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

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CIVIL DIVISION

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Dear Mr. Gulledge:

We have examined into certain aspects of the college housing program administered by the Department of Housing and Urban Development (HUD). Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Housing Act of 1954 (42 U.S.C. 1435), and was performed, for the most part, at HUD headquarters in Washington, D.C., and at the HUD regional office in Philadelphia.

Our review was concerned primarily with HUD's current policy of requiring private educational institutions to issue revenue bonds as security for direct Federal loans made for the construction of housing facilities. On the basis of our review, it appeared to us that if HUD's policy were changed to require private educational institutions to use general obligation notes, instead of revenue bonds, as security for their loans from the Federal Government, the basic program objective of helping educational institutions provide housing at the lowest cost to the student would be advanced and the cost of the loan to both the borrower and the Federal Government would be reduced.

We estimated that, for the 77 direct loan projects approved by HUD for private educational institutions during fiscal year 1969, the Government could have realized annual savings of about $16,000 (or about $647,000 over an assumed 40-year loan period) if general obligation notes, instead of revenue bonds, were used as security for the loans. At the same time, an even larger amount of savings could be realized by the borrowing institutions. Additional savings may be possible in the case of direct loans made to public educational institutions. The above matter is discussed in more detail in the following sections.

Title IV of the Housing Act of 1950, as amended (12 U.S.C. 1749) gives the Secretary of HUD the responsibility for administering the college housing program which authorizes financial assistance to colleges, universities, eligible hospitals, and special college housing organizations for the construction or acquisition of housing and essential service facilities.

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The law authorizes Federal financial assistance in two forms--debt service grants to reduce the cost of borrowing on the private market, or direct Federal loans. Direct Federal loan assistance has been available since the beginning of the program in 1950. Such loans may be made for any period up to 50 years, but are generally made for a period of 40 years. The Housing and Urban Development Act of 1965 established a maximum interest rate of 3 percent per annum on such loans.

The program of debt service grants was authorized by the Housing and Urban Development Act of 1968. Such grants may be made for a period not to exceed 40 years and may be in an amount equal to the difference between the average annual debt service which would have been required if the loan were made at a 3 percent per annum rate and the average annual debt service payments on private market loans at market interest rates.

During the nearly two decades of the direct loan program, HUD has approved over 3,100 direct loans to colleges, universities, and teaching hospitals totaling in excess of $3.6 billion.

Direct loans are made to institution applicants through HUD's purchase of the institutions' bonds. HUD regulations require that the bonds be publicly offered before sale, and that the Government purchase only those issues, or parts of issues, for which equal or better bids are not received from private investment firms, banks, or other bidders. This regulation was established to ensure compliance with the provision of the law which states that loans will not be made under the program if the applicants are able to obtain the required financing elsewhere on equally favorable terms and conditions. However, throughout the history of the program, the Government has been the only bidder for the private institutions' non-tax-exempt bonds and, in December 1967, HUD eliminated the public sale requirement for private institutions on the basis that prevailing yields for various corporate obligations indicated that there was no private market for non-tax-exempt bonds of private institutions bearing an interest rate of 3 percent per annum.

With regard to public educational institutions, we found that, in the past, some of the tax-exempt bonds offered for sale by such institutions under the program requirements established by HUD were purchased by investors other than the Federal Government. However, we were informed by a program assistant in the college housing branch of HUD that almost all of the bonds offered for sale by public educational institutions in the past were purchased by the Federal Government.

Prior to offering bonds for sale, a loan applicant must secure the services of a bond counsel to render an opinion as to the legality of the bond issue and to prepare the bond indenture. The fee of the bond counsel, the cost of advertising for the sale of bonds, and other costs identified with the preparation and sale of bonds are included by the applicant in the total eligible project costs.

We reviewed the costs incurred by applicants to prepare and sell bonds for 36 private institution housing projects and found that the total of the bond counsel fees and the bond printing costs for these projects was about $247,000, or an average of about $7,000 per project. If these bond costs were eliminated, the Government could reduce the amount of its bond purchases by $7,000 per project. Assuming that the Government were to borrow at an interest rate of 6 percent per annum to finance college housing loans made at 3 percent per annum, we estimate that, over the 40-year life of the bonds, the Government could realize savings of about $8,400 in interest costs for each project ($210 a year).

Based on the 77 direct loans approved by HUD for private educational institutions in fiscal year 1969, we estimate that the Government could have realized savings of about $16,000 during fiscal year 1969, or about $647,000 over the 40-year loan period, if the applicants' bond costs were eliminated. A similar amount of interest savings could have been realized by the borrowing institutions. If the Government were to borrow at an interest rate higher than our assumed rate of 6 percent per annum, the Government would realize even greater savings through the elimination of the bond costs.

Additional savings could be realized by the borrowing institutions if HUD's bond requirements were eliminated. Currently, private institutions must pay an annual bond trustee fee which is considered an operating expense and is not eligible for inclusion in the total project costs. Trustee fees vary according to the amount of work required under each indenture; however, based on trustee fees that HUD officials consider reasonable, a minimum fee of about $50 a year would be incurred for each project.

HUD officials stated that although the college housing program now stresses the debt service form of financing, direct Federal loans will still be available whenever institutions are unable to borrow in the private market at reasonable interest rates. A HUD regional official told us that private institutions are experiencing some difficulty securing funds in the private market at acceptable interest rates.

With regard to the matters discussed above, we note that the findings of the HUD task force on college housing policies and procedures, dated September 18, 1968, state, in part, as follows:

"The use of revenue bonds should not be applied to the obligations of private institutions. Neither program objectives, legal requirements, or loan characteristics require such an approach. On the contrary, elimination of the revenue bond concept will further the basic objective to help colleges provide housing at the lowest possible cost to students. It also should reduce the cost of loan development to both the borrowers and the lender, and should expedite loan processing within HUD."

The task force recommended that instead of revenue bonds for private colleges, HUD should use a note and mortgage coupled with a full faith and credit pledge of the borrower.

At the time of our review, we found no indication that HUD had implemented the task force's recommendation, even though HUD's elimination of the public sale requirement for private institutions had given recognition to the fact that there was no private market for non-tax-exempt bonds of private institutions bearing an interest rate of 3 percent per annum.

Subsequent to our discussion of the foregoing matters in August 1969 with the Chief, College Housing Operations Branch, HUD Region II, a trial project was iniated in HUD Region II by arranging to have an obligation note, instead of revenue bonds, issued by a private educational institution as security for a direct Federal loan. During a recent interview with the Chief, College Housing Branch, at HUD headquarters in Washington, D. C., we were informed of two additional trial projects of this nature in two other HUD regions. Since the new method for securing direct loans made to private institutions described herein is being tried by HUD on an experimental basis, we are making no recommendations at this time. However, we would appreciate being informed of the results of HUD's study and any further actions contemplated by HUD regarding direct loans made to either private or public educational institutions.

We appreciate the cooperation extended to our representatives during our examination. A copy of this report is being furnished to the Secretary of Housing and Urban Development.

Sincerely yours,
Stanley S. Sargol

for Max Hirschhorn
Associate Director

The Honorable Eugene A. Gulledge
Assistant Secretary for Housing Production
and Mortgage Credit and Federal
Housing Commissioner
Department of Housing and
Urban Development