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REPORT BY THE

Comptroller General

OF THE UNITED STATES

HUD Should Improve Its Management Of Acquired, Formerly Subsidized Multifamily Projects

HUD's financial management system does not provide agency and project employees information needed to control project costs adequately at formerly subsidized multifamily housing projects which HUD has acquired and manages. Without such information, HUD officials cannot easily control project expenses. When rent revenues are insufficient to meet expenses, the deficit is paid by HUD's General and Special Risk Insurance Funds.

Because operating expenses are not identified and subsequently are absorbed by the insurance funds, there is limited congressional budgetary oversight over HUD's operation of its acquired multifamily housing inventory.

HUD can reduce its losses at these projects by improving management in such areas as project monitoring, tenant income verifications, and controls over expenditures.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-197087

The Honorable Cardiss Collins
Chairwoman, Subcommittee on
Manpower and Housing
Committee on Government Operations
House of Representatives

Dear Madam Chairwoman:

As requested in the subcommittee's June 26, 1978, letter, this is our report on the Department of Housing and Urban Development's management of its inventory of acquired, formerly subsidized multifamily housing projects.

The Department of Housing and Urban Development was unable to provide written comments on this report within the 30 days provided for such comment. We did, however, obtain oral comments on the report from the Assistant Secretary for Housing-Federal Housing Commissioner, which are incorporated in the report.

We are sending copies of this report to the Secretary, Department of Housing and Urban Development, and to the Director, Office of Management and Budget.

As arranged with your office, we will make this report available to other interested parties 3 days after the issue date, unless you publicly release its contents earlier.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE SUBCOMMITTEE ON MANPOWER AND HOUSING, COMMITTEE ON GOVERNMENT OPERATIONS, HOUSE OF REPRESENTATIVES

HUD SHOULD IMPROVE ITS MANAGEMENT OF ACQUIRED, FORMERLY SUBSIDIZED MULTIFAMILY PROJECTS

D I G E S T

Over the last 2-1/2 years the Department of Housing and Urban Development (HUD) has made important policy changes in the way it charges rent at, and sells its inventory of, formerly subsidized multifamily housing projects by

--charging lower income tenants no more than 25 percent of their income for rent while HUD owns the projects (see p. 2) and

--providing rental assistance subsidies (under section 8) to the projects after they are sold. (See p. 2.)

Although these new policies help guarantee that housing will remain available to and affordable by low- and moderate-income families, they result in substantial additional costs to the Government. At nine HUD-owned projects GAO visited, annual revenues had decreased by 32 percent after rents were limited to 25 percent of tenant income. At projects sold with section 8 rental assistance, the 15-year subsidy commitments have averaged about $3,000 per unit annually. GAO estimates that HUD will need about $1 billion for the 15-year section 8 rental assistance commitments to sell its April 30, 1979, inventory of over 280 projects with over 24,000 housing units. (See pp. 3 and 27 .)

WHY LOSSES OCCUR

GAO's analysis of the financial records of HUD-owned projects showed that HUD was incurring annual losses of about

$19 million on its inventory of about 221 projects with over 20,000 housing units for the year ended February 1978. These losses occurred because monthly costs (about $165 per unit) exceeded rents collected (about $88 per unit). These losses may be even greater in the future because HUD's revised policy of limiting rents to 25 percent of tenant income has reduced rent charges.

Losses incurred during operation of HUD's acquired, formerly subsidized projects are not accounted for separately; rather, HUD's total loss including subsidy is absorbed by the General and Special Risk Insurance Funds when the projects are sold. As a result, information on costs, which could be a valuable tool for oversight and management of acquired projects, is not readily available. (See p. 10.)

HUD's policy limiting rents to 25 percent of tenant income results in additional subsidies which are financed by the insurance funds. In effect, HUD is using the insurance funds to provide housing subsidies above and beyond the amounts appropriated by the Congress.

FINANCIAL INFORMATION NEEDED FOR ADEQUATE MANAGEMENT AND MONITORING

The operating costs at these projects are relatively high compared to other multifamily projects because HUD

--lacks financial information necessary to control costs (see p. 12),

--has no cost standards for project managers and HUD area office personnel to use to evaluate the reasonableness of costs (see p. 12), and

--does not adequately monitor project operations. (See p. 22.)

GAO believes that the unidentified absorption of losses and subsidies by the insurance funds, coupled with the financial management system's failure to identify and report project operating expenses, revenues, and losses, does little to foster cost consciousness in HUD and project employees in operating HUD-owned projects.

IMPROVEMENTS NEEDED IN INCOME CERTIFICATION

Project managers did not adequately comply with HUD requirements to verify tenant incomes upon which rents are based. At the nine projects reviewed, GAO found indications that some tenants were underreporting their incomes and paying even lower rents than they should under HUD's revised rent reduction policy. Such underreporting often goes undetected because project managers

--have done a poor job in verifying reported incomes;

--often have no means to identify unreported tenant incomes; and

--based on the way HUD sets management fees, have little incentive to accurately verify incomes.

Furthermore, HUD has not adequately monitored income certifications and verifications. (See p. 23.)

RECOMMENDATIONS

The Secretary of Housing and Urban Development should:

--Develop a financial information system to produce timely data on the costs, subsidies, and losses at HUD-owned projects for comparative analyses. (See p. 25.)

--Develop cost standards for projects to assist project managers and HUD employees in evaluating project expenses. (See p. 25.)

--Improve the monitoring of project operations through more frequent site visits, with emphasis on reviews of the reasonableness of costs incurred and project income certifications and verifications. (See p. 25.)

--Penalize project managers who do not fulfill their managerial responsibilities by reducing their fees or replacing them. (See p. 25.)

--Identify in its annual budget request the losses and rental assistance subsidies being absorbed by the General and Special Risk Insurance Funds in operating HUD's acquired, formerly subsidized multifamily housing projects. (See p. 25.)

AGENCY COMMENTS AND OUR EVALUATION

The Assistant Secretary for Housing-Federal Housing Commissioner said that HUD generally agreed with GAO's recommendations and has either taken or plans to take several actions in line with them. If properly implemented, these actions should improve HUD's management of and controls over acquired projects. (See p. 25.)

Contents

ABBREVIATIONS

GAO	General Accounting Office
HUD	Department of Housing and Urban Development
IREM	Institute of Real Estate Management

CHAPTER 1

INTRODUCTION

We reviewed the Department of Housing and Urban Development's (HUD's) inventory of acquired, formerly subsidized projects at the request of the Chairwoman, Subcommittee on Manpower and Housing, House Committee on Government Operations, to determine the effect of HUD's policy changes in its management and disposition of these projects. The subcommittee specifically requested that we inquire into such matters as HUD's cost of operating its projects, the validity of tenant income certifications and verifications, and the estimated cost of its disposition policy.

BACKGROUND

The National Housing Act (12 U.S.C. 1701 *et seq.*), as amended, allows HUD to insure loans made by private lending institutions on various types of housing, including multifamily rental housing projects. To assist low- and moderate-income families to obtain housing at reduced rents, the Congress established multifamily housing programs primarily under sections 221(d)(3) and 236. These programs authorize HUD to insure privately financed mortgage loans for construction or substantial rehabilitation of multifamily housing projects and to pay a portion of the interest on the mortgage loans or rent supplements for qualified tenants.

The section 221(d)(3) below-market-interest-rate program provides that HUD may pay the interest in excess of 3 percent on privately financed loans. Under the section 236 program, HUD may pay the interest in excess of 1 percent on privately financed loans. The difference in the cost of market rate financing and the subsidized rates is passed on to the tenants in the form of lower rents. In spite of these subsidies, however, many owners of these projects have defaulted on their mortgages. The major reasons cited by HUD for these problems included inadequate project income, inadequate HUD program management, and inadequate onsite project management. When a project defaults, HUD pays the mortgagee (lender) all or most of the remaining mortgage and either has the mortgage assigned to it or acquires the project.

After acquisition, HUD operates and maintains its projects through private real estate firms and area management brokers, called "project managers," until it sells or otherwise disposes of them. Project managers are responsible for the day-to-day management of the projects, including the collecting of rents and paying expenses. When the project income is not sufficient to cover costs, the excess expenses are paid by the HUD central office. HUD field office personnel monitor the performance of project managers.

As of April 1979, HUD owned about 24,300 units in 282 projects which had formerly been subsidized under sections 221 or 236 of the National Housing Act. In addition to these already acquired units, 884 additional formerly subsidized projects with about 93,300 units have already had the mortgages assigned to HUD due to defaults; 20,000 of these units are now in the foreclosure process. Another 132 subsidized, HUD-insured projects with about 16,100 units are in default.

Until 1977, HUD's objectives for its acquired, formerly subsidized multifamily projects were to

--maximize occupancy and rents during ownership and

--dispose of the projects at the earliest possible time at the highest price obtainable.

Since that time, HUD has changed its policies to emphasize keeping the projects available to and affordable by low- and moderate-income families. These policy changes include charging lower income tenants in HUD-owned units a maximum of 25 percent of reported income for rent and utilities and attaching a rental subsidy (primarily section 8) to the sale of these properties. The basis for the rental charge and the subsidy is the tenant's income certification, which is verified by the project manager for HUD-owned projects and by the private owner for sold projects.

SCOPE OF REVIEW

We made our review at HUD headquarters in Washington, D.C., and HUD's field offices in Atlanta, Georgia; Cincinnati and Columbus, Ohio; Indianapolis, Indiana; Los Angeles and San Francisco, California; Tampa, Florida; and Washington, D.C. We visited nine HUD-owned projects, two projects sold with section 8 subsidies, and held discussions with project managers, and HUD headquarters and field office representatives.

During our work we reviewed relevant HUD internal audit reports and considered them in the conduct of our review.

CHAPTER 2

LOSSES AT HUD-OWNED, FORMERLY SUBSIDIZED MULTIFAMILY PROJECTS ARE SUBSTANTIAL

We estimate that HUD incurred losses of about $19 million in operating its inventory of 221 formerly subsidized multifamily housing projects (with about 20,400 units) for the year ended February 1978. These losses will be greater in subsequent years because, during the period of our analysis, HUD changed its rental policy to provide that tenants in these projects would pay not more than 25 percent of their income for rent and utilities. Before the change, tenants had to pay the established rent and utilities. The 25-percent limitation reduces project revenues and, consequently, increases losses. The limitation, however, is consistent with rent limitation provisions of HUD's public housing and section 8 housing programs.

We were unable to identify the portion of these losses that were attributable to the new rental policy because not all HUD field offices implemented the policy immediately nor did they implement it consistently. It appears, however, that the 25 percent rent limitation substantially increases project operating losses. For example, our analysis of nine HUD-owned projects where HUD's policy had been fully implemented showed that annual revenues for the nine projects had dropped from $1.6 million to $1.1 million, a decrease of 32 percent, resulting in increasing the loss from $78 per unit per month to $125 per unit per month.

The desirability of increasing the payment of rent and utilities from the maximum of 25 percent of tenants' income to a higher amount for HUD's public housing and section 8 housing programs was discussed briefly in 1979 congressional hearings, apparently because many renters nationwide who live in unsubsidized housing pay more than 25 percent of their incomes for rents. Slight increases in the maximum rents paid by tenants of public housing and section 8 housing programs were provided for in 1979 House bill, H.R. 3875, but not in the Senate's version. The legislative differences were being considered by conferees of the House and Senate as of October 25, 1979.

LOSSES WILL INCREASE

Because HUD's financial management system does not readily identify and report project operating costs and revenues, we reviewed financial records for 154 projects, consisting of about 16,600 housing units, to determine what losses were being incurred by HUD in operating its inventory of formerly subsidized multifamily housing projects. For the year ended February 1978, we determined that the 154 projects incurred average operating expenses of $165 per unit per month. The projects also collected average revenues of $88 per unit per month, resulting in an average operating loss of $77 per unit per month.

As of February 1978, HUD owned 221 formerly subsidized multifamily projects. The projects had a total of about 20,400 units. Therefore, projection of the $77 per unit per month loss to these units results in an estimated operating loss of $19 million for the year ended February 1978.

In computing the operating loss, we included HUD expenditures for ordinary and recurring items, such as maintenance, utilities, management fees, and real estate taxes. Expenditures for major repairs which extended the useful life of the project or which benefited future accounting periods were identified, and one-tenth of the expenditures was included as a current cost on the assumption that the repair would have a useful life of 10 years. We also included the Government's interest cost on the operating loss--that is, the cost to the U.S. Treasury for borrowing funds to cover the loss.

The $19 million operating loss was incurred from March 1, 1977, through February 28, 1978. The full effect of HUD's 25 percent rent limitation policy is not reflected in the loss because HUD did not establish the policy until May 1977. At that time, HUD changed its rental policy to provide that qualified tenants residing in HUD-owned, formerly subsidized projects pay not more than 25 percent of their income for rent and utilities. Before the change, tenants in such projects had to pay the authorized rent and utilities. HUD initiated the new policy to help assure that formerly subsidized units would remain available to and affordable by low- and moderate-income families.

The 25-percent limitation is consistent with legislative rent limitation provisions of HUD's public housing and section 8 housing programs, which provide generally that rents paid by tenants cannot exceed 25 percent of family income.

The new rental policy reduces project revenues and, consequently, increases project operating losses. However, the policy was not immediately or consistently implemented by all HUD field offices, thereby minimizing its effect on reducing revenues during our analysis period. As late as mid-1978, more than a year after establishment of the policy, it continued to be inconsistently and incompletely implemented. For example, as of June 1978, one area office had implemented the policy in only one of its eight projects. In another area office with five projects, project managers computing the tenants' maximum payments had not credited tenants for utilities they had paid. Because of the delays in implementing the change in rental policy, at least two HUD field offices granted tenants refunds for rent reductions they should have received if the policy had been implemented when established.

The Land of Lincoln Legal Services Office, an independent, nonprofit organization which provides legal services to needy people, reported that tenants in one locality had received $17,000 in such refunds. Also, tenants in several projects in another area office received credits against future rents.

To determine the effect of HUD's rent reduction policy on project revenues, we analyzed revenues for 6-month periods before and after the policy was fully implemented at nine projects. The revenues received for the 6 months before the policy's implementation amounted to $1.6 million annually for the nine projects. The average operating loss for these projects was $78 per unit per month. Following implementation of HUD's policy limiting tenant payments, the annual revenues for the nine projects decreased 32 percent to $1.1 million. The revenue reduction amounts to about $47 per unit per month, increasing the operating loss to $125 per unit per month after implementation of the policy. (See app. I.)

Our determination of revenue reduction was based on the rents paid by the tenants living in the projects at the time of our review, as compared with the authorized rents that these same tenants were paying or would have paid had they lived in the projects before May 1977. Part of this rent reduction is due to tenants' underreporting of income, which is discussed in chapter 3.

INCREASES IN 25-PERCENT LIMITATION UNDER CONSIDERATION

Proposed legislation providing for slight increases in the maximum rents paid by tenants of public housing and section 8 housing programs was under consideration by the Congress as of

October 25, 1979. The proposed legislation apparently was introduced because there are many renters nationwide who pay more than 25 percent of their income for rents.

In 1977 about 49 percent of all renters paid 25 percent or more of their income for rent; about 30 percent paid 35 percent or more of their income for rent. Since 1970 there has been a steady increase in rent-to-income ratios. During the period 1970 through 1977, median gross rent as a percentage of income has increased from 20 to 25 percent. The generally accepted rule of thumb is that housing costs should not be more than 25 percent of family income. The following schedule shows the increased number of renters paying 25 percent of annual income for rent in 1977 compared with 1973.

Gross rent as percentage of income (note a)	1973 Number of renters (millions)	1973 Percent	1977 Number of renters (millions)	1977 Percent
25 to 34 percent	3.7	16.5	4.5	18.4
35 percent or more	5.5	24.4	7.4	30.3
Total	9.2	40.9	11.9	48.7

a/Number of renters for which data was computed was 22,438,000 in 1973 and 24,365,000 in 1977.

As shown above, the number of renters paying 35 percent or more of their income for rent has increased by about 1.9 million (or 35 percent) during the 1973-77 period. Of the 7.4 million renters paying 35 percent or more of their income for rent, 4.2 million (or about 57 percent) paid more than 50 percent of their income for rent.

We also analyzed the rent-to-income ratios of four projects, constructed for low- and moderate-income families, located near HUD-owned projects. The four projects are insured and subsidized by HUD, but the tenants are required to pay at least a basic rent covering the cost of operating the project with payments of principal and interest at below-market-interest rates. As shown in the following table, the tenants paid from 28 to 36 percent of adjusted family income for rent and utilities at these projects during the August-October 1978 period.

Project	Average percent of income paid for rent and utilities
Carriage Hill (Atlanta, Ga.)	30
Bonnie Bell (Lakeland, Fla.)	33
Oaks II (Anderson, Ind.)	28
Danner Park (Dayton, Ohio)	36

A HUD task force also analyzed HUD-insured subsidized and nonsubsidized projects which had been acquired by HUD or whose mortgages were either assigned to HUD or were being foreclosed. The HUD Task Force on Multifamily Property Utilization reported to HUD management in August 1977 that, although average rent-to-income ratios varied widely by project, the average percentage of income paid for rent was about 30 percent in about 37 percent of the HUD projects which were assigned, in process of foreclosure, or HUD owned. The task force did not consider utility costs in its study. Had utility costs been included, the average percentage of income paid by the tenant would have been greater than 30 percent.

The desirability of increasing the payments of HUD-subsidized tenants to an amount greater than 25 percent of income was discussed in 1979 congressional hearings. On May 2, 1979, House bill 3875 was introduced providing for slight increases in rental payment limitations. Legislation subsequently passed by the House of Representatives provided for the following changes in HUD's public housing and section 8 housing programs.

Public housing--The House bill retains the rental payment limitation of 25 percent of adjusted family income for very low-income families (incomes of 50 percent or less of area median) but increases the limitation to 30 percent of such income for other families.

Section 8 housing--The House bill provides that the limitation for very low-income families would increase from 15 percent to 25 percent of family income. Other families would be required, based on relative levels of income, to pay at least 20 percent, but not more than 30 percent, of income, rather than the present minimum of 15 percent and maximum of 25 percent of such income.

Proposed housing legislation passed by the Senate in 1979 did not contain provisions for increasing tenant rent limitations. As of October 25, 1979, the legislative differences were still being considered by conferees of the House and Senate.

CONCLUSIONS

HUD incurred losses of about $19 million in operating its acquired multifamily housing projects for the year ended February 1978. Because the effect of HUD's rent reduction policy was not fully reflected in the period covered by our analysis, these losses will be greater in the future. Our analysis of nine projects showed that annual revenues decreased by 32 percent after the rent reduction policy had been implemented.

Proposed legislation providing for increases in the maximum rents paid by tenants of public housing and section 8 housing programs is being considered by conferees of the House and Senate.

CHAPTER 3

LOSSES CAN BE REDUCED BY IMPROVING

HUD MANAGEMENT AND MONITORING

The losses being incurred by HUD in operating its acquired, formerly subsidized multifamily housing projects can be reduced by improved management and monitoring of project operations. However, HUD lacks (1) the financial information needed to identify operating expenses of individual projects and (2) the cost standards necessary to enable HUD realty specialists responsible for reviewing and approving payment of project expense vouchers to judge the reasonableness of such expenses.

Also, projects are losing substantial revenues because poor certification and verification of tenant incomes is resulting in underreporting of those incomes. Our review of nine HUD projects identified an estimated $46,800 annually in lost revenues due to underreporting of social security and welfare incomes and potential lost revenues of as much as $112,100 annually because other income may have been underreported.

Furthermore, project expenses in excess of project revenues, and a few other expenses such as real estate taxes, are paid for by HUD headquarters with General and Special Risk Insurance Funds. Project expenditures are recorded cumulatively for each project during HUD's ownership, usually a period of several years, until the project is sold. At that time, HUD's total project loss or gain is absorbed by the General and Special Risk Insurance Funds. Annual operating losses for individual projects or for the total inventory are not identified by HUD, nor are they subject to HUD and congressional budgetary oversight. In our opinion, the unidentified absorption of losses and subsidies by the insurance funds, coupled with the financial management system's failure to identify and report project operating expenses, revenues, and losses, does little to foster cost-consciousness in HUD and project employees in operating HUD-owned projects.

HUD LACKS FINANCIAL INFORMATION NECESSARY TO ADEQUATELY CONTROL COSTS

HUD's financial management system does not provide HUD and project employees with the financial information needed to adequately control project costs. Total project operating expenses are not identified and summarized by project for comparative cost analysis. HUD personnel are unaware of (1) the total costs of operating projects for which they are responsible, (2) which projects are incurring the highest or lowest costs, and (3) how cost categories compare among the various projects.

Because of the lack of such cost information and the methods used to pay expenses, there is little real concern over control of project expenses. Project expenses are normally paid out of project revenues. However, when project revenues are insufficient to pay expenses, the excess expenses are paid by HUD headquarters with General and Special Risk Insurance Funds. A few other project expenses, such as real estate taxes and centrally procured goods, are also paid from these funds. The payment of expenses is done routinely with little scrutiny and, lacking cost standards, with little basis for judging the reasonableness of such expenses.

Project operating costs are not recorded and reported

HUD's financial management system is directed toward determining its net investment in a project so that, when the project is sold, the total loss or gain can be determined. The system does not provide the information needed to identify and report project operating costs because it does not record all project expenditures and revenues, nor does it distinguish between operating costs (expenditures which provide benefits in the current accounting year) and capitalized costs (expenditures which provide benefits in future years).

When HUD acquires a project, a Property Account Card is established to identify HUD's net investment in the project, and the costs of acquiring the property (payment of the mortgage balance and incidental costs) are recorded. Subsequently, HUD's net investment in the project is increased by additional project expenditures or decreased by project revenues.

Under the present system, however, the annual operating expenses cannot be determined by project even by a review of each project's Property Account Card because not all revenues and expenses are recorded. For example, each month the project manager sends a report to HUD listing the project's disbursements and receipts for that month. However, only the difference between the monthly disbursements and receipts is recorded on the Property Account Card. Total expenses are not recorded. Furthermore, in recording expenses, HUD makes no distinction between operating expenses and capitalized expenses. The failure to record all expenses and to properly categorize operating and capitalized expenses significantly distorts actual operating costs.

For example, to identify the costs of operating HUD-acquired, formerly subsidized multifamily housing projects, we reviewed the source documents for postings to Property Account Cards for 154 projects. Our analysis showed that operating costs averaged about $165 per unit per month. Our analysis of the data posted to the Property Account Cards disclosed that $88 of the $165 per unit per month operating expenses (about 53 percent) was not identifiable as project operating expenses because of the procedure of posting only the net difference between project receipts and disbursements.

Also, many of the payments made by headquarters and/or the project are for capital expenditure items, only a portion of which should be considered as operating expenses in any specified accounting period. In this regard, we identified about $10.1 million of capital costs posted to the Property Account Cards for 51 of the 154 projects reviewed. Unless this amount was identified and depreciated, the cost for the 12-month period of our review would have been overstated by about $38 per unit per month (that is, the difference between $42 per unit per month based on $10.1 million and $4 per unit per month based on depreciation of $10.1 million over a 10-year period).

Therefore, under HUD's current financial management system, analysis of each source document for each item on the Property Account Card would be required to accurately identify the costs of operating the projects. This is not practical because the large number of source documents for each project makes such an analysis tedious and time consuming.

Finally, the differences between expenses and revenues, together with other expenditures, are recorded cumulatively for each project during HUD's ownership of the project until it is sold or otherwise disposed of. At that time, HUD's total project loss or gain is absorbed by the General and Special Risk Insurance Funds.

The General and Special Risk Insurance Funds finance mortgage insurance operations, including the acquisition costs of and operating losses incurred at HUD-acquired projects. The operating losses incurred at projects formerly subsidized under section 221 of the National Housing Act are financed by the General Insurance Fund; losses incurred at formerly subsidized section 236 projects are financed by the Special Risk Insurance Fund. In fiscal year 1977 these two funds incurred a net loss of $645.9 million from mortgage insurance operations.

The funds often finance their operations by borrowing from the U.S. Treasury. These borrowed moneys are then repaid to the Treasury by periodic congressional appropriations.

Cumulatively, through September 1977, HUD had borrowed over $5 billion from the Treasury to replenish the deficits in these two funds.

HUD does not specifically identify its operating losses. Because such unidentified losses are absorbed by the General and Special Risk Insurance Funds, congressional budgetary oversight excercised over HUD's operation of its acquired multifamily housing inventory is limited. Furthermore, the policy limiting rents to 25 percent of income results in subsidies being provided to the tenants which are absorbed by the General and Special Risk Insurance Funds. Thus, HUD is, in effect, using the insurance funds to provide housing assistance subsidies above and beyond the amounts appropriated by the Congress.

Area offices lack adequate control of project operating expenses

The area office is required to review the monthly report of cash receipts and disbursements prepared by each project manager. When receipts are insufficient, the excess project expenses are paid by headquarters. The area office is required to approve the vouchers covering the excess project expenses to be paid by headquarters and to retain copies of them. Therefore, it is important that the area office identify and carefully analyze the project expenses which it approves.

However, the area offices (1) had no summary of each project's operating costs, (2) had no standards to judge the reasonableness of costs being incurred, and (3) had copies of only some of the vouchers which they approved for payment by headquarters. In the latter case, one area office was unable to locate supporting vouchers for 94 of 157 expense items posted to the Property Account Cards of two projects. Furthermore, the area offices receive no project cost information from headquarters, currently the focal point for accumulating information on HUD's total investment in a project. The net effect is that the area offices have no knowledge of the annual project operating costs.

We believe that HUD should develop a financial information system which will identify operating costs for each project to enable HUD personnel to effectively monitor project management.

Lack of cost standards

HUD has no standards for determining whether operating costs of its acquired projects are reasonable. In response to the recommendation of a HUD task force on multifamily property utilization commissioned in June 1977, HUD testified before the House Subcommittee on Manpower and Housing in September 1978 that it was planning to develop cost standards. Our inquiry disclosed, however, that the standards were to be established for HUD-insured and HUD-held projects only. We were advised that these standards would also be applied to acquired projects, but this action was not planned for the immediate future.

In the absence of cost standards for acquired projects, other information exists which could be used to determine the reasonableness of operating expenses. For example, HUD could compare project costs with the annual income/expense analysis prepared by the Institute of Real Estate Management 1/ (IREM) for privately owned apartment complexes or with comparable HUD-insured projects. However, HUD's financial system for HUD-owned projects does not provide cost data for comparative purposes.

We made such a comparison for six of the nine projects in our review and found that operating costs at acquired projects were substantially higher than similar costs at HUD-insured and IREM projects. These comparisons highlighted significant differences in payroll and security costs between the IREM data and the projects, and even among the projects reviewed.

Comparison between HUD-owned and HUD-insured project costs

Our comparison of costs incurred during 1977 by three HUD-owned projects in HUD's region IX showed that the overall costs for the HUD-owned projects were about double the costs for HUD-insured projects. The primary categories where the costs differed substantially were onsite management, maintenance and groundskeeping, security, and apartment renovations. Even the garbage collection costs for the HUD-owned projects were about double those for the HUD-insured projects. It seems unlikely that there should be such a difference for garbage collection costs in the same locality. The details of the cost comparison are shown in the following schedule.

1/The Institute of Real Estate Management is an organization of professional property managers.

	HUD-owned projects			HUD-insured projects		
Selected cost category per unit per month	Marcus Garvey Square	Martin Luther King	San Juan Batista	Prince Hall	Banneker	El Rancho
Onsite management payroll	$ 27	$ 28	$ 14	$ 14	$15	$11
Maintenance and groundskeeping payroll	35	46	34	13	11	10
Renovation	31	31	6	24	0	4
Garbage collection	11	12	9	5	6	4
Security	37	34	46	11	1	2
Other costs (note a)	61	74	56	73	53	62
Total operating costs per month per unit	$202	$225	$165	$140	$86	$93

a/Other costs include primarily utilities and management fees.

Comparison of HUD-owned project costs with IREM costs

In HUD's region IV we compared the costs incurred during 1977 and 1978 by three HUD-owned projects with costs for similarly constructed projects developed for region IV by IREM. Operating expenses for the HUD-owned projects ranged from about 18 to 69 percent higher than the average for similarly constructed private projects in the same geographical area. The details for selected cost factors are shown in the following schedule.

	Total cost per square foot (note a)	Percent of cost variance from region average	Cost per square foot attributable to payroll		
			Payroll other than security	Security payroll	Total
Region IV IREM average	$1.43	-	$.23	$ .01	$ .24
Brooker Gardens	2.37	+65	.85	.20	1.05
Citrus Gardens	1.70	+18	.73	.08	.81
Sunset Ridge	2.43	+69	.76	-	.76

a/Exclusive of any depreciation or interest.

HUD San Francisco area office personnel advised us that the high payroll costs of its projects (region IX) were attributable primarily to unspecified paperwork burdens and the need for full-time maintenance personnel to respond quickly to maintenance and service needs. They also advised us that security costs were very high because of crime and violence in the HUD-owned projects. They said that the area director had considered closing down one project but instead had hired armed guards.

It may be necessary to have permanent personnel to respond to maintenance and service needs. However, the ratio of employees to occupied units is very inconsistent even when the projects have been in the inventory for long periods. For example, as of June 1977 the San Juan Batista project had been in the HUD inventory over 1-1/2 years and only 90 of its 192 units were occupied. The remaining 102 units were not habitable. Nevertheless, there were 11 permanent employees, none of whom were security personnel. This represents a ratio of one employee for each eight occupied units. In contrast, the Martin Luther King and Marcus Garvey Square projects, almost fully occupied as of June 1977, had ratios of 1 employee to 14 and 1 employee to 18 occupied units, respectively. Even the ratios for Martin Luther King and Marcus Garvey Square, which equate to about one-half the personnel of the San Juan Batista project, are still high in comparison with the payroll costs of the HUD-insured projects.

The HUD-owned projects in region IV had total payroll costs, including security costs, that were three to four times greater than the region IV IREM payroll costs. The Booker Gardens project, in particular, appeared excessive.

Because he employed eight full-time persons and two additional persons during the summer, we questioned the Booker Gardens site manager about his high payroll costs. Based on full occupancy of the 106 units, this housing project has a ratio of 1 employee for 13 occupied units normally and 1 employee for 11 occupied units during the summer. The manager advised us that his two security guards and the maintenance supervisor were not needed. He explained, however, that he had no control over staffing because it was determined by the Tampa service office. HUD's Tampa office personnel were unable to explain the basis for the level of staffing.

During the 3 weeks we spent reviewing the Booker Gardens operations, we also observed that the site manager was physically present at the site less than half the time. Although he advised us that he was performing project business, the frequency and length of his absences cast doubt on whether he was fulfilling his managerial responsibilities.

Booker Gardens is a project that has been in HUD's inventory since November 1974 and was fully occupied at the time of our review in October 1978. Furthermore, about two-thirds of the current tenants had been living in the project since April 1977. With 100 percent occupancy, a limited turnover of tenants, admission by the site manager that he has three unnecessary employees, and the numerous and lengthy absences of the site manager, it was doubtful whether continuing the level of payroll expenditures was justified.

HUD field office personnel advised us in December 1978 that they were unaware of the lengthy absences of the site manager and that they would assess the need for personnel at all projects within their jurisdiction. They told us in June 1979 that the staff at this project had been reduced by one part-time and two full-time employees. They also said additional staff reductions would have been made but no more employees had been released because the project was soon to be sold.

Because HUD has neither cost standards nor complete cost information, project managers and HUD realty specialists have little or no basis for judging whether project costs are reasonable and necessary. As a result, HUD sometimes has paid too much for goods and services for projects or has failed to detect excessive project costs.

In one instance which was the subject of a separate report to the HUD Secretary, 1/ the HUD Cincinnati service office incurred about $1 million in excessive costs on three contracts awarded for grasscutting, painting, and tiling services for projects during 1978. The contract prices were based on the estimates of HUD-contracted specification writers.

The specification writers' estimates resulted in prices that were 2 to 10 times greater than those paid earlier at the projects for similar services or were greater than the going market prices. Furthermore, HUD personnel were not aware that costs were excessive. In fact, a Cincinnati service office realty specialist responsible for monitoring several projects told us that the contracting officer was doing a good job.

POOR INCOME VERIFICATIONS RESULT IN LOST REVENUES

Our review of HUD's management of nine projects which HUD had acquired after loan defaults shows that the managers employed by HUD had not always verified the income tenants reported or adjusted the reported income and rents when a later verification showed that the reported income had been substantially understated.

Before May 1977, tenants in HUD-owned, formerly subsidized projects were paying the authorized rent and utilities. At that time, HUD changed its rental policy to provide that tenants residing in HUD-owned multifamily projects pay not more than 25 percent of their income for rent and utilities.

The basis for the rent charge under the revised policy is the tenant income, which has to be certified and verified. The certification procedure requires each tenant to report all household income and certify that it is true and correct. The project manager is required to verify the reported income of tenants and is expected to be alert to situations where the tenants have obviously understated their incomes. Under such circumstances, the income certifications and consequent rent adjustments are to be corrected as quickly as possible. Also, the HUD area office is required to assure that the proper procedure is being followed by reviewing the income certification and verification process at each project.

1/"Review of Selected Contracts Awarded by the Cincinnati Service Office" (CED-79-67, Apr. 12, 1979).

Income not verified

At three of the nine projects we reviewed, project managers did not verify all incomes but instead merely accepted the data reported by most of the tenants. In fact, the incomes of 203 of the 261 tenants in these three projects had not been verified as required.

At one of these projects, 27 tenants had been paying rent and utilities from $132 to $160 per month before HUD's policy changed in May 1977. We found that, as of August 1978, 24 of these 27 tenants were paying no rent and 3 were paying rent of less than $5 per month. While some rent reductions could logically be expected, we believe such extreme reductions to be questionable. Nevertheless, the project manager had not attempted to verify the incomes reported.

Income not reported

Project managers at the remaining six projects had attempted to verify the reported income but could not assure themselves that the income reported was the tenant's total income. They were not notified when tenants changed employment and had no way to identify unreported income of other individuals in the apartment units.

For example, at the nine projects we reviewed, 183 tenants in the 795 occupied units received social security payments. However, of these 183, 43 did not report their social security incomes and another 18 underreported income by at least $500 annually. The nine projects are losing about $29,000 in annual rents due to the nonreporting and underreporting of income by these 61 tenants. (See app. II.)

We also reviewed the local welfare office records of tenants from seven of the nine projects for which we could obtain information. For the seven projects, we determined that 191 of 712 tenants were receiving welfare incomes at the time of certification and that 36 of the 191 tenants (19 percent) did not report their welfare incomes. Based on our determination of tenant welfare payments, the 36 nonreporting tenants would have received about $72,800 annually. We estimate HUD's rent loss to be about $17,000 annually because of this unreported welfare income. (See app. III.)

In addition, at eight projects with 802 occupied units, we identified tenants in 99 units who had possibly underreported their incomes for certification. These tenants were living in the projects before the May 1977 rent reduction policy took effect and were paying the authorized rent and utilities. For certification purposes, however, they reported monthly incomes that either were less than or barely covered the rent and utilities they had paid previously. After certification, 85 of the 99 tenants were paying less than $50 per month rent; 25 were paying no rent and 24 others were paying less than $30 per month. (See app. IV.)

The following case study illustrates the underreporting of income at one project.

At this project, rental income decreased from an average of about $10,900 per month before the rent reduction to an average of about $3,800 per month after implementation of the rent reduction policy. This represents an income reduction of about $7,100 monthly, or $85,000 annually, even though most of the current tenants were living at the project before the reduction went into effect. While some reductions are expected, such large reductions seem questionable. Nevertheless, the project manager had not attempted to verify the incomes reported by the tenants.

As of August 1978, 69 of the 106 units in this project were occupied by the same tenants who had lived there before the May 1977 policy change. Before the policy change these 69 tenants were paying both the authorized rent and utilities, ranging from $132 to $160 per month. For certification purposes, however, 39 reported monthly incomes that either were less than or barely covered the rent and utilities they had paid previously. After certification, 25 tenants are now paying no rent, 8 tenants are paying less than $20 per month, and 6 tenants are paying less than $40 per month.

Our analysis of the social security income at this project showed that there were five tenants who underreported their annual social security incomes by a total of about $9,790. As a result, HUD's annual rent loss was about $2,290. One of these tenants underreported $3,650 in social security income in a subsequent certification.

We also reviewed the local welfare office records for 32 tenants who were receiving welfare payments. Based on welfare records, nine of the tenants had not reported or had underreported their total annual welfare income and/or wages by about $7,900. As a result, we estimate the annual rent loss to be about $1,870.

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Rent not increased

Three of the nine project managers did not always increase the rent when their verification showed that the certified income was understated. At these three projects, verification forms showed that 13 tenants had understated their incomes by an average of about $1,120 per year, ranging from about $100 to $7,000. Yet, the project managers did not increase the rent. We estimate HUD's annual rent loss for these 13 cases to be about $2,380.

The situation was particularly significant at one project where seven tenants had understated their incomes by an average of $1,600 per year, ranging from about $100 to $7,000. Our calculation of the correct rent, based on their verified incomes, disclosed that these seven tenants should have been paying a total additional rent of about $1,410 annually.

Possible improvements in income certifications and verifications

Some improvements in the income certification and verification process are possible within existing procedures. Project managers could place more emphasis and higher priority on the certification and verification process. They can do a better job of explaining to the tenants the importance of accurate reporting and certification of their incomes and impressing on them that false certification statements are subject to prosecution under title 18 of the U.S. Code. By adhering to established HUD procedures, managers could more accurately verify incomes reported by tenants.

HUD could also improve its monitoring of the income certifications and verifications. HUD field offices have historically done little or no monitoring of income certifications and verifications. (See p. 24.) We believe it is unreasonable to expect that project managers will adequately emphasize income certifications and verifications when HUD itself places little emphasis on them. Further compounding this problem is the fact that project managers have little if any incentive to accurately verify incomes.

For example, before the HUD rent reduction policy was implemented, most project managers' fees were based on a percentage of the gross rental income collected. Therefore, it was in their interest to collect as much rent as possible. Following implementation of the rent reduction policy, which would result in reducing the management fee, HUD amended some contracts to provide that the management fee be based on the authorized rent for the occupied units at the time of the policy change. One HUD official advised us that the current procedure results in a disincentive for the project manager because by allowing tenants to report less than their actual income and pay substantially less rent, he can better assure full occupancy and prompt rent payment. However, project managers are required to verify tenant incomes, and we believe HUD needs to penalize managers who do not meet their responsibilities, either by reducing their management fees or by replacing them.

Although these steps would improve the situation, it should be recognized that there are problems in the income verification process which impose limitations. For example, the current system has no procedure for identifying families with two or more incomes if the families do not choose to report these additional incomes.

Project managers do not have access to independent information sources, such as Federal income tax data and social security data, which could be helpful in identifying certain omissions of reported income. The Congress amended the disclosure provisions of the Internal Revenue Code in 1976, greatly restricting access to income tax return information. Thus, HUD would have to require tenants to provide their own tax data or require their written consent to allow the Internal Revenue Service to provide the data.

Additionally, there are inherent limitations in such data. Not all persons file income tax returns, and certain income, especially for lower income persons, is not taxable and would not be included on the returns. Information in the social security data system could, however, fill this gap in some instances.

Furthermore, housing assistance benefits are based on prospective income whereas income tax and social security data cover past periods and therefore are somewhat dated. Also, changes in employment and family situations could result in many cases where certified incomes did not match previous income tax return and social security data. Nevertheless, data regarding past incomes could provide valuable guidelines for estimating future income. Such data could be used to identify cases where large differences exist between certified prospective incomes and past data, indicating the need for additional review and reconciliation of the differences.

A possible solution to these problems is a provision contained in the 1979 housing amendments passed by the House and the Senate but not yet been enacted into law. The proposed legislation provides for HUD to establish procedures to assure that income provided by tenants under the section 8 program is complete and accurate by utilizing data drawn from unemployment compensation; Federal income taxation; and data relating to benefits made available under the Social Security Act, the Food Stamp Act of 1977, or title 38 of the U.S. Code in verifying reported tenant incomes. If enacted, a similar procedure could be implemented for verifying tenant incomes at HUD's acquired, formerly subsidized projects.

INADEQUATE HUD MONITORING OF PROJECT OPERATIONS

HUD field office personnel are required to review monthly project accounting reports and to make periodic site visits to spot check all aspects of project operations. Such monitoring can be an important managerial technique in improving project manager performance and reducing project costs. However, HUD area offices have not adequately monitored project manager activities or project operations.

Accounting report reviews and site visits

Five of the field offices in our review were not making timely reviews of the accounting reports or making sufficient or meaningful site visits, as illustrated by the following examples.

Example 1

Our review at one project disclosed several instances of project funds being used to pay for apartment repairs when no repairs were made. We also noted other instances of unnecessary costs. For example, the project had at least three employees more than the HUD area office had authorized, was charging about $125 to the project each month for project manager administrative expenses that should have been absorbed in the project manager's fee, improperly charged charitable contributions as advertising expenses, and rented small office equipment for 2 years at twice what it would have cost to buy the equipment. Our inquiry into the extent of HUD site visits and reviews of monthly accounting reports for the project revealed that (1) no visits were made from April 1976 to September 1977 (a 17-month period), (2) when visits were made after September 1977 they were concerned primarily with the physical condition of the project, and (3) the area office was 10 months behind in reviewing monthly accounting reports. We brought these matters to the area office's attention and were subsequently advised that corrective action had been taken.

Example 2

At another HUD field office there were lengthy delays in the review of the monthly accounting reports. At two of the projects, the field office was almost a year behind in its review of these reports. In addition, we were told that shortage of staff had prevented HUD personnel from visiting projects on a regular basis. Instead, they had the project managers come to the HUD field office or talked with them by telephone.

We discussed the problems of inadequate site visits and lack of timely accounting report reviews with HUD field office personnel. They advised us that lack of staff and higher priority work had precluded them from making such visits and reviews.

Inadequate HUD monitoring of income verifications by project managers

The HUD offices included in our review did not adequately monitor the project income certifications and verifications. Any such reviews made by the project managers generally concentrated on assuring the mathematical accuracy of the income certifications. Also, the office reviews of some project certifications were not done by the HUD realty specialists, who should have the best knowledge of each project's peculiarities. Instead, reviews were done by clerks who had no direct contact with the projects. Clerks made the reviews partly to relieve the realty specialists' administrative workload.

The three projects discussed on page 18, which had no verifications of tenant income, illustrate the lack of attention to the income certification and verification process by two HUD field offices. It is unlikely that nonverification of income and the numerous calculation errors made by project personnel could have gone undetected had the projects' income certification and verification records been reviewed by HUD field personnel.

Even when HUD became aware of situations warranting corrective action, it did not move as quickly as it could have. For example, at one project, a HUD review disclosed that tenant incomes had been certified incorrectly, resulting in tenants paying less rent than they should have paid. HUD requested the project manager to recompute the rents, but it was four months before he did so.

HUD historically has done little or no monitoring of income certifications and verifications. Since 1971, we have issued five reports which identified inadequate HUD monitoring of income reporting and verification relative to HUD's housing assistance programs. HUD area office officials acknowledged that they have not done a thorough job of monitoring income certifications. They explained, however, that management of HUD-owned projects has traditionally had lower priority than other HUD activities and has not been provided the needed quantity and quality of staff.

After we brought the matters noted during our review to the attention of HUD headquarters personnel, they issued instructions to the field offices to improve controls and monitoring of operating expenses at the acquired projects. HUD notified the field offices of the irregularities on September 12, 1978, and reemphasized the critical need to improve monitoring and contracting activities. Specifically, field offices were directed to

--increase their visits to the projects,

--exercise greater control over their contracting practices, and

--timely review monthly expense reports.

CONCLUSIONS

HUD currently exercises little control over project costs because it lacks financial information, including cost standards, needed for good oversight management. Furthermore, the practice of paying for some expenses from the General and Special Risk Insurance Funds, coupled with the lack of reporting of individual project operating expenses, revenues, and losses, does little to foster cost consciousness in HUD and project employees in operating HUD-owned projects.

Also, there are indications that tenants are underreporting their incomes and therefore are paying even lower rents than they are entitled to under HUD's revised rent reduction policy. This underreporting often goes undetected because project managers have done a poor job of verifying reported incomes.

Finally, HUD has generally done an inadequate job of monitoring project operations.

RECOMMENDATIONS

We recommend that the Secretary of Housing and Urban Development:

- --Develop a financial information system to produce, for comparative analyses, timely data on the costs, subsidies, and losses at HUD-owned projects.
- --Develop cost standards for projects to assist project managers and HUD employees in evaluating project expenses.
- --Improve the monitoring of project operations through more frequent site visits, with emphasis on reviews of the reasonableness of costs being incurred and project income certifications and verifications.
- --Penalize project managers who do not adequately fulfill their managerial responsibilities by reducing their management fees or replacing them.
- --Identify in its annual budget request the losses and rental assistance subsidies being absorbed by the General and Special Risk Insurance Funds in operating HUD's acquired, formerly subsidized multifamily housing projects.

AGENCY COMMENTS AND OUR EVALUATION

HUD officials advised us in early December 1979 that, due to a heavy workload, they would be unable to provide written comments on this report in the time allotted for comments. Instead, we obtained oral comments from the Assistant Secretary for Housing-Federal Housing Commissioner and his staff.

HUD officials told us that they recognized that there are major problems in the management of HUD-acquired projects and they generally agreed with our recommendations. They stated that they were involved in a substantial effort to provide the financial information needed to manage not only the HUD-owned multifamily housing projects, but HUD-insured and -assigned projects as well. They explained that the management system currently in effect for acquired projects has remained essentially unchanged since the early 1970s when HUD had few acquired projects, almost all of which were formerly unsubsidized projects. The Federal Housing Commissioner told us that the increase in total HUD-owned projects since the mid-1970s, and the fact that many of the projects were formerly subsidized (often requiring more intensive management review), should have resulted in increased HUD attention and staffing for this area. He also stated that steps which had historically been taken to address this problem were inadequate.

However, HUD has recognized for some time the need to improve its management and monitoring of HUD-owned properties. The commissioner told us that HUD has been involved in a comprehensive effort to improve the management and control of its insured, assigned, and acquired projects. Specifically, he told us that HUD has increased staffing levels in field offices responsible for monitoring insured, assigned, and acquired projects from about 790 persons to about 1,150 persons in the last 2 years. Additionally, HUD is now planning to take actions (as part of an overall management improvement plan for all insured, assigned, and acquired projects) to

--require annual operating budgets for acquired projects;

--improve the accounting system for acquired projects to better identify, categorize, and control costs incurred;

--perform annual management reviews of the projects; and

--provide training of personnel in the loan management and property disposition functions.

HUD officials told us that implementation of these actions is planned for calendar year 1980.

We believe that the actions planned by HUD should improve HUD's management of and control over acquired projects. However, a judgment of the degree to which these actions will resolve the problems identified in our report cannot be made until the actions planned by HUD are actually implemented.

CHAPTER 4

SALE OF HUD-OWNED, FORMERLY SUBSIDIZED PROJECTS WITH SECTION 8 SUBSIDIES WILL COST BILLIONS OF DOLLARS

In 1977 HUD began making major changes in the way it disposes of acquired, formerly subsidized multifamily housing projects. Basically, the objective of HUD's new policy is to sell these projects in a manner which will keep them available to and affordable by low- and moderate-income families. HUD plans to meet its objective by selling these projects with commitments of section 8 subsidies attached to the sales.

We estimate that it may cost HUD about $1 billion in section 8 funds over the 15-year commitment period to dispose of its inventory (as of April 30, 1979) of 283 projects. If HUD acquires and subsequently disposes of 766 other subsidized projects, which are either in foreclosure or in serious financial difficulty, an additional $3.7 billion in section 8 commitments may be needed to sell these projects. On the basis of annual increases already experienced during the last 3 years on section 8 projects, we estimate that the funds needed for the last year of the contract period could be more than double the amount budgeted under existing contracts; thus, the above estimates may be conservative.

POLICY CHANGES MADE IN THE SALE OF FORMERLY SUBSIDIZED PROJECTS

Until 1977 HUD generally treated all acquired multifamily housing projects similarly. During ownership, HUD attempted to obtain the highest possible occupancy rate at maximum possible rentals. When disposing of these properties, HUD attempted to sell them at the earliest possible time at the highest prices obtainable.

HUD was concerned that when these projects were sold, the new owners could raise rents substantially, thus working a hardship on lower income tenants. HUD has not, however, performed an analysis of projects sold without subsidies to establish the degree to which such problems were occurring.

Because formerly subsidized projects (primarily those originally insured under sections 221 (d)(3) and 236) were originally designed to serve low- and moderate-income families, HUD believed that it would be a breach of the Federal Government's commitment to sell its inventory of these projects in a manner which would not ensure that these projects remained available to and affordable by low- and moderate-income families. To ensure that formerly subsidized projects would remain available to such families after they were sold, HUD established a policy of selling these projects with section 8 subsidies attached to the sales.

Under the section 8 program, HUD pays the project owner the difference between what a lower income tenant can afford and the fair market rent for an adequate housing unit. No eligible tenant need pay more for rent than 25 percent of adjusted income. To be eligible for the program, tenants must have income of 80 percent or less of the area median income.

In October 1978, the Housing and Community Development Amendments of 1978 (Public Law 95-557, dated Oct. 31, 1978) formally legislated the goal of preserving these housing units so that they can remain available to and affordable by low- and moderate-income families.

In addition to its policy of selling these projects with section 8 subsidies, HUD has also revised its procedures for advertising the sale of these projects and for evaluating purchasers' proposals. Essentially, these projects will be offered for sale on a purchase proposal basis with a minimum price based on fixed rents. HUD evaluates and rates the purchase proposals on several nonprice factors, as follows:

--Ability to provide sound financial management.

--Ability to provide sound physical management.

--Ability to respond to tenants' economic and social needs and to work with resident and neighborhood organizations.

--Quality of proposed management and ownership plan.

--Adequacy of organization and staff.

--Responsiveness to any general comments relating to the disposition of the project submitted by community groups.

A responsible HUD official told us that he believed the use of these nonprice factors in selecting the successful bidder for its projects will better ensure the long-term success of the projects after they are sold.

BILLIONS OF DOLLARS OF SECTION 8 SUBSIDIES WILL BE NEEDED UNDER HUD'S NEW SALE WITH SUBSIDY POLICY

Based on the number of formerly subsidized units HUD either owns or may own in the future (over 100,000 units), section 8 commitments of about $4.7 billion may be needed over the 15-year term of the commitments to dispose of the projects in accordance with HUD's new policy of sale with section 8 subsidies.

Current and potential inventory

The following table shows the number of formerly subsidized projects and units which HUD either owned as of April 30, 1979, or may own in the future:

Status	Projects	Units
HUD-owned	283	24,332
In foreclosure process	235	19,974
Assigned--currently in default	531	61,897
Not yet assigned--in default	132	16,069
Total	1,181	122,272

In fiscal year 1979 HUD received funding for a new flexible-subsidy program to assist financially troubled subsidized projects. Some of the units shown in the table above may be assisted under this program and thus may not be acquired. As of July 1979 HUD had not yet decided which projects would be assisted under the flexible subsidy or the exact level of assistance. One of the program objectives of the flexible-subsidy program is to avoid claims for insurance benefits. Since HUD has already paid the claims for all projects in the assigned and foreclosure categories, it is questionable at this point whether many of these projects will receive the flexible subsidy. Other projects may independently cure their defaults and likewise may not be acquired. Thus, although it is difficult to accurately predict the future, it appears that of the 1,181 projects with 122,272 units either already owned or experiencing financial difficulty, HUD could own over 100,000 of these units.

Section 8 subsidy commitments experienced and projected in the sale of these projects

When HUD adopted the policy of selling these projects with section 8 commitments in 1977, it used section 8 Substantial Rehabilitation subsidies in conjunction with these sales.

Between June 1977 and September 1978, HUD sold 16 formerly subsidized projects having 1,921 units with commitments of section 8 subsidies. Under the section 8 contracts, HUD agreed to provide section 8 assistance on behalf of the tenants of a designated number of units in the project. The subsidy commitments under these sales are as follows:

Projects	Units	Annual section 8 commitment	Commitment per unit: Per month	Per year	For 20 years
16	1,921	$6,568,020	$285	$3,419	$68,380

In September 1978, HUD modified its use of section 8 in conjunction with these sales by converting to the section 8 Existing program. A HUD official told us that he expects the contract rents under the section 8 Existing program to be less than those experienced under the Substantial Rehabilitation program because established fair market rents for existing rental housing are less than the established rents for new or substantially rehabilitated housing.

HUD planned to sell about 14,000 units under the section 8 Existing program in fiscal year 1979 and budgeted about $35 million in contract authority to meet these commitments. This amounts to about $208 per unit monthly, or about $2,500 per unit yearly. However, HUD's cost estimate of $2,500 per year in section 8 commitments may be low. For example, as of May 1979, HUD had made section 8 Existing fund reservations for about 5,456 units in the amount of $16,078,351, or an average commitment of about $2,947 per unit yearly.

For fiscal year 1980 HUD planned to change to the use of section 8 Moderate Rehabilitation subsidies. HUD officials told us they believe the section 8 commitments per unit under this program will fall somewhere between the cost of the section 8 Substantial Rehabilitation and section 8 Existing program commitments.

Because HUD has not yet developed any experience with the section 8 Moderate Rehabilitation subsidies, it is difficult to accurately predict the level of future commitments. For projection purposes, however, we used $3,000 per unit per year, a figure which is in the range of the commitments experienced under the Section 8 Existing program and Substantial Rehabilitation program commitments.

The following table shows a breakdown of the projected section 8 costs to dispose of HUD's formerly subsidized inventory (as of April 30, 1979) and projects it may acquire in the future.

Project status	Projects	Units	Per unit per year	Total for all units 1 year	Total 15-year runout
HUD-owned	283	24,332	$3,000	$ 72,996,000	$1,094,940,000
In foreclosure process	235	19,974	3,000	59,922,000	898,830,000
Assigned--currently in default	531	61,897	3,000	185,691,000	2,785,365,000
Not yet assigned--in default	a/132	a/16,069	-	-	-
Total	1,049	106,203	$3,000	$318,609,000	$4,779,135,000

a/Not included in the total since a number of these projects may be assisted under the flexible-subsidy program.

As shown above, it could cost HUD over $1 billion in section 8 commitments to dispose of its current inventory of formerly subsidized projects.

If HUD eventually acquires the currently troubled projects which may not be assisted by the flexible-subsidy program, an additional $3.7 billion in section 8 subsidies will be needed to dispose of these projects under HUD's current policy.

A factor affecting both past and future section 8 commitments is that contract rents are not fixed but are subject to annual adjustments. For the section 8 program, this annual increase has averaged about 6 percent per year for the last 3 years. Continuation of this trend would result in the contract rents in the 15th year of the commitment period being more than double the current amount. Thus, existing fund reservations to honor these section 8 commitments may be insufficient, and additional or supplemental appropriations may be necessary in the later years of these commitments.

CONCLUSIONS

It may cost HUD about $1 billion in section 8 funds over the 15-year commitment period to dispose of its inventory of 283 acquired, formerly subsidized multifamily housing projects. If HUD acquires and subsequently disposes of 766 additional subsidized projects which are either in foreclosure or in serious financial difficulty, an additional $3.7 billion in section 8 commitments may be needed to sell these projects over the 15-year commitment period.

ANNUAL RENT REVENUE REDUCTION

BASED ON INCOME CERTIFIED FOR

TENANTS IN NINE HUD-OWNED PROJECTS

Project	Total occupied units	Annual rent revenue: Actual or authorized: Before policy	After policy	Decrease: Total	Average per unit
Sunset Ridge	127	$ 210,300	$ 183,108	$ 27,192	a/$214
Booker Gardens	106	142,020	42,324	99,696	941
Citrus Gardens	131	222,984	150,480	72,504	553
Martin L. King	97	233,232	174,732	58,500	603
Marcus G. Square	94	225,132	160,080	65,052	692
San Juan Batista	79	157,020	123,432	33,588	425
Pinetree Village	139	216,048	148,608	67,440	485
Western Manor	81	115,512	50,268	65,244	805
Olive Hill	75	104,820	69,984	34,836	464
Total	929	$1,627,068	$1,103,016	$524,052	
Average per unit per year		$1,751	$1,187	$564	
Average per unit per month		b/$146	$99	$47	

a/ This decrease would be $336 if the section 8 payments made by the local housing authority were excluded. The local housing authority was paying the project $1,258 per month as of August 1978 for 17 tenants under the section 8 program, or about $15,100 annually. This equates to about $890 per tenant per year.

b/ Based on the occupied rather than the total units in each project.

APPENDIX I

PROJECTS WITH TENANTS WHO DID NOT REPORT OR UNDERREPORTED SOCIAL SECURITY INCOMES OVER $500 FOR CERTIFICATION RESULTING IN LOST REVENUES TO HUD (notes a and b)

Project	Tenant households: Total reviewed	Tenant households: Number receiving social security incomes	Number of tenant households with social security incomes over $500: Not reported for certification	Number of tenant households with social security incomes over $500: Underreported for certification	Total annual income over $500 not reported or underreported by tenants: Not reported	Total annual income over $500 not reported or underreported by tenants: Underreported	Total annual income over $500 not reported or underreported by tenants: Total	Estimated annual loss of rent revenues to HUD due to social security incomes: Not reported	Estimated annual loss of rent revenues to HUD due to social security incomes: Underreported	Estimated annual loss of rent revenues to HUD due to social security incomes: Total
1	117	29	2	3	$ 3,998	$ 2,654	$ 6,652	$ 949	$ 469	$ 1,418
2	93	16	4	1	9,222	570	9,792	2,147	136	2,288
3	126	22	7	3	16,451	4,359	20,810	2,619	560	3,179
4	82	21	5	1	13,303	2,050	15,353	3,326	512	3,838
5	73	34	9	2	23,676	7,371	31,047	5,490	1,751	7,241
6	57	18	4	2	15,082	2,699	17,781	3,488	675	4,163
7	103	18	3	4	5,634	4,233	9,867	1,196	1,058	2,254
8	80	17	8	1	18,068	793	18,861	4,291	188	4,479
9	64	8	1	1	2,962	776	3,738	704	184	888
Total	795	183	43	18	$108,396	$25,505	$133,901	$24,210	$ 5,533	$29,743

a/Percent not reporting--23.

b/Percent not reporting or underreporting--33.

APPENDIX II

SELECTED TENANTS DETERMINED TO BE RECEIVING WELFARE INCOMES, SOME OF WHICH WAS NOT REPORTED AT THE TIME OF CERTIFICATION

Project	Tenants receiving welfare incomes at time of income certification: Total number	Number not reporting	Percent not reporting	Total welfare incomes not reported: Monthly	Annually	Total rent revenue lost due to nonreported welfare incomes: Monthly	Annually
1	32	6	19	$ 659	$ 7,908	$ 156	$ 1,872
2	13	4	31	327	3,924	76	912
3	3	0	0	0	0	0	0
4	29	10	34	2,342	28,104	586	7,032
5	30	6	20	793	9,516	137	1,644
6	38	5	13	1,301	15,612	310	3,720
7	46	5	11	648	7,776	157	1,884
Total	191	36	19	$6,070	$72,840	$1,422	$17,064

APPENDIX III

ANNUAL LOST RENT REVENUE FROM TENANTS IN EIGHT PROJECTS BEFORE MAY 1977 WHO POSSIBLY UNDERREPORTED THEIR INCOMES FOR CERTIFICATION BASED ON THE REPORTED INCOMES BEING LESS THAN OR BARELY COVERING THE RENTS AND UTILITIES THEY HAD PAID PREVIOUSLY

	Apartments		Tenants possibly underreporting		Tenants reporting monthly incomes in excess of amounts paid previously for rent and utilities		Tenants reporting monthly incomes that were less than amounts paid previously for rent and utilities		Monthly rents paid by tenants after certification			
Project	Total	Occupied at time of review	Total number	Potential annual rent revenue loss	Total	Range of excess income	Total	Range of lesser income	No rent	$1-30	$31-50	Over $50
1	132	131	7	$ 9,648	7	$24 to 136	0	0	1	6	0	0
2	106	106	38	46,476	34	10 to 200	4	$7 to $35	24	11	3	0
3	192	79	2	1,320	2	166	0	0	0	0	0	2
4	102	81	23	20,813	22	53 to 200	1	7	0	0	20	3
5	110	97	5	6,984	4	24 to 121	1	74	0	1	2	2
6	101	94	6	8,076	5	66 to 187	1	37	0	1	1	4
7	110	75	8	6,937	8	64 to 194	0	0	0	0	5	3
8	168	139	10	11,853	10	6 to 118	0	0	0	5	5	0
Total	1,021	802	99	$112,107	92		7		25	24	36	14

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APPENDIX IV

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