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

RESOURCES AND ECONOMIC
DEVELOPMENT DIVISION

MAR 8 1976

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The Honorable
The Secretary of Housing and
Urban Development

Dear Mrs. Hills:

GAO has reviewed HUD's rehabilitation loan programs in Chicago and San Francisco to see whether (1) the programs are reaching property owners of low and moderate incomes and/or limited economic circumstances and (2) HUD is making the most effective use of the limited funds available by restricting their use to repairs and improvements essential to restoring housing to a decent, safe, and sanitary condition.

We concluded that the programs have considerably upgraded rundown properties and benefited their owners, tenants, and neighborhoods. However, in one Chicago project, which received most of the rehabilitation funds for that city, 67 percent of the loans were made to persons with annual incomes of $15,000 or over. In San Francisco 46 percent of the loans we reviewed were made to persons with annual incomes of $15,000 or over. In addition, many of the loans in the Chicago project and in San Francisco were used for major reconstruction and refurbishing in excess of that required for decent, safe, and sanitary housing.

Although such use of rehabilitation loans is not prohibited by the program's relevant legislation, we question the practice of making a large percentage of the loans in these projects to persons with incomes higher than $15,000 and of making loans that were used for major reconstruction and refurbishing work in excess of that necessary for decent, safe, and sanitary housing.

The rehabilitation program has been extended through August 1976, at which time it will end unless the Congress further extends it. The repair and rehabilitation of housing, however, is one of the activities that can be



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carried out under the block grant program authorized by the Housing and Community Development Act of 1974 (42 U.S.C. 5301 et seq.). This act consolidated several categorical programs, including the rehabilitation program, into one program. Community plans in Chicago and San Francisco provide for continuing the rehabilitation of existing housing under the block grant program.

Under the act, HUD requirements for review and approval of community applications have been reduced and simplified. Also communities have greater flexibility in determining how block grant funds will be spent for community development. It is clear from the 1974 act, however, that the activities funded under the program should benefit primarily persons of low and moderate incomes.

The situations we noted in the Chicago projects and in San Francisco illustrate the need for HUD to closely monitor the rehabilitation activities undertaken with block grant funds, to insure that they benefit principally persons of low and moderate incomes.

## GENERAL INFORMATION

The Congress declared, in the Housing Act of 1949 (42 U.S.C. 1441), the goal of a decent home and a suitable living environment for every family. Many times since then the Congress has expressed its concern that this goal was not being fully realized for many of the Nation's lower income families.

The Housing Act of 1964 (42 U.S.C. 1452b) authorized loans to property owners for repairs and improvements necessary to bring their properties up to applicable local code requirements, carry out the objectives of the urban renewal plans for the areas, and generally improve the conditions of the properties.

The Housing and Urban Development Act of 1969 (42 U.S.C. 1452b(a)) stipulated that priority for rehabilitation loans be given to applications from low- and moderate-income persons, as defined by section 221(d)(3) of the National Housing Act. HUD, in implementing the program, has stated that its basic purpose is to make it possible for property owners of limited incomes and/or economic circumstances to rehabilitate their properties.

If an applicant cannot obtain comparable financing from other sources, rehabilitation loans can be made for up to 20 years at a maximum interest rate of 3 percent. The maximum loan amount for residential structures for Chicago and San Francisco is $17,400 for each dwelling unit.

## SCOPE OF REVIEW

We made our review at HUD's central office in Washington, D.C., at HUD's regional offices in Chicago, Illinois, and San Francisco, California; and at HUD's area offices within these regions.

We reviewed:

--Federal laws and congressional hearings related to the rehabilitation loan program.

--HUD policies, procedures, and administrative regulations.

--HUD and local community correspondence, documents, statistical records, and pertinent data.

We interviewed HUD and city officials responsible for administering the rehabilitation program. We also accompanied HUD and city officials on inspections of selected properties.

## LOANS TO PROPERTY OWNERS WITH ANNUAL INCOMES OVER $15,000

A large percentage of the beneficiaries of the rehabilitation program in the Lincoln Park project in Chicago and in San Francisco have been property owners with annual incomes over $15,000. The low- and moderate-income limits during fiscal years 1973 and 1974, when most of the loans were made, for Chicago ranged from $8,000 for a family of one to about $15,000 for a family of seven or more. These limits for San Francisco ranged from about $7,300 to about $13,500.

### Chicago

During fiscal years 1973 and 1974, four areas received all the rehabilitation loan funds in the city of Chicago--Lincoln Park ($2,243,000), Near Westside ($851,000), Southeast Englewood ($580,000), and Douglas-Lawndale ($410,000).

Of the 64 loans made in the Lincoln Park project, 43, or 67 percent, were made to persons with annual incomes of $15,000 or over. Included in the 64 loans were 21 loans made to investors with average annual incomes of $54,400 and average net worths of $172,600.

The Lincoln Park area, where 55 percent of the loan funds were allocated, is just north of Chicago's central business district and is a highly desirable community for families seeking a close-in urban environment. In 1964 the area was described as a high-prestige community atracting scores of upper-middle-income professional families and ex-suburbanites.

Many Lincoln Park borrowers had substantial financial resources. For example:

--An owner-occupant had an annual income of $43,000, assets of $199,000, and a net worth of $130,000. This owner received a 3-percent, 15-year loan of $16,050.

--Another owner-occupant had an annual income of $40,000, assets of $313,000, and a net worth of $255,000. This owner received a 3-percent, 20-year loan of $25,000 for two units.

--An investor had an annual income of $158,000, assets of $902,000, and a net worth of $443,000. This investor obtained a 3-percent, 20-year loan of $35,000 to rehabilitate a four-unit complex.

In the other 3 projects in Chicago, a total of 66 loans were made to persons with average annual incomes of $11,407 and average net worths of $7,233. Of the 66 loans in these 3 projects, 52, or 79 percent, were made to persons with annual incomes under $15,000.

Enclosure I shows the average financial resources of borrowers who received rehabilitation loans in each of the four areas in Chicago.

San Francisco

San Francisco initiated a code enforcement program in 1958 and became a part of the Federal program in 1966. Through June 30, 1974, HUD had approved 964 loans, amounting to about $12.7 million, in the San Francisco code enforcement areas. This was one of the largest commitments of rehabilitation loans in the country for a federally assisted code enforcement project.

Of the 964 loans, 866 were for rehabilitation of structures with 1 to 4 dwelling units and 98 were for structures with 5 or more units. The statistics on 393 loans which follow are based on data available from 94 of the loans for structures of 5 or more units and a statistical sample of 299 loans for structures of 1 to 4 units.

Of these 393 loans, 180, or 46 percent, were made to persons with annual incomes of $15,000 or over. Included in the 393 loans were 194 loans to investors with average annual incomes of $29,800 and average net worths of $149,900.

Following are examples of San Francisco borrowers who had substantial financial resources.

--One homeowner, who had an annual income of $42,000 and a net worth of $330,000, received a $17,500 rehabilitation loan. His monthly loan payment of $97, combined with all other housing expenses, amounted to only 5 percent of his income.

--An investor with an annual income of $240,000, assets of $2,700,000, and a net worth of $1,500,000 received a 3-percent, 20-year loan of $22,000.

--An investor with an annual income of $48,000, assets of $6,200,000, and a net worth of $1,900,000 received a 3-percent, 20-year loan of $86,700.

Enclosure II shows the average financial resources of the 393 San Francisco property owners we reviewed who received rehabilitation loans.

## USE OF REHABILITATION LOAN FUNDS FOR MAJOR RECONSTRUCTION AND FEATURES NOT NEEDED FOR DECENT, SAFE, AND SANITARY HOUSING

In the Lincoln Park project in Chicago and in San Francisco, some property owners used subsidized loan funds to substantially reconstruct their properties.

In the Lincoln Park area, property owners used loan funds for work that went far beyond the correction of cited code violations, including the installation of many features which, in our opinion, were in excess of those needed for decent, safe, and sanitary housing. Property owners in Southeast Englewood, a low- and moderate-income area of Chicago with average incomes about one-third that of property owners in Lincoln Park, used their loan funds primarily to correct code violations and/or unsafe and unsanitary conditions.

In 8 of the 12 properties we visited in the Lincoln Park area, the work done involved such things as wholesale gutting of interiors and installation of new walls and floors and of heating, electrical, and plumbing systems. In several cases, considerable exterior work also was done. In addition, property owners used loan funds to provide such items as recessed spotlights, dishwashers, central air-conditioning, skylights, parquet floors, cedar siding, and fireplaces.

The situations concerning properties in San Francisco were similar.

HUD auditors questioned the use of rehabilitation funds to substantially reconstruct property. Their November 1972 report noted that HUD regulations directed that a rehabilitation loan not provide for new construction, substantial reconstruction, or expansion of the size of the structure. The report concluded that using funds for substantial reconstruction resulted in loans being made for rehabilitation work that was not appropriate for financing with rehabilitation loans, and as a result, loan funds which could have been used for loans which better implement the intent of the program were committed. In view of the limited loan funds available, the auditors questioned whether this was the most prudent manner in which to use the funds.

Furthermore, a HUD rehabilitation specialist commented in a 1969 report that:

> "The overall situation in the Lincoln Park area is being run by architectural firms interceding for rehab loans for the ultra-modernization of old structures so that excessive rents can be charged * * *. Some tenants of these structures are now paying $200 to $300 a month for rent. It seems that the poor people for which this program was intended have been totally forgotten."

Former Secretary of HUD, James T. Lynn, in responding to a subcommittee of the Senate Committee on Appropriations inquiry, said that HUD was not making greater use of the rehabilitation loan program because:

> "Rehabilitation in the sense that it is used by HUD means really taking a shell of a house, in most cases, and rebuilding a house at a cost which exceeds the market value of that structure."

A subcommittee member responded that rehabilitation involving $3,000 to $4,000 worth of repairs was needed rather than the massive rehabilitation the Secretary referred to.

Although the rehabilitation loan program will end in August 1976, the activities carried out under the program, including making loans for repairing and rehabilitating housing, are eligible under the block grant program authorized by the Housing and Community Development Act of 1974.

The primary objective of Title I--Community Development--of the 1974 act is:

> "* * *the development of viable urban communities, by providing decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income."

Applicants must also certify that their community development programs have been developed so as to give maximum feasible priority to activities which will benefit low- or moderate-income families or aid in preventing or eliminating slums or blight.

Under the 1974 act, HUD requirements for review and approval of community applications have been reduced and simplified. In reviewing applications from communities for funding, HUD must approve applications, unless the description of community development and housing needs is plainly inconsistent with generally available information, or the activities proposed are plainly inappropriate to meeting stated needs and objectives. The act also limits the amount of time available to HUD for considering and processing an application by specifying that a submitted application be deemed approved within 75 days after receipt, unless the Secretary informs the applicant of specific reasons for disapproval.

Reducing and simplifying HUD requirements for review and approval of community applications necessarily increases the importance of adequately monitoring the activities being undertaken to insure that the objectives of the act are being achieved.

In its report (H. Rept. 93-1114 (p. 10) accompanying USE 00700 H.R. 15361) on the bill which evolved into the 1974 act, the House Committee on Banking and Currency stated:

"The committee wishes to emphasize the importance of these post-audit and review procedures to be conducted by the Secretary. Since Federal application review requirements are being simplified to such a great extent, the post-audit and review requirements will serve as the basic assurance that block grant funds are being used properly to achieve the bill's objectives * * *."

The need to closely monitor block grant activities was also recognized by the Senate Committee on Banking, Housing and Urban Affairs in its report on the 1974 act. (S. Rept. 93-693, (p. 55) accompanying S. 3066.)

Senate

## CONCLUSIONS

The rehabilitation loan programs in Chicago and San Francisco have considerably upgraded rundown properties and benefited their owners, tenants, and neighborhoods. However, in the Lincoln Park project in Chicago, which received most of the rehabilitation funds for that city, 67 percent of the loans were made to persons with annual incomes of $15,000 or over. In San Francisco 46 percent of the loans we reviewed were made to persons with annual incomes of $15,000 or over. In addition, many of the loans in the Chicago project and in San Francisco were used for major reconstruction and refurbishing in excess of that required for decent, safe, and sanitary housing.

Although such use of rehabilitation loans is not prohibited by the program's relevant legislation, ~~we question~~ the practice of making a large percentage of the loans in these projects to persons with incomes higher than $15,000 and of making loans that were used for major reconstruction and refurbishing work in excess of that necessary for decent, safe, and sanitary housing. is questionable. The situations we noted in Chicago and in San Francisco illustrate the need for HUD to closely monitor the rehabilitation activities undertaken with block grant funds, to insure that they benefit principally persons of low and moderate incomes.

## RECOMMENDATIONS to agency

We recommend that, in administering the community development block grant program, HUD should closely monitor the use being made of funds provided for rehabilitation purposes, to insure that they are made available principally to persons of low and moderate incomes.

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We appreciate the cooperation of the HUD staff we have dealt with and we shall appreciate being advised of any action taken on matters discussed in this report.

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As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House and Senate Committees on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the four committees mentioned above and to your Inspector General and Assistant Secretary for Community Planning and Development. We are also sending copies to the Director, Office of Management and Budget, and to the Chairmen of the House Committee on Banking, Currency and Housing and the Senate Committee on Banking, Housing and Urban Affairs.

Sincerely yours,

Henry Eschwege

Henry Eschwege,
Director

Enclosures - 2

## SUMMARY OF THE FINANCIAL RESOURCES OF BORROWERS CHICAGO, ILLINOIS

| Category | Owner-occupant | Investor | Total |
|---|---|---|---|
| **Lincoln Park:** | | | |
| Number of loans | 43 | 21 | 64 |
| Applicant's average: | | | |
| Income | $19,700 | $ 54,400 | $ 31,100 |
| Assets | 35,600 | 318,900 | 128,500 |
| Net worth | 29,200 | 172,600 | 76,300 |
| **Southwest Englewood:** | | | |
| Number of loans | 38 | 4 | 42 |
| Applicant's average: | | | |
| Income | $9,800 | $20,800 | $10,900 |
| Assets | 4,300 | 88,500 | 12,300 |
| Net worth | 2,600 | 43,100 | 6,400 |
| **Near Westside:** | | | |
| Number of loans | 15 | 5 | 20 |
| Applicant's average: | | | |
| Income | $11,400 | $17,400 | $12,900 |
| Assets | 4,000 | 77,700 | 22,400 |
| Net worth | 3,000 | 31,300 | 10,100 |
| **Douglas-Lawndale:** | | | |
| Number of loans | 4 | 0 | 4 |
| Applicant's average: | | | |
| Income | $9,600 | - | $9,600 |
| Assets | 2,900 | - | 2,900 |
| Net worth | 1,600 | - | 1,600 |

SUMMARY OF THE FINANCIAL

RESOURCES OF BORROWERS

SAN FRANCISCO, CALIFORNIA

| Category | Owner-occupant | Investor | Total |
|---|---|---|---|
| Number of applicants | 199 | 194 | 393 |
| Applicant's average: | | | |
| Income | $11,334 | $ 29,779 | $ 20,439 |
| Assets | 40,124 | 274,656 | 155,898 |
| Net worth | 24,002 | 149,851 | 86,126 |