covered by the grantees' future program funds, the decline in funding for CDBG entitlement grantees envisioned in the bill would make repaying lenders more difficult for these grantees, potentially resulting in greater claims against HUD, which guarantees these loans.

In addition, HUD's role as a collection agent for \$131.4 million in outstanding notes from section 108 offerings would have to be transferred to another agency. Financing for the section 108 program is currently provided through the sale of guaranteed notes in periodic public offerings. However, prior to July 1, 1986, the guaranteed notes were purchased by the Federal Financing Bank, under the Department of the Treasury. Although the notes are no longer sold to the Federal Financing Bank, HUD continues to serve as a collection agent for the bank.

Other Funds Borrowed by HUD

Several HUD programs have the authority to borrow funds for their operations. During the 1960s, 1970s, and 1980s, public housing authorities (PHA) and Indian housing authorities borrowed funds from the private sector and from the Federal Financing Bank to finance the construction and rehabilitation of low-rent housing. These funds are being repaid by HUD on behalf of the PHAs. In addition, HUD borrows from Treasury to finance section 202 loans, and FHA's Mutual Mortgage Insurance fund borrows to cover cash shortfalls. As of September 30, 1995, HUD projected that its payments of principal on the borrowed funds would total \$15.3 billion. Additionally, HUD reported that during fiscal years 1994 and 1995, it paid \$1.2 billion in interest on the borrowed funds.

Comments From the Department of Housing and Urban Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
THE SECRETARY
WASHINGTON, D.C. 20410-0001

January 24, 1997

Mr. James F. Hinchman
Acting Comptroller General
of the United States
U.S. General Accounting Office
Room 7B02
441 G Street, NW
Washington, DC 20548

Dear Mr. Hinchman:

Thank you for the opportunity to review and comment on the draft report "Implications of Legislation to Dismantle HUD."

The report is deeply flawed in its methodology, content, and conclusions. It fails to fully discuss the problems S.1145 would create by dismantling the Department and slashing the funds for 4,000 rural, suburban, and urban communities. The Department's comments focus on three major issues the report does not fully discuss:

- the harm to the Department's customers;
- the loss of a national policy for the needs of communities -- rural and suburban as well as urban -- and for the housing needs of low and moderate income Americans and first-time homebuyers; and
- the difficulties involved in transferring Department's functions to other agencies or other levels of government.

As GAO states, its mission was to examine "the potential impacts of these changes on the customers of these programs." The report utterly fails to do so. Instead of a meaningful analysis, the survey relies on anecdotal survey information. There is little or no methodological rigor which would provide a sound basis for understanding the impact of dismantling the nation's housing and community development agency. Devoid of detailed analysis, the report amounts to little more than a six-state opinion poll. Without substantive analysis, the value of this report is questionable.

See comment 1.

See comment 2.

**Appendix III
Comments From the Department of Housing
and Urban Development**

Harm to the Department's Customers

See comment 3.

The bill would have devastating effects on the Department's low and moderate income customers and their communities in rural, suburban, and urban areas.

See comment 4.

S.1145 would substantially reduce homeownership opportunities. The bill's proposals relating to single family insurance, including the elimination of the current full-faith and credit backing of the Federal Government and the limitation on the amount of the home loan insured, will leave low and moderate income borrowers unserved.

Since most of the FHA borrowers would not qualify for private mortgage insurance (because of downpayment, credit or other requirements), the national rate of homeownership will decline as a result.

See comment 5.

Similarly, the report does not address the adverse effects of terminating FHA insurance for rental housing. The great majority of tenants in HUD-insured unsubsidized properties are lower income residents who do not have alternative housing opportunities.

The bill's call for elimination of public housing and replacing it with housing vouchers could have significant impacts on all communities.

See comment 6.

A 1994 GAO report identified the problems with this "one size fits all approach:" in many communities public housing is a more cost effective mechanism for providing housing assistance for the poor than are housing vouchers. For example, in Dade County, Florida, vouchers cost twice as much as public housing. Thus, the same amount of money would provide housing for only half as many people.

See comment 7.

The impact on communities and on the poor of combining the Community Development Block Grant, the HOME program and the Homeless programs -- with a 40 percent cut -- will also be devastating. These cuts are on top of the \$6.3 billion cut in the Department's budget in Fiscal Year 1995. The report contains no analysis on how more cuts will impact communities. GAO's report should be clear that such reductions will sharply reduce the ability of communities to provide housing, create jobs, and help the homeless become self-sufficient.

For example, the rural, suburban, and urban communities throughout the State of North Carolina will lose \$50 million dollars in the first year alone. Each year, the loss will increase. Over four years, the State will lose over \$250 million -- over 60 percent of which currently goes to rural communities. These cuts are compounded when the bill eliminates the States's public housing which currently serves 95,000 North Carolina residents.

**Appendix III
Comments From the Department of Housing
and Urban Development**

See comments 7
and 8.

In every State, the cuts in funding will hit rural areas harder than other areas because the percentage of funding for smaller communities will decrease substantially. In addition, the elimination of Ginnie Mae -- an organization that is a model of efficiency -- will hurt both moderate income residents in rural areas and veterans trying to secure mortgages. Utah, Nebraska, Wyoming, Nevada, South Dakota, and other States with predominately rural communities will be hit harder than most.

The Homeless programs and the HOME programs were created in large part because communities were not using their CDBG grants to address the needs of low-income renters or of the homeless. Eliminating the targeting and collapsing the specific goals of the programs into a single grant will once again leave these groups literally out in the cold.

Loss of a National Policy

The GAO Report ignores the leadership, coordination and focus on housing and community development that a single cabinet-level agency provides.

There is a vital need for Federal leadership in highlighting the challenges in our rural, suburban, and urban communities. Only a single agency can efficiently provide accurate and timely information about the severity and complexity of the problems and marshal the energy and commitment to address them.

Without strong Federal initiative, it is difficult to imagine, for example, the recent successes in serving the homeless or boosting the homeownership rate.

This Federal leadership is best provided through a cabinet level agency. Only cabinet status allows the agency and its leader to have direct access to the highest councils of government and to be an effective advocate for housing and communities with the White House and Congress as decisions are rendered on policies and budgets.

Difficulties Involved in a Transfer of Functions

The report minimizes the difficulties that would be involved in a transfer of functions to other agencies and other levels of government.

In many cases, agencies slated to receive the Department's functions have questioned their own ability to effectively carry out the function. In all cases, these receiving agencies have said that if they were required to take on the Department's functions, they would need additional staff and resources. Thus, there would be no direct savings coming from the break-up of the Department, and there could be additional costs. The report contains no analysis of these proposed organizational shifts.

See comment 9.

See comment 10.

**Appendix III
Comments From the Department of Housing
and Urban Development**

See comment 10.

Examples of potential difficulties in the transfer of function are:

The Department of the Treasury, which is slated to administer the mortgage insurance function, considers the proposed transfer a "difficult fit." Treasury sees itself as the formulator and manager of the Federal Government's domestic and international tax and financial policies, and not as an agency to develop housing policy.

The Department of Justice, which is supposed to receive the Fair Housing enforcement functions, believed that the Fair Housing Act would be undermined if both the Justice and HUD functions were combined in a single agency. The HUD mission of quickly resolving fair housing complaints through conciliation and administrative hearings would be replaced with the Justice Department's mission of taking fair housing cases to court.

In the case of intergovernmental transfers of functions, States and localities lack the political systems and financial capacity to provide essential funding to their communities.

Under S.1145 -- because of its 40 percent funding cut -- States and localities would need to raise taxes to keep the same level of services, to prevent neighborhoods from declining and to spur the recent resurgence we have seen in many cities.

GAO's survey of State officials found that "almost all of these officials believed their States would not provide additional funds because of (1) inability or unwillingness to increase State tax rates and (2) the State's balanced budget requirement."

In addition to scattering the Department's integrated functions to other agencies, the bill would create four new bureaucracies: (1) the Office of Federalism, (2) Federal Housing Voucher Agency, (3) Housing and Community Opportunities Agency, and (4) Federal Home Mortgage Insurance Fund Administration. The Department has already made substantial progress in streamlining its staff and programs and believes that creating new bureaucracies is not the answer.

Finally, key support functions -- policy development, legal advice and support, budgeting, information systems, accounting systems -- have been worked together on an agency-wide basis, and cannot continue to work together efficiently if they are parceled out to individual programs.

The field staff work together, supporting more than one program. For example, both the FHEO Field staff and the General Counsel's staff work with all program offices. The report does not address how these key support functions are maintained if the Department's programs they support are separated.

**Appendix III
Comments From the Department of Housing
and Urban Development**

Conclusion

The break-up of the Department and the changes to the Department's programs proposed in S.1145 would devastate the Department's customers in 4,000 rural, suburban, and urban communities. It will also hurt the nonprofits, businesses, financial institutions, housing authorities, and State and local governments with whom the Department works to revitalize communities because with fewer resources and no coordination at the Federal level, the massive burden will shift to them. The real losers from this bill would be very-low income families, poor neighborhoods, minority and low-income homebuyers, etc. In short, enacting the bill means the United States is giving up on communities.

Sincerely,



Dwight P. Robinson
Acting Secretary

The following are GAO's comments on the Department of Housing and Urban Development's letter dated January 24, 1997.

GAO's Comments

1. After reviewing HUD's comments, we added information to the report to recognize additional consequences to HUD's customers of the proposed changes to FHA. HUD expressed concern that dismantlement would result in the loss of a national housing and community development policy and focus. This is a policy question appropriately decided by the Congress and the administration. In response to HUD's comments about the difficulties involved in transferring HUD's functions to other agencies or other levels of government, we added several references to HUD's position in the report. All three issues are discussed in more detail in the comments that follow.

2. We believe that the report examines the bill's potential impact on HUD's customers and discusses the capacity of the states and other federal agencies to assume HUD's functions and the tasks to be accomplished in dismantling HUD within the 5 years specified in the bill. HUD's principal criticism of our analysis is that the report ". . . amounts to little more than a six-state opinion poll. . .". However, HUD does not recognize that our visits to these states were but one method used to collect information. Chapter 1 includes a description of the methodology we used in completing our analysis. In addition to the visits—the results of which we recognize may not be projected to all 50 states—we met with officials from national associations representing state and local governments; surveyed community development officials from the 47 states represented by the Council of State Community Development Agencies; reviewed existing literature on states' capacity; discussed S. 1145 with officials from the Office of Management and Budget (OMB), HUD, the National Academy of Public Administration, interest groups and associations, and think tanks; interviewed and gathered studies and position papers from senior HUD officials, think tanks, and interest groups representing HUD's clients, including tenant organizations, public housing authorities, lenders, major bond-rating agencies, government-sponsored enterprises, private mortgage insurers, state agencies, and local governments; and conducted interviews and collected documentation and studies from the federal agencies designated to receive HUD's functions and from HUD. We also drew on our own prior and ongoing work on HUD and on reorganizing federal agencies.

3. The bill's impact on low- and moderate-income customers and their communities are described in chapters 2 and 3. While we recognize that the bill could adversely affect the availability of mortgage capital, supply

of affordable housing, and vulnerable populations—for example—we cannot say with certainty to what degree these customers would be adversely affected.

4. While HUD believes that eliminating the federal backing for mortgage insurance would exclude clients now served, we believe the number of prospective borrowers who would be unable to obtain a home mortgage under the bill's provisions is uncertain. While our analysis recognizes the percentage of FHA borrowers who, on the basis of the loans they received, did not meet the most liberal private-sector underwriting guidelines, we cannot say with certainty that all of these borrowers could not qualify for other mortgages. In addition, because the bill does not specify the terms for sharing risk with qualified mortgage insurers, we cannot say with certainty how many borrowers would be affected. In this regard, we share HUD's concern that mortgages insured under the risk-sharing provisions might be those products already offered on the private market. Specifically, we recognize in the report that the restriction on the loan-to-value ratio alone replicates features of products already offered by the private market.

5. We expanded our description in chapter 3 of FHA's role in the multifamily mortgage market to reflect this point.

6. Chapter 2 of the report mentions several impacts on communities, including possible reductions in the supply of affordable housing. It also notes the uneven nature of housing markets nationwide that makes across-the-board approaches to housing assistance unworkable. In addition, we cite the findings from our 1995 report that the condition of the existing housing stock and its per-unit operating costs vary tremendously.

7. Chapter 2 discusses the 40-percent cut in these programs and the potential impact of consolidating these programs on vulnerable populations. We specifically mention several studies that support the concern of some stakeholders that under a consolidated block grant, the states and localities would reduce the funding targeted to very poor households. However, it is not possible to predict the exact impact of these potential funding cuts because the bill gives states and localities increased flexibility in making spending decisions. We have no way to assess with any certainty the spending choices states and communities might make.

8. Chapter 3 discusses the impact on veterans and rural residents of eliminating Ginnie Mae. We made no changes in response to HUD's comments.

9. Assessing the need for a single cabinet-level agency to provide leadership, coordination, and focus on housing and community development was outside the scope of this report, as agreed with our requesters. However, both the executive summary and the body of the report discuss HUD's position that this bill would eliminate the focus on housing and community development that it has provided as a cabinet-level department.

10. Chapters 4 and 5 describe the difficulties of transferring HUD's functions. We assessed the compatibility of HUD's missions with those of the receiving agencies; differences in the agencies' organizational structures, staffing and expertise; and the limitations on resolving HUD's current commitments. However, we have made a number of changes in the report to further clarify and emphasize HUD's perspective on some of these difficulties. Finally, as agreed with the requesters' offices, we did not estimate the costs of transferring these functions and creating new agencies, as envisioned in the bill, because CBO plans to publish a cost estimate in a separate report.

Comments From the Department of Health and Human Services

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



THE SECRETARY OF HEALTH AND HUMAN SERVICES
WASHINGTON, D.C. 20201

JAN 23 1997

Mr. James F. Hinchman
Acting Comptroller General of the United States
United States General Accounting Office
Room 7B02
441 G. St., NW
Washington, D.C. 20548

Dear Mr. Hinchman:

We appreciate the opportunity to review the draft GAO report, Implications of Legislation Proposing to Dismantle the Department of Housing and Urban Development (HUD). The report examines the implications of S.1145, the Housing Opportunities and Empowerment Act, which was introduced during the 104th Congress. Title II of the bill would convert HUD's public housing and Section 8 programs into a single voucher program administered by HHS.

HHS is concerned that the draft GAO report does not accurately and clearly state the views of this Department regarding the negative impacts that would result from the enactment of S.1145. HHS strongly believes in the importance of having HUD continue as the lead, cabinet-level Federal agency that focuses on the nation's pressing housing and urban development issues. HHS also believes that the proposal in S.1145 to shift certain HUD programs to HHS is not well advised.

The result of the transfer might well be little or no cost saving to the Federal Government and the nation's cities would have lost a targeted urban policy presence in the President's cabinet in the bargain. We think this is a very poor deal for cities and the housing and urban development needs of their residents. It also would not bode well for the Federal Government's ability to interact in a thoughtful and supportive way with the leaders of our metropolitan areas around their efforts to strengthen their metropolitan economies, and thus the nation's as a whole, to compete more successfully in the global economy.

The Department appreciates the opportunity to comment on this report before its publication.

Sincerely,

A handwritten signature in black ink, appearing to read "Donna E. Shalala".

Donna E. Shalala

Enclosure

See comment 1.

See comment 2.

The following are GAO's comments on the Department of Health and Human Service's letter dated January 23, 1997.

GAO's Comments

1. We added several references to HHS' position in the report, noting the Department's belief that the proposal to shift some of HUD's programs to HHS is not well advised and that the shift may provide little or no cost savings to the federal government. However, the need for a cabinet-level department to address housing and community development issues is a policy question for the Congress and the administration to decide. Additionally, in appendix I, we mention HHS' concerns about the proposed transfers of certain programs, including the concern that an extensive field structure would be needed to administer some programs.

2. Projections of the bill's impact on the federal budget will be developed and published by CBO in a separate report. Chapter 2 points out that although the states and localities would have greater flexibility in setting priorities, the funding cuts envisioned in the bill and the increase in the proportion of funds for entitlement communities would reduce either the amounts of the grants to the 3,000 nonmetropolitan areas or the number of communities receiving grants. We also note that service to the poorest clients could decline, though the effects of the funding cuts are uncertain, since the extent to which the states and localities would use their own funds to offset the funding reductions is unknown.

Comments From the Office of Management and Budget

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

JAN 6 1997

Ms. Judy A. England-Joseph
Director, Housing and Community
Development Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Ms. England-Joseph:

Thank you for the opportunity to comment on the GAO draft report, Implications of Legislation Proposing to Dismantle the Department of Housing and Urban Development (HUD). I have been asked to respond to you on behalf of OMB Director, Franklin Raines.

The purpose of the GAO report is to examine the implications of S.1145, the Housing Opportunities and Empowerment Act, which was introduced in the 104th Congress to dismantle HUD, reduce authorized funding levels, and transfer many functions to other agencies.

In our view, issues related to the reorganization and administration of HUD's functions should be evaluated on their own merits, not as a strategy for reducing the deficit by seemingly arbitrary reductions in spending. The Administration, led by Secretary Cisneros, thoroughly reviewed HUD's performance and organization two years ago. We concluded that the best way to reinvent the federal role in housing and urban development is to strengthen HUD's programs and management by streamlining and restructuring to make HUD more responsive to communities and give housing aid recipients more housing choices.

The Administration continues to believe that it would be counterproductive relative to its reinvention goals to assign HUD's functions to other agencies. Indeed, the Administration concluded that HUD programs will work most effectively -- and States and communities will benefit most -- if they are administered in a closely coordinated way. HUD is already working hard toward the goal of better integrating its program administration.

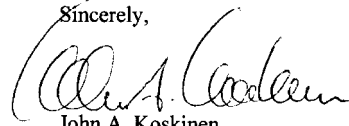
We have not prepared a detailed analysis of the likely impact on the Federal budget of S.1145. However, once the Congressional Budget Office (CBO) report now in preparation is available to OMB, we will be prepared to review and comment on it.

See comment 1.

Appendix V
Comments From the Office of Management
and Budget

OMB will continue to work with HUD and the Congress to consider further reforms and restructuring that will advance the goal of making HUD's programs more responsive to communities and more cost-effective.

Sincerely,



John A. Koskinen
Deputy Director for Management

The following are GAO's comments on the Office of Management and Budget's (OMB) letter dated January 6, 1997.

GAO's Comments

1. At the end of the report's executive summary, we note that OMB strongly disagrees with the provisions of S. 1145 and believes that HUD's "functions should be evaluated on their own merits, not as a strategy for reducing the deficit. . . ." OMB also observed that assigning HUD's functions to other agencies would be counterproductive relative to HUD's reinvention goals. We do not take a position on these issues because we believe they are policy questions for the Congress and the administration to decide.

Comments From the Department of the Treasury

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

January 14, 1997

SECRETARY OF THE TREASURY

The Honorable James F. Hinchman
Acting Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Hinchman:

Thank you for the opportunity to comment on your report, "Implications of Legislation Proposing to Dismantle HUD." Treasury strongly disagrees with the legislation introduced in the 104th Congress that proposed to dismantle the Department of Housing and Urban Development.

Treasury believes that the Federal Government plays an important role in encouraging access to affordable housing and homeownership. The Department of Housing and Urban Development ensures that the nation's housing and urban development needs are addressed in a well-reasoned and coordinated fashion. In addition, during the last four years the Department has played a pivotal role in such issues as transforming public housing, increasing home ownership opportunities, and providing more comprehensive and coordinated assistance to the homeless. New innovative efforts have been undertaken, such as the Campus of Learners and the Bridges to Work programs. At the same time, the Department has undertaken significant changes to provide services in a more efficient and effective way, changes that are at times under-appreciated.

For more than thirty years, Democratic and Republican administrations have recognized the value of a cabinet representative to articulate the needs and concerns of residents of urban America. The dismantling of the Department would result in the loss of this voice when critical issues are being discussed and national policies are being developed.

Sincerely,

A handwritten signature in black ink, appearing to read "Rubin".

Robert E. Rubin

See comment 1.

The following are GAO's comments on the Department of Treasury's letter dated January 14, 1997.

GAO's Comments

1. At the end of the report's executive summary, we note that the Department of the Treasury disagrees with the provisions of S. 1145 and supports a cabinet-level department to provide focus for housing and community development issues. The need for a cabinet-level department to address housing and community development issues is a policy question for the Congress and administration to decide.

Comments From the Environmental Protection Agency

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OFFICE OF
PREVENTION, PESTICIDES AND
TOXIC SUBSTANCES

JAN 16 1997

MEMORANDUM

SUBJECT: Review of Draft GAO Report Entitled "Implications of Legislation Proposing to Dismantle HUD"

FROM: *W. Sanders*
William H. Sanders III, Director
Office of Pollution Prevention and Toxics

TO: Judy A. England-Joseph, Director
Housing and Community Development Issues

The Office of Pollution Prevention and Toxics (OPPT) appreciates the opportunity to review the draft GAO report concerning the impacts of a possible transfer of HUD's lead-based paint program to EPA. We have several comments on the draft report.

First, we object to parts of the last paragraph on page 12 of Chapter 4, in particular the third sentence, which reads:

"In addition, HUD and EPA officials believe that if HUD's lead-based paint functions were transferred to EPA, the nature of the relationships between the program's customers and clients would change because EPA is not cognizant of the housing constituencies' concerns about lead-based paint abatement."

OPPT maintains that EPA is very cognizant of the concerns of housing constituencies about lead-based paint abatement and control activities within the private housing sector. Where we do not have significant experience is in the area of the management of lead-based paint abatement and control activities in public housing (i.e., actual oversight of abatement activities that are funded by HUD and performed by contractors). EPA certainly would not wish to become involved in the management of public housing in general. However, as long as only the lead-based paint functions were transferred here, and a clear separation was made between that mission and other public housing functions, EPA would have no problem absorbing the lead program from HUD, which could result in a number of efficiencies over the current arrangement.

See comment 1.

**Appendix VII
Comments From the Environmental
Protection Agency**

We suggest that the first and third sentences in the paragraph be rewritten as follows:

(First sentence) “A primary concern of HUD about the impact of transferring its various functions to different agencies was the less extensive housing expertise at the new agencies and the disruption of networks that HUD has built up to help implement its programs.”

See comment 2.

(Third sentence) “In addition, HUD and EPA officials believe that if HUD’s lead-based paint functions were transferred to EPA, the nature of the relationships between the program’s customers and clients would change because EPA does not manage housing and because EPA’s contacts are not as well developed as HUD’s.”

See comment 2.

Similarly, referring to Appendix I, page 17, the second-to-last sentence in the last paragraph reads as follows:

“Whereas HUD performs risk assessments and controls lead-based paint in public housing, EPA has neither the expertise nor the willingness to undertake these public housing operational activities.”

We suggest that the sentence read:

“Whereas HUD performs risk assessments and oversees the management (i.e., abatement, interim controls) of lead-based paint in public housing, EPA has neither the expertise nor the willingness to undertake these public housing operational activities.”

See comment 2.

Finally, on the same page but in the preceding paragraph, the second sentence currently reads as follows:

“HUD provides technical guidance to housing authorities and health departments on detecting and controlling lead-based paint hazards in housing...”

See comment 3.

The sentence, as written, implies that HUD is the only party providing guidance on detecting and controlling lead-based paint hazards for housing. This is not correct. EPA also provides extensive guidance and has performed numerous technical studies to support our technical outreach functions to government entities, property managers, homeowners and renters. To clarify this, we suggest that the sentence be modified slightly to read,

“HUD provides technical guidance to housing authorities and health departments on detecting and controlling lead-based paint hazards in public housing...”

If you have any questions about these comments, please contact Mr. Ron Carlson of the OPPT staff at 260-4352.

**Appendix VII
Comments From the Environmental
Protection Agency**



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

JAN 24 1997

OFFICE OF
PREVENTION, PESTICIDES, AND
TOXIC SUBSTANCES

97

JAN 28

AM 11:00

RECEIVED
USGAG
6 ST. WINDOW

Honorable James F. Hinchman
Principal Assistant Comptroller General
U. S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Hinchman:

As you know, EPA, along with a number of other Government Agencies, was asked to comment on a draft General Accounting Office (GAO) report entitled Housing and Urban Development: Implications of Legislation Proposing to Dismantle HUD. Although we have already provided formal comments, I want to personally share with you the Environmental Protection Agency's (EPA) concerns regarding efforts to dismantle HUD.

We feel strongly that the partnership role played by the HUD Office of Lead-Based Paint Abatement (OLBPA) in the nationwide effort to prevent childhood lead poisoning has been extremely valuable to us. The OLBPA has worked closely with EPA and the Centers for Disease Control in forming a Federal partnership to develop the national lead poisoning prevention strategy.

This successful partnership has led to many joint actions which have better leveraged scarce Federal resources, better utilized the full expertise of each Agency, and better served the American public. Recent successes include the publication of the final rule on the disclosure of lead-based paint and hazards during real estate transactions. In addition, EPA and HUD working closely with the real estate industry to minimize the impact of this rule on both the real estate industry and the housing industry.

HUD also plays a key role in the operational management responsibilities for lead abatement activities in public housing. HUD is uniquely situated to manage these efforts; EPA has neither the expertise, experience, nor desire to assume this role.

See comment 4.

See comment 5.

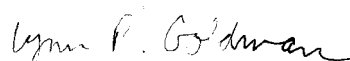
See comment 1.

**Appendix VII
Comments From the Environmental
Protection Agency**

HUD's work also meshes well in areas where EPA plays a critical role, which includes managing the national training and accreditation program, working with our State counterparts to establish State programs, managing the HUD-funded State grant program, and setting abatement standards. HUD also relies on EPA for technical assistance for the development of lead housing policies.

We believe that the cooperative efforts of HUD and EPA enhance Federal efforts to address the problems of lead hazards in our country's housing. It is our hope that our close and productive working relationship will continue.

Sincerely,



Lynn R. Goldman, M.D.
Assistant Administrator

cc: Mike Stegman, HUD

The following are GAO's comments on the Environmental Protection Agency's (EPA) memorandum dated January 16, 1997, and letter dated January 24, 1997.

GAO's Comments

1. In chapter 4, we note EPA's concern about assuming a broad role in managing lead-based paint in public housing, and in appendix I we cite EPA's concern that the agency does not have the expertise, experience, or willingness to manage public housing. However, appendix I also notes that EPA could assimilate certain specific lead-based paint activities, such as grants administration.
2. We revised the sentences to address EPA's comments.
3. The paragraph cited by EPA discussed HUD's assistance to housing authorities and health departments in detecting and controlling lead-based paint hazards in housing. This assistance is not limited to public housing, as EPA suggests. HUD also oversees a grant program for controlling lead-based paint in private low-income housing. Therefore, we did not revise the paragraph.
4. The formal comments referenced by EPA are contained in its January 16, 1997, memorandum addressed earlier in this appendix.
5. Our report states that EPA and HUD work closely together to help reduce childhood lead poisoning. However, appendix I also notes EPA's concern that although the agencies' missions are complementary, HUD's mission is broader—HUD focuses on reducing childhood lead poisoning while still managing housing so that the housing market is not disrupted.


Comments From the Federal Reserve Board

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Memo

DATE: January 7, 1997

TO: Frank Minore, Senior Evaluator
Government Accounting Office

FROM: Dolores S. Smith, Associate Director 

SUBJECT: Draft report to Congressional Committees regarding HUD

Thank you for the opportunity to review the draft report on the possible transfer of responsibilities from the Department of Housing and Urban Development (HUD) to state and federal agencies. This is to confirm the conversation you had with Sheilah Goodman yesterday regarding the report. As Ms. Goodman explained, we have no substantive comments to offer. The report accurately reflects our views on any possible transfer of responsibility for the Real Estate Settlement Procedures Act from HUD to the Board.

cc: Mr. Griffith L. Garwood
Mr. S. David Frost
Ms. Sheilah A. Goodman

Comments From the Department of Agriculture

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



JAN 8 1997

**United States
Department of
Agriculture**

Rural Economic
and Community
Development

Operations and
Management

Washington, D.C. 20250

SUBJECT: GAO/RCED-97-36, "Implications of Legislation
Proposing to Dismantle HUD"

TO: Judy A. England-Joseph
Director, Housing and Community
Development Issues
Operations and Management
U. S. General Accounting Office

The subject draft report was reviewed in the Rural Housing Service, including both Single Family Housing and Multiple Family Housing Programs and they have no comments.

The Deputy Administrator for Operations and Management had the following comment:

There are only 18 employees assigned; would not create an administrative problem. Only need funding for salary and related expenses.

We appreciate the opportunity to review and comment prior to the final report's release.

If you have any questions, you may contact me at 690-0300.

A handwritten signature in cursive script that reads "A. Sherie Henry".

A. SHERIE HENRY
Director
Financial Management Division

See comment 1.

The following are GAO's comments on the Department of Agriculture's letter dated January 8, 1997.

GAO's Comments

1. Appendix I notes that officials within Department of Agriculture's Rural Housing Service (RHS) stated that assuming the manufactured housing function's broad enforcement powers, such as the powers to issue subpoenas and use injunctive relief, should not be a problem for RHS. Additionally, section 144 of S. 1145 states that transferred functions would include the funds associated with the functions.

Major Contributors to This Report

**Resources,
Community, and
Economic
Development Division**

R. Tim Baden
Susan Beekman
Leslie Black-Plumeau
Erin Bozik
Larry Dyckman
Bess Eisenstadt
Mathew Scire

**General Government
Division**

Scott Derrick
Frank Minore

Atlanta Field Office

Anne Olson
Paige Smith

Boston Field Office

Diana Gilman
Rich LaMore

Appendix X
Major Contributors to This Report

Appendix X
Major Contributors to This Report

Related GAO Products

High-Risk Series: Department of Housing and Urban Development
(GAO/HR-97-12, Feb. 1997).

Multifamily Housing: Effects of HUD's Portfolio Reengineering Proposal
(GAO/RCED-97-7, Nov. 1, 1996)

Homeownership: FHA's Role in Helping People Obtain Home Mortgages
(GAO/RCED-96-123, Aug. 13, 1996).

Department of Energy: Observations on the Future of DOE
(GAO/T-RCED-96-224, July 23, 1996).

Housing Enterprises: Potential Impacts of Severing Government Sponsorship (GAO/GGD-96-120, May 13, 1996).

FHA Hospital Mortgage Insurance Program: Health Care Trends and Portfolio Concentration Could Affect Program Stability (GAO/HEHS-96-29, Feb. 27, 1996).

Homeownership: Mixed Results and High Costs Raise Concerns About HUD's Mortgage Assignment Program (GAO/RCED-96-2, Oct. 18, 1995).

Multifamily Housing: Issues and Options to Consider in Revising HUD's Low-Income Housing Preservation Program (GAO/T-RCED-96-29, Oct. 17, 1995).

Housing and Urban Development: Public and Assisted Housing Reform
(GAO/T-RCED-96-25, Oct. 13, 1995).

Housing and Urban Development: Public and Assisted Housing Reform
(GAO/T-RCED-96-22, Oct. 13, 1995).

Commerce Dismantlement: Observations on Proposed Implementation Mechanism (GAO/T-GGD-95-233, Sept. 6, 1995).

Block Grants: Issues in Designing Accountability Provisions
(GAO/AIMD-95-226, Sept. 1, 1995).

HUD Management: Greater Oversight Needed of FHA's Nursing Home Insurance Program (GAO/RCED-95-214, Aug. 25, 1995).

Property Disposition: Information on HUD's Acquisition and Disposition of Single-Family Properties (GAO/RCED-95-144FS, July 24, 1995).

Housing and Urban Development: HUD's Reinvention Blueprint Raises Budget Issues and Opportunities (GAO/T-RCED-95-196, July 13, 1995).

Public Housing: Converting to Housing Certificates Raises Major Questions About Cost (GAO/RCED-95-195, June 20, 1995).

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

Multifamily Housing: HUD's Mart-to-Market Proposal (GAO/T-RCED-95-230, June 15, 1995).

Multifamily Housing: HUD's Proposal to Restructure Its Portfolio (GAO/T-RCED-95-226, June 13, 1995).

Government Restructuring: Identifying Potential Duplication in Federal Missions and Approaches (GAO/T-AIMD-95-161, June 7, 1995).

HUD Management: FHA's Multifamily Loan Loss Reserves and Default Prevention Efforts (GAO/RCED/AIMD-95-100, June 5, 1995).

Program Consolidation: Budgetary Implications and Other Issues (GAO/T-AIMD-95-145, May 23, 1995).

Government Reorganization: Issues and Principles (GAO/T-GGD/AIMD-95-166, May 17, 1995).

Resolution Trust Corporation: Management Improvements Reduce Risks, but Transition Challenges Remain (GAO/T-GGD-95-163, May 16, 1995).

Multifamily Housing: Better Direction and Oversight by HUD Needed for Properties Sold With Rent Restrictions (GAO/RCED-95-72, Mar. 22, 1995).

Housing and Urban Development: Reforms at HUD and Issues for Its Future (GAO/T-RCED-95-129, Mar. 14, 1995).

Housing and Urban Development: Reforms at HUD and Issues for Its Future (GAO/RCED-95-108, Feb. 22, 1995).

Housing and Urban Development: Reinvention and Budget Issues
(GAO/T-RCED-95-112, Feb. 22, 1995).

Block Grants: Characteristics, Experiences, and Lessons Learned
(GAO/HEHS-95-74, Feb. 9, 1995).

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

High-Risk Series: Department of Housing and Urban Development
(GAO/HR-95-11, Feb. 1995).

Housing and Urban Development: Major Management and Budget Issues
(GAO/T-RCED-95-89, Jan. 24, 1995 and GAO/T-RCED-95-86, Jan. 19, 1995).

Reengineering Organizations: Results of a GAO Symposium (GAO/NSIAD-95-34, Dec. 13, 1994).

Federally Assisted Housing: Expanding HUD's Options for Dealing With Physically Distressed Properties (GAO/T-RCED-95-38, Oct. 6, 1994).

Rural Development: Patchwork of Federal Programs Needs to Be Reappraised (GAO/RCED-94-165, July 28, 1994).

Federally Assisted Housing: Condition of Some Properties Receiving Section 8 Project-Based Assistance Is Below Housing Quality Standards
(GAO/T-RCED-94-273, July 26, 1994, and Video, GAO/RCED-94-01VR).

Public Housing: Information on Backlogged Modernization Funds
(GAO/RCED-94-217FS, July 15, 1994).

Homelessness: McKinney Act Programs Provide Assistance but Are Not Designed to Be the Solution (GAO/RCED-94-37, May 31, 1994).

Section 8 Rental Housing: Merging Assistance Programs Has Benefits but Raises Implementation Issues (GAO/RCED-94-85, May 27, 1994).

Lead-Based Paint Poisoning: Children in Section 8 Tenant-Based Housing Are Not Adequately Protected (GAO/RCED-94-137, May 13, 1994).

HUD Information Resources: Strategic Focus and Improved Management Controls Needed (GAO/AIMD-94-34, Apr. 14, 1994).

Multifamily Housing: Status of HUD's Multifamily Loan Portfolios
(GAO/RCED-94-173FS, Apr. 12, 1994).

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

Multifamily Housing: Status of HUD's Multifamily Loan Portfolios
(GAO/RCED-94-3, Oct. 27, 1993).

State and Local Finances: Some Jurisdictions Confronted by Short- and Long-Term Problems (GAO/HRD-94-1, Oct. 6, 1993).

Government National Mortgage Association: Greater Staffing Flexibility Needed to Improve Management (GAO/RCED-93-100, June 30, 1993).

Multifamily Housing: Impediments to Disposition of Properties Owned by the Department of Housing and Urban Development (GAO/T-RCED-93-37, May 12, 1993).

HUD Reforms: Progress Made Since the HUD Scandals but Much Work Remains (GAO/RCED-92-46, Jan. 31, 1992).

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web Home Page at:

<http://www.gao.gov>

**United States
General Accounting Office
Washington, D.C. 20548-0001**

**Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100**

**Official Business
Penalty for Private Use \$300**

Address Correction Requested

