BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Section 8 Subsidized Housing-- Some Observations On Its High Rents, Costs, And Inequities

Like the subsidized housing programs which preceded it, the Department of Housing and Urban Development's Section 8 Rental Assistance Program is costly and serves only a fraction of the millions of households in need. Since its inception in 1974 the program's rents and costs have risen at rapid rates and to significant levels. While much of this increase is justified in light of housing market conditions, a portion of it is the result of program or administrative weaknesses.

There are no easy or inexpensive solutions to the problem of providing housing assistance to the poor but efforts must be made to ensure that available dollars are spent in ways that allow meaningful assistance to be provided to the maximum number of households.

There are some actions the Secretary of Housing and Urban Development can take to hold down individual unit costs of section 8, provide greater program equity, and create a more acceptable program image.

UNITED STATES GENERAL ACCOUNTING OFFICE

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

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To the President of the Senate and the
Speaker of the House of Representatives

This report presents our findings on the high rents, costs, and inequities of the Department of Housing and Urban Development's principal program for providing rental housing assistance to the poor--the Section 8 Program.

Our review was made to determine whether any opportunities existed for better containing the rapidly rising costs of the Section 8 Program, thereby enabling it to serve more people. We also wanted to determine how well the Section 8 Program was dealing with certain of the problems experienced by the subsidized housing programs which preceded it.

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

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

SECTION 8 SUBSIDIZED HOUSING--SOME OBSERVATIONS ON ITS HIGH RENTS, COSTS, AND INEQUITIES

D I G E S T

The Department of Housing and Urban Development's (HUD's) Lower Income Rental Assistance Program--the Section 8 Program--costs more than it should and is serving only a fraction of those in need. There are actions HUD should take to hold down costs and extend the program to more households. GAO did find that the projects it visited were having a positive impact on the neighborhoods in which they were located and were providing adequate housing to the families living in them.

At the end of fiscal year 1979, just over 750,000 existing, newly constructed, and substantially rehabilitated housing units were occupied by tenants being assisted by section 8. Expenditures were running at the rate of about $2 billion annually. Budget authority for these units, and an additional 250,000 units which are expected in fiscal year 1980, has been set at about $128 billion. (See p. 5.)

The Section 8 Program and its associated costs are tied very closely to so-called fair market rents which are (1) established by HUD for each major housing market in the Nation, (2) updated at least annually, and (3) computed separately for existing and newly constructed/substantially rehabilitated units. Fair market rents are supposed to be based on actual rents of comparable, modest type housing. They are the principal basis for determining maximum gross rents (including utilities) permitted to be paid for initial occupancy of dwelling units assisted under section 8. Additionally, eligible households must have incomes of no more than 80 percent of the area median income. Households have been required to pay at least 15 but no more than 25 percent of their incomes toward rent, with the

Federal Government subsidizing the difference between what the households pay and the contract rents.

In recent years it has become very costly to build or rent new housing--subsidized or not. Factors contributing to these high costs are many and varied, and often the result of economic, social, and political considerations for which HUD cannot be held accountable. It is not these costs and this type of situation with which GAO is concerned in this report. Rather, GAO's review of the establishment of program rents and its visits to selected projects disclosed instances, controllable by HUD, where rents and costs were greater than they should have been. It is these costs with which GAO is concerned.

SHARPLY RISING RENTS RESULT IN HIGH PROGRAM COSTS

A contributing factor to the high program costs has been the manner in which HUD has determined fair market and gross rents. Although GAO made no effort to determine whether the rents are substantially higher than needed to achieve program goals, and although the rents were initially criticized for being too low, they have since risen at rates and to levels which could in the future provoke serious challenges to the very existence of the program. Fair market rents, for example, for newly constructed/substantially rehabilitated 2-bedroom walk-up units in San Francisco, California, went up 121 percent during the 4-year period from 1974 to 1978; in Cincinnati, Ohio, the increase was 95 percent; and in Atlanta, Georgia, the increase was 72 percent. The average increase for the 17 cities GAO sampled was 53 percent. Similar and even more noticeable increases were experienced in the existing housing portion of the program. (See pp. 14 to 18.)

Fair market rent increases from 1974 to 1978 in 8 of the 17 cities for which data was available outpaced increases relating to each of the cities in the overall Consumer Price Index, the housing component of the Consumer Price Index, and two reputable indexes which measure construction costs. While these individual indexes do not account for all rental market conditions, time differences, and other factors which have an effect on the costs of constructing and operating housing, collectively the indexes do provide some gauge against which the rise in fair market rents can be compared. (See pp. 18 to 27.)

Fair market rents published in 1979 generally followed the same rising trend as the previous 4 years and have reached rather lofty heights. For newly constructed/substantially rehabilitated housing, \$400 to \$600 monthly rental levels for various sizes and types of units in many locations were commonplace. In New York City and San Francisco, two high cost areas, levels for some 3- and 4-bedroom units were set at \$900 to almost \$1,100.

Fair market rental levels for existing housing units were considerably less; generally ranging from \$150 to \$400 per month depending on the size, type, and location of the units. (See p. 29.)

Although gross rents are not supposed to exceed fair market rents except in special circumstances, they were found to be higher in 68 percent of the projects GAO sampled. (See pp. 30 to 33.)

The magnitude of currently established fair market and gross rents suggests high potential annual subsidy payments for some units. In its annual budget justifications, HUD estimated for fiscal year 1979 the average annual unit cost (not considering any tenant contribution toward rent) for the existing housing segment of the program to be \$2,670; for new construction about \$4,300; and for substantial rehabilitation about \$4,700. GAO's analysis disclosed some families receiving housing subsidies as high as \$5,000 to \$7,000 per year and even higher. (See pp. 33 to 37.)

OTHER FACTORS LEADING TO HIGH PROGRAM COSTS

Although GAO did not identify all of the reasons for the high costs of section 8, the following additional factors were noted as having some impact.

--Little show of concern for the program's high rental and subsidy levels on the part of some HUD officials involved in the rent-setting processes. This was reflected in many instances by a lack of administrative care and discipline. (See ch. 4.)

--Too few market rent comparables to use in establishing the rents have forced those making the determinations to use less refined and reliable methods. (See pp. 42 to 44 and 48.)

--Too much emphasis by HUD headquarters on meeting production goals and not enough emphasis on costs. (See pp. 40, 43, and 49 to 52.)

--A generous HUD attitude regarding features and amenities not normally expected in subsidized housing. Such housing is costly to produce, involves high unit rents, and invites resentment on the part of the taxpaying public who see their subsidized neighbors living in better accommodations than they themselves can afford. (See pp. 62 to 70 and 77.)

--Failure of owners and public housing agencies to properly verify tenant income and allowances. (See pp. 72 to 75.)

Most of the housing presently being provided by section 8 is from the costly new construction/substantial rehabilitation program segments. The high cost of this housing has, in many instances, blocked the achievement of a program goal of promoting economically mixed housing. The housing is often so costly that moderate and even middle income unassisted households cannot afford to live in it. (See pp. 5, 9, and 75 to 77.)

The Housing and Community Development Amendments of 1979 authorized, among other things, an increase in the maximum rental contribution required from program beneficiaries from 25 to 30 percent of income. HUD, however, considered the provision to be discretionary and rejected it because of the agency's feeling that it would place an added burden on lower income tenants. HUD's position, however, ignores the large number of needy households for which there are currently no subsidized housing dollars. (See pp. 85 and 89.)

The Section 8 Program is inequitable in the sense that there is insufficient funding available to help the millions of households in need of housing assistance. This inequity is further exacerbated by the disparities in the quality of housing provided under the program. Some families are assisted with housing modest in nature, while others are assisted with housing which, at least, approaches the luxury category. (See pp. 10 and 11.)

GAO solicited advice from a variety of sources concerning what might be done to improve the way in which housing assistance is provided to the poor. While most experts agreed that section 8 costs too much and serves too few, there was no consensus regarding what should be done. Suggestions offered were varied and ranged from slight modifications in the way in which the assistance is now provided to more substantive changes. (See ch. 6.)

RECOMMENDATIONS

Recent changes in HUD regulations should help to reduce costs within the program and thereby enable more households to be assisted. To further help in this effort, the Secretary of HUD should:

--Issue a notice to all program personnel outlining the economic, social, and political reasons why section 8 costs must be curbed and why greater equity and uniformity in the distribution of benefits is needed. (See p. 52.)

--Ensure either through strengthened procedures or better monitoring of established procedures that fair market and contract rents are properly established. (See p. 52.)

--Strengthen the procedures used in verifying tenant income and allowances. (See p. 78.)

--Increase tenant contributions toward rents as authorized by the 1979 legislation. (See p. 89.)

--Establish a work group within HUD to conduct socioeconomic research directed to finding ways in which section 8 and other federally subsidized housing costs can be reduced and a greater degree of equity achieved among the many households determined to be in need. (See p. 89.)

AGENCY COMMENTS

HUD disagreed generally with GAO's observations on the Section 8 Program's high rents, costs, and inequities. HUD attributes the costs of the program very simply to the fact that today it costs more to build new housing and to subsidize low-income families living in that housing. HUD indicated that it has generally done all that can be done to ensure program efficiency, economy, and effectiveness. HUD stated that the report raises a critical question for those concerned with Federal housing policy:

> "Is a program which combines a production subsidy for new housing construction with a rent subsidy to enable low income families to live in that new housing too costly and troublesome to be politically and socially desirable?"

Regarding GAO's recommendations that a higher degree of section 8 cost consciousness be stimulated within HUD and that procedures should be strengthened or better monitored to ensure the proper establishment of fair market and contract rents, HUD denied that there had been a lack of concern within the agency regarding high program rental and subsidy levels. HUD conceded that errors in the rent-determining processes were sometimes made. HUD provided no specifics as to how GAO's recommendations in these matters had been addressed. GAO believes that its recommendations warrant careful attention by HUD and that guidance and direction from HUD headquarters to its field offices on the need for greater attention to establishing fair market and contract rents is necessary.

HUD agreed with GAO's findings and recommendations regarding the need for greater verification of tenant incomes. It outlined several procedures, notices, and training courses which it had developed or is developing which answer GAO's recommendations. In response to GAO's recommendation that there is a need within the agency for socioeconomic research in the subsidized housing area, HUD stated it is constantly challenging and re-evaluating its programs in light of their objectives and their success in achieving those objectives.

GAO does not believe that HUD has adequately recognized the potential which exists for better containing costs of the Section 8 Program through more effective administration nor of the need for more intensive research of ways to achieve both cost reductions and a more equitable distribution of program benefits.

Contents

ABBREVIATIONS

BLS	Bureau of Labor Statistics
CBO	Congressional Budget Office
CPI	Consumer Price Index
CRS	Congressional Research Service
FMRs	fair market rents
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
MIS	Management Information System
OMB	Office of Management and Budget
PHAs	Public Housing Agencies

CHAPTER 1

INTRODUCTION

The concept of Government-subsidized housing for lower income families began in 1937 with a program aimed at stimulating employment and clearing slums. Nonetheless, it marked the first time Federal funds were used to finance new housing construction for the poor.

Since then, many Federal housing programs designed to help lower income families have been established, spurred by the Housing Act of 1949 which set a national goal of "a decent home and suitable living environment for every American family." These programs were generally production oriented and have included rental and homeownership units, urban and rural areas, and profit and nonprofit developers.

Concern about the subsidized housing programs began in the early 1970s when homes in certain areas were abandoned and overproduction occurred elsewhere. The cost of construction under certain programs came under attack as did the fact that the programs were serving only a fraction of the poor. In addition, the programs were criticized from the standpoint that they concentrated the poor in housing projects and burdened them with the stigma of being wards of the Government.

In response to these problems and others, the Nixon administration in January 1973, suspended federally assisted housing programs, and construction in a number of the programs since then has generally been limited to commitments made before the suspension.

Many Americans do not have the financial means to obtain suitable housing. The Department of Housing and Urban Development (HUD)--which administers the principal Federal programs which provide assistance for housing and for the development of communities--estimated not long ago that there were over 18 million families in this country needing some form of housing assistance. Six million of these families were living in substandard housing, 10 million were spending a disproportionate share of their incomes for housing, and the remaining 2 million were living in overcrowded housing. To help correct this situation and in a further attempt to solve the problems discussed above, the Nixon administration shifted its emphasis from production oriented programs to programs that provide recipients with funds or other means to compete for existing housing in the neighborhoods of their choice. The major Federal program for doing this is the new leased housing program known as section 8.

SECTION 8 PROGRAM DESCRIPTION

The Housing and Community Development Act of 1974 (Public Law 93-383) amended the United States Housing Act of 1937 and added, under section 8, a new lower income housing assistance program. According to the act, the purposes of the program were to (1) help lower income families obtain a decent place to live and (2) promote economically mixed housing. Section 8 of the act was to become effective no later than January 1, 1975. From inception, the program has made use of existing housing stock and newly constructed and substantially rehabilitated units. More recently, moderately rehabilitated units have also been made a part of the program.

Section 8, in actuality, provided for the continuation, on a modified basis, of the leased housing assistance program set forth in section 23 of the United States Housing Act which was enacted in 1965. This was a program whereby public housing agencies (PHAs) leased privately owned accommodations and, in turn, subleased the units to low-income families. Under this arrangement, some 150,000 units were leased. Section 8 has been the major program for providing federally subsidized housing since its 1974 enactment.

Under the existing housing segment of the Section 8 Program, HUD makes assistance payments for annual contribution contracts generally to PHAs authorized to engage or assist in developing or operating housing for lower income families. The PHAs, in turn, pay the owners of section 8 units on behalf of eligible families and in accordance with executed housing assistance payment contracts. Under the newly constructed and substantially rehabilitated segments, HUD is authorized to make assistance payments to owners or prospective owners who agree to construct or substantially rehabilitate housing in which some or all of the units are made available for occupancy by lower income families.

The moderate rehabilitation segment of the program involves the less than substantial repair and upgrading of existing dwelling units. Allowable rents under the program are to be adjusted to reflect reasonable costs attributable to the upgrading.

Owners under each of the Section 8 Program segments are responsible for operating and maintaining their units.

PROGRAM ELIGIBILITY

Eligibility for assistance under section 8 is generally limited to families with incomes which do not exceed 80 percent of the median income for the particular area of residence. An eligible family's contribution toward rent is determined by formula and may vary between 15 and 25 percent of income depending upon such factors as income level, family size, and extraordinary expenses such as high medical costs which the family must support. At least 30 percent of the program's newly constructed or substantially rehabilitated units are to be occupied by families with incomes which are below 50 percent of the median area income, and to the extent possible, this ratio is to be maintained in subsequent leasing. A Federal subsidy is paid equal to the difference between the contract rent--based on the market rent of comparable standard units in the area--and the amount of rent paid by the eligible family.

FAIR MARKET RENTS

The Section 8 Program and its costs are tied very closely to so-called fair market rents (FMRs) which have been defined (24 CFR parts 880, 881, and 882) as the rents, including utilities (except telephone), ranges and refrigerators; and all maintenance, management, and other services, which would be required to be paid to obtain (1) privately developed and owned, newly constructed rental housing of a modest (nonluxury) nature with suitable amenities and sound architectural design meeting the objectives of the HUD Minimum Property Standards or (2) privately owned, existing, decent, safe, and sanitary rental housing of a modest (nonluxury) nature with suitable amenities. Separate FMRs are to be established for dwelling units of varying size (number of bedrooms) and types (e.g., elevator, non-elevator, detached, semi-detached) and for different market areas. HUD should determine FMRs at least annually. As the above definition indicates, two different sets of FMRs are published--one covering the existing housing segment of the program, the other covering the new construction segment. FMRs developed for new construction are used for the substantial rehabilitation segment as well.

The two sets of FMRs are calculated differently. For existing housing, the FMRs are intended to reflect the average rents now being charged with suitable amenities in the market area. FMRs for new construction and substantial rehabilitation are based primarily on the levels of rentals paid for recently completed or newly constructed dwelling units of modest design within each market area as determined by HUD field staff. FMRs should reflect the rentals that prospective tenants who are not assisted would be willing and able to pay for recently completed or newly constructed dwelling units of modest design.

FMRs are published as proposals in the Federal Register before their publication in the same document in final form. This is done to encourage public participation in the formulation of FMRs and the receipt of useful comments from persons familiar with local market conditions.

Congressional conferees, in deliberating the contents of what was to become the Housing and Community Development Act of 1974, believed that the establishment of realistic FMRs would be a prime factor in the success or failure of the proposed new housing assistance program. During that time, the House Committee on Banking and Currency stated that FMRs were to be used to establish the maximum rental which may be charged with respect to any dwelling unit and that the actual rental charged was to be justified on the basis of the costs of owning and maintaining the dwelling unit. Otherwise, it was believed that Federal subsidies might be used to provide windfall profits to housing owners and the construction of shoddy and cheap projects could become commonplace.

Section 8 FMRs were first published in March and April 1975 for the new construction/substantial rehabilitation and existing segments of the program, respectively. Since then, revisions have been made annually as follows. 1/

New construction/ substantial rehabilitation	Existing housing
4-6-76 (effective 4-1-76)	3-29-76
6-30-77 (effective 4-1-77)	7-1-77 (effective 3-29-77)
6-13-78 (effective 4-1-78)	3-29-78

PROGRAM STATUS

As of September 30, 1979, HUD's Section 8 Management Information System (MIS) reflected the following program activity.

1/Revisions to the FMRs were again made in 1979 after much of our analysis had been completed. See pages 29 and 40 for discussions on the most recent changes.

Status	New construction Projects	New construction Units	Substantial rehabilitation Projects	Substantial rehabilitation Units	Existing housing Units	Total Units
Occupied	2,252	151,200	267	18,711	582,923	752,834

	New and rehabilitated Projects	New and rehabilitated Units	Existing housing Units	Total Units
Reserved--not started	3,343	188,384		
Started--not completed	3,279	264,303		
Completed--not occupied	142	23,737		476,424
Reserved--contract not executed			93,723	
Contract executed--not occupied			117,976	211,699
Total				1,440,957

HUD's earlier budget data had estimated that through fiscal year 1979 there would be 898,000 section 8 units eligible for $2.220 billion in annual payments. It also estimated that an additional 250,000 units would become eligible for payment during fiscal year 1980 from (1) new construction--105,600, (2) substantial rehabilitation--41,800, and (3) existing housing--102,600 segments of the program. Contract authority for these units was set at about $940 million.

From program inception through fiscal year 1980, HUD estimates that the contract authority approved by the Congress for the Section 8 Program will be about $5.6 billion. Budget authority, which is to cover the costs of the units throughout their respective contracts, is estimated in fiscal year 1980 to be about $128.2 billion.

SCOPE OF REVIEW

We performed our review at HUD headquarters in Washington, D.C.; its regional and/or area offices in Chicago, Illinois; New York City, New York; and Washington; and at PHAs in both Chicago and New York City. In addition, we obtained rental information for selected projects from officials of other HUD field offices and PHAs.

We reviewed the legislation and many of HUD's regulations, procedures, and statistical reports relating to the Section 8 Program.

We selected specific projects for detailed review in Chicago and New York City. We examined tenant files at these projects. We also visited each of the projects to identify amenities and to talk with several of the tenants.

We maintained contact with personnel from HUD's Office of Inspector General (OIG) throughout the review. We obtained copies of related OIG reports and, where appropriate, incorporated some of the findings in this report.

We discussed the Section 8 Program and the results of our review with numerous HUD officials. In addition, we discussed problems with, and alternatives to, the program with people in and outside the Government we considered knowlegeable about housing problems, techniques, strategies, and solutions.

As indicated, the bulk of our field work was performed in Chicago and New York City. These locations were chosen because of their known high levels of Section 8 Program activity and high costs. While findings in these two locations may not be directly compared to all other locations in the country, our additional work involving other cities throughout the country, both large and small, corroborated our Chicago and New York findings and lead us to believe that section 8's high rents and costs are widespread.

Throughout our review we accepted the fact that in recent years it has, indeed, become very costly to build new housing--subsidized or not. Factors contributing to these high costs are many and varied, and the result of economic, social, and political considerations for which HUD cannot generally be held accountable. It is not these costs and this type of situation with which we are primarily concerned in this report. Rather, our review of the establishment of fair market and contract rents and our visits to selected newly constructed and substantially rehabilitated projects disclosed to us instances, controllable by HUD, where program rents and costs were greater than they should have been. It is these costs we are concerned about, and we believe HUD can reduce these costs and thereby improve its ability to serve more people with the funds available.

AGENCY COMMENTS AND OUR EVALUATION

We obtained formal comments on a draft of this report from HUD and have included them as appendix I. The comments state generally that the report creates false and misleading impressions and contains biases and misrepresentations. We have addressed HUD's comments both at the end of each chapter and in the appendix.

In its comments on this chapter, HUD stated that the 1973 moratorium was a most vehemently debated subject, that many believed it to have been motivated by reasons of partisanship and ideology, and that some of the terminated programs were more successful than given credit for.

With regard to the scope of our review, HUD stated that neither the specific projects we selected for review in Chicago and New York City nor the method of analysis used offer any basis for making predictions about conditions in the Section 8 Program. HUD also stated that subsequent chapters contain no analysis to support the contention that program rents and costs were greater than they should have been, nor that there is any significant opportunity for HUD to reduce costs and thereby serve more people with available funds.

In our view, HUD has unjustifiably discounted or misconstrued most of the information presented in our report, while offering very little in the way of substantive rebuttal. In subsequent chapters we present extensive information on HUD's deficient administration in establishing fair market and contract rents; the apparent lack of concern by some officials for the Section 8 Program's high rental and subsidy levels; the wide range in the quality of housing being provided under the program; the fact that tenant income and allowances are not always properly verified; and on various other circumstances controllable by HUD which we believe result in higher program rents and costs than necessary. To the extent we felt it necessary, language in the report has been revised to preclude misinterpretation of our findings. (See pp. 102 to 106 for HUD's comments and our response to those comments.)

CHAPTER 2

POSITIVE AND NEGATIVE ASPECTS OF THE SECTION 8 PROGRAM

Following the January 1973 suspension of most federally subsidized housing programs, the Section 8 Program emerged in August 1974 as the alternative to several past programs. It was announced as a program which would take the Federal and local governments out of the housing production subsidy business by providing direct subsidies to consumers. A key objective was mixed income housing. It was designed to correct some of the problems of the past programs. While it does, in fact, have certain advantages over some of the earlier programs and while it provides significant aid to those families given the opportunity to participate in it, it too has cost, equity, and incentive problems similar to those of the earlier programs.

POSITIVE ASPECTS OF SECTION 8

The Section 8 Program has advantages over its predecessor programs in that it:

--Provides recipients a greater freedom of choice of where and in what they live.

--Allows the use of newly constructed, rehabilitated, and existing units, according to each community's particular needs.

--Promotes deconcentration of lower income families needing housing assistance, thus encouraging racial and income integration.

--Provides a subsidy which keeps up with increases in operating costs. Recipient families never experience rent hikes unless their incomes have likewise risen. Owners and developers are insulated from default, since the Federal subsidy rises with increases in operating costs and rental levels.

--Eliminates the income gap problem prevalent in other subsidy programs since section 8 can aid the full range of lower income families.

The existing housing segment of the overall program has additionally been cited by HUD as a program which has proven to be very effective and which offers the advantages of

" * * * rapid delivery of housing assistance at relatively low cost, freedom of housing choice by families, dispersion of lower-income families, maintenance and improvement of the existing housing stock, neighborhood preservation and avoidance of displacement in areas undergoing revitalization activities, and involvement of owners which have not previously participated in federally subsidized housing programs."

NEGATIVE ASPECTS OF SECTION 8

Notwithstanding the various positive aspects of the Section 8 Program, the program has not overcome some of the problems of the past. In certain instances, its problems may even be more severe and of more consequence than those of yesteryear.

For example, budget and cost considerations were among the major reasons earlier programs were suspended and terminated. The fact that some families were receiving annual subsidies of as much as $1,850 caused alarm. So did the fact that the principal subsidy programs were relying too much on new construction at its higher unit costs per assisted family.

Today, costs under the Section 8 Program appear to be much higher. HUD estimated for fiscal year 1979 average annual unit costs of $2,670 for existing units, about $4,300 for newly constructed units, and about $4,700 for substantially rehabilitated units. Some families are receiving annual subsidies at much greater rates than even these estimates which do not consider the amount tenant families pay toward their rent. We found numerous examples of families receiving annual subsidies in the $5,000 to $7,000 range with some going even higher.

As of September 30, 1979, approximately 77 percent of the occupied section 8 units were in the existing housing segment of the program. Due, in part, to a shrinking supply of rental housing in recent years, there has been increased emphasis placed on new construction and substantial rehabilitation. For example, in the HUD budget for fiscal year 1980, almost 60 percent of the 250,000 section 8 unit reservations estimated for the year are to come from the new construction and substantial rehabilitation segments of the program--segments which are nearly twice as costly as the existing housing segment.

Long-term cost implications of the Section 8 Program are interesting to observe. For example, the Congressional Budget Office (CBO) in a March 1979 budget issue paper entitled "The Long-Term Costs of Lower-Income Housing Assistance Programs," projected the long-term direct subsidy costs for one unit of section 8 new construction/substantial rehabilitation under 30 year commitments to range from $161,200 to $343,400, depending upon the rate of inflation. Under 40 year commitments, the costs are estimated to range from $242,600 to $710,300. With almost one million units now being assisted under section 8, it is easy to see that the long-term costs of the program have reached large proportions. In a June 5, 1978, "Business Week" article it was estimated that if the program was terminated on September 30 of that year, ongoing costs could amount to $83 billion; if the program continued a year beyond that, costs would rise to $107 billion. The article indicated that if annual cost increases were more than 6 percent, the long-term cost estimates would be even greater.

A long-term cost estimate being considered by the House Committee on Appropriations in June 1979 was higher. Relative to the HUD-Independent Agencies Appropriation Bill, 1980 (H.R. 4394), the committee report stated that

> "When the Section 8 low-income housing assistance program was first proposed, the Committee raised a number of questions concerning its ultimate cost and workability. Those concerns were well founded. The following points illustrate the magnitude of subsidized housing costs in the United States today:
>
> --An appropriation of $5,529,000,000 is required in fiscal year 1980 to liquidate obligations previously made on various subsidized housing programs. If not a single housing unit is supported beyond 1980, the appropriation requirement will continue to climb--reaching $9,494,000,000 by fiscal year 1990.
>
> --Without a single additional housing unit added beyond 1980, the Federal government is committed to pay out approximately $231,000,000,000 for subsidized housing assistance over the next 40 years."

Earlier subsidized programs were criticized for being inequitable because they served only a small fraction of the poor. This is another major reason why the programs were suspended. Is the Section 8 Program's track record in terms of equity any better? The information we gathered during our review indicated that section 8 serves only a fraction of the poor and that, additionally, there are significant disparities in the types of housing and level of benefits provided program participants.

Approximately 40 percent, or 30 million, of the Nation's 76 million households are eligible for assistance under section 8 and other housing assistance programs. CBO has estimated that of the households income-eligible for assisted housing (in the case of section 8, this means those households making 80 percent or less of median income), 12.9 million pay more than 25 percent of their incomes for rent, and 5.4 million live in housing that is substandard.

The Congressional Research Service (CRS) recently estimated in a report prepared for the Subcommittee on Housing and Urban Affairs, Senate Committee on Banking, Housing and Urban Affairs, that a total of 12.4 million new, substantially and moderately rehabilitated units over a 10-year period are required to meet the housing needs of the country's low-income residents. In its report, CRS stated that much of the need has occurred because of the number of inadequate (5.7 million) or overcrowded (3.4 million) units, and growing numbers of units which are lost through conversion and obsolescence.

Concerning housing assistance needs, the Office of Management and Budget (OMB) estimated in a paper supporting welfare reform that, of the households eligible for assistance, only 8 percent were then receiving housing subsidies. Further, OMB stated that of the households earning less than $6,000, only 1 out of every 13 was receiving benefits under a housing subsidy program.

The above estimates indicate that, today, there continues to exist in this country a tremendous need for housing assistance. Inequities in our housing programs continue to prevail. An official of HUD wrote in an article entitled "American Housing Policy: Perverse Programs By Prudent People" that

> "* * * after much toil and trouble, the program (section 8) pulled out of the federal legislative cauldron retained the faulty features of the previous programs. In fact, the criticisms made of the old programs in 1973 by the Nixon Administration apply with full force to the new:
>
>> Our present approach is highly inequitable. Rather than treating those in equal circumstances equally, it arbitrarily selects only a few low-income families to live in federally supported housing, while ignoring others. Moreover, the few often get a new home, while many other families--including those who pay the taxes to support these programs--must make do with inferior older housing. . . The present approach is also very wasteful, for it concentrates on the most expensive means of housing for the poor, new buildings."

One final point needs to be made at this juncture. The Section 8 Program, as was typical with its predecessors, lacks certain incentives which would help to hold down program costs and offers little incentive or inducement for the participating family to want to move from section 8 into unsubsidized housing. Much of the housing being produced by the program is of high cost and quality. Much of the new and substantially rehabilitated housing we observed was of high standard, very attractive, and had rental values in excess of what many families would be willing and able to pay on an unsubsidized basis. Many section 8 families, particularly the elderly, are not upwardly mobile. The Section 8 Program may be likened somewhat to a lottery in which only a few strike it big. For those families fortunate enough to get into the program many can be expected to stay in it for a long time in the future.

CONCLUSIONS

The Section 8 Program is the most recent in a series of Federal programs aimed at solving the problem of providing housing assistance to the poor. While the program offers advantages over and corrects certain weaknesses of the earlier programs, it too is plagued by high costs and an inability to serve no more than a small fraction of the households defined to be in need. There are disparities in the type of housing and level of benefits provided to program participants. Additionally, there is a lack of certain incentives which would help control costs and encourage participating families to work themselves up and out of the program.

These problems are interrelated in many ways. The problems, and some of their causes, are discussed more fully in the remaining chapters of this report. The chapters also contain recommendations to HUD which will help to (1) reduce program and individual unit costs, (2) improve program equity, and (3) create a more acceptable program image.

AGENCY COMMENTS AND OUR EVALUATION

HUD commented that while there may have been savings expected initially from the Section 8 Program, these savings were predicated on the extensive use of existing rather than newly constructed housing. HUD stated that these initial expectations were thwarted by (1) the Congress' insistence that HUD comply with the proportions of new, rehabilitated, and existing housing, as expressed in local housing assistance plans, (2) a shrinking supply of rental housing in the later 1970s, and (3) the general increase in construction, financing, and operating costs.

HUD stated that any disparities in the type of housing and level of benefits being provided program participants is basically due to the fact that occupants of new units generally have nicer units at higher rents than those who occupy older, existing units. Regarding our statement that, collectively, Federal housing programs serve only a small fraction of eligible households, HUD stated that Federal housing programs can be viewed as serving a small fraction of the needy only if they are viewed separately and if the need is substantially overstated. Finally, HUD stated that there is no basis for our suggesting that there are insufficient incentives to encourage families to work out of the program.

Our estimates of the number of households in need of housing assistance were obtained from HUD and CBO. They show that between one-tenth and one-fifth of the eligible households get housing aid.

We found very little in the way of incentives in the Section 8 Program for the beneficiaries to ever give up the substantial benefits they receive. The cost of much of the housing the program provides is equal to or exceeds the income of many of the families being served. For a family receiving housing assistance equal to its income, a quadrupling of income would be required before that family could pay its rent with no more than 25 percent of its income. We are concerned about this captivating effect of the program. (See pp. 106 to 111 for HUD's comments and our response.)

CHAPTER 3

RENTS AND SUBSIDY PAYMENTS HAVE RISEN SIGNIFICANTLY SINCE PROGRAM INCEPTION IN 1974

In the early months of section 8, program rents were believed by many to be too low, thereby curtailing program activity. The rents have since risen significantly and many are now at very high levels. New construction/substantial rehabilitation FMRs in 1979, for example, were in the $400 to $600 per month range in many cases, with some much higher. In 17 selected cities, FMRs for new construction/substantial rehabilitation units had increased an average of 53 percent from 1974 to 1978--with the highest increases occurring in San Francisco (121 percent), Cincinnati (95 percent), and Atlanta (72 percent). FMRs for existing housing units rose at an even greater rate over the 4-year period. For the 17 cities we sampled, the average increase was 68 percent.

From 1974 to 1978, FMR increases in 8 of the 17 sample cities for which data was available were higher than increases in the overall Consumer Price Index (CPI), higher than increases in the housing component of the CPI, and higher than two reputable indexes which measure construction costs (Boeckh and Dodge).

Gross rents, which are normally set under FMR levels, exceeded the FMRs in 68 percent of the new construction/ substantial rehabilitation projects we reviewed.

Section 8 fair market and gross rents have a direct bearing on individual subsidies, and ultimately, on overall program costs. As these rents rise, so do the costs of supporting the related section 8 units. Rents can be judged to be too high only if they exceed the amounts needed to compete for vacancies in existing units or to construct new units that meet program guidelines. We were unable to determine, however, whether section 8 rents were substantially higher than needed to achieve program goals.

SECTION 8 FMRs INITIALLY CRITICIZED FOR BEING TOO LOW

Rents initially established under section 8 were criticized for being too low and were cited as a reason for the low level of program activity during the program's early years. For example, in both House and Senate committee reports on the Housing Authorization Act of 1976, the following statement was made.

"The committee believes that HUD is overly restrictive in establishing contract rents for certain kinds of new construction and rehabilitation projects * * * we would expect HUD to encourage the use of section 8 by permitting realistic maximum rents under section 8."

In a report we issued to the Congress on January 28, 1977, "Major Changes Are Needed in the New Leased-Housing Program," (CED-77-19), we noted that weaknesses in the methods HUD used to establish section 8 FMRs resulted in rents which were too low to encourage sufficient private participation by housing owners in the program. We recognized that FMRs must be high enough to (1) overcome an owner's reluctance to lease to lower income persons, especially families with children, (2) cover any extra cost to an owner participating in a Federal program, and (3) enable an owner to finance, construct or rehabilitate, manage, and maintain a section 8 project. Regarding the development of new construction/substantial rehabilitation FMRs, we pointed out that HUD's methods neglected several costs integral to a Federal program, such as Davis-Bacon wage requirements and HUD minimum property standards. This situation resulted in lower FMRs than there otherwise would have been.

Problems also existed in the method HUD initially used to develop existing housing FMRs. We stated in our report that much of the difficulty could be traced to the method HUD used in 1973 to establish rents for the Section 23 Program, since these rents were subsequently updated for use in the section 8 existing program. Among the problems found in the method used was the fact that it included a 1-percent census sample which may have included both substandard and subsidized units and that it probably included a disproportionate number of lower income families. These factors and others resulted in rents that were lower than prevailing market rents.

Even today there are some who claim that the rent levels are too low and that it is not economically feasible to construct or rehabilitate units within these constraints. Information gathered during our review shows, however, that over the life of the program, section 8 FMRs and corresponding costs have in many instances risen significantly and are now at high levels.

FMRs HAVE INCREASED SINCE PROGRAM INCEPTION

As indicated in chapter 1, the Section 8 Program was, in effect, a modified follow-on to the Section 23 Leased Housing Assistance Program. Because of similarities between the two programs, and in an attempt to determine the rate of increase of FMRs since inception of section 8, we used 1974 as the base year and compared a sample of section 23 FMRs existing at that time with the levels of section 8 FMRs published since then.

Our sample included 17 cities of various sizes geographically distributed throughout the country. We found that section 8 FMRs published in 1978 were at much higher levels than those published under section 23, 4 years earlier. Specifically, we found--using the FMRs for 2-bedroom walkup units--the following increases in the new construction/substantial rehabilitation and existing housing segments of the program.

SCHEDULE OF FMR INCREASES FROM 1974 TO 1978

2-BEDROOM WALKUP UNITS (note a)

City	New construction/substantial rehabilitation: Sect. 23 FMRs 7-8-74	Sect. 8 FMRs 4-1-78	Increase	Increase (percent)	Existing housing: Sect. 23 FMR 7-8-74	Sect. 8 FMR 3-29-78	Increase	Increase (percent)
Atlanta, Ga.	$ 186	$ 320	$ 134	72	$ 158	$ 231	$ 73	46
Bettendorf, Iowa	255	343	88	35	147	245	98	67
Boston, Mass.	299	404	105	35	173	316	143	83
Chicago, Ill.	288	435	147	51	161	293	132	82
Cincinnati, Ohio	180	351	171	95	130	219	89	68
Concord, N.H.	246	357	111	45	140	215	75	54
Flint, Mich.	254	344	90	35	147	234	87	59
Fresno, Calif.	230	325	95	41	121	217	96	79
New York, N.Y.	357	555	198	55	171	b/ 275	104	61
Newark, N.J.	321	464	143	45	169	b/ 275	106	63
Norfolk, Va.	207	310	103	50	135	206	71	53
Pierre, S.D.	216	320	104	48	96	220	124	129
Port Angeles, Wash.	193	296	103	53	122	189	67	55
San Francisco, Calif.	285	631	346	121	184	288	104	57
St. Petersburg, Fla.	195	281	86	44	114	214	100	88
Tyler, Tx.	180	248	68	38	84	156	72	86
Washington, D.C.	309	434	125	40	173	286	113	65
Total	4,201	6,418	2,217		2,425	4,079	1,654	
Average FMRs	$ 247	$ 377			$ 143	$ 240		
Average increases since program inception			$ 130	53			$ 97	68

a/Two-bedroom walkup units were used in our analysis because (1) the size was probably the most prevalent in the program and (2) the walkup structure type was less costly than other structure types. To elaborate, the average FMR increase for 2-bedroom, elevator (5+ story) units in the above 17 cities over the same 4-year period was 59 percent. In Cincinnati, the increase for a 2-bedroom elevator unit FMR was 166 percent (from $206 in 1974 to $547 in 1978); in San Francisco the FMR increase for the same size and type unit was 128 percent (from $356 in 1974 to $812 in 1978).

b/Effective date 8-8-78.

The schedule shows that in our 17-city sample, FMRs for new construction/substantial rehabilitation increased from an average FMR level of $247 per month in 1974 to an average level of $377 per month in 1978--an average increase of 53 percent over the 4-year period. FMRs for existing housing increased from an average level of $143 per month in 1974 to an average level of $240 per month in 1978--an average increase of 68 percent over the 4 years. In all cases, existing housing FMRs were lower than the FMRs for new construction/substantial rehabilitation and, in fact, averaged 36 percent less in 1978.

The schedule shows some rather dramatic increases in some cities during the period. For example, FMRs for new construction/substantial rehabilitation increased in San Francisco, 121 percent (from $285 to $631) during the period; in Cincinnati, 95 percent; and in Atlanta, 72 percent. FMRs for existing housing increased in Pierre, South Dakota, 129 percent (from $96 to $220); in St. Petersburg, Florida, 88 percent; in Tyler, Texas, 86 percent; and in Boston and Chicago, 83 and 82 percent, respectively.

As discussed, FMR levels in some instances have become very high and their rate of increase over 4 years has been rather significant. A November 1978 study prepared for the Subcommittee on Priorities and Economy in Government, Joint Economic Committee concluded:

> "The program is enormously costly. At a time when median rental levels in New York City, for example, hover at around the $200 per month mark, the fair market rents for new construction and substantial rehabilitation in elevator buildings within that city range from $491 for an efficiency apartment to $873 for a four-bedroom unit. For extant housing, the equivalent figures are $223 and $390. There is increasing evidence that the nominal maximums, particularly for new construction, become the minimums."

We add, however, that rent control has existed in New York City for some time and has undoubtedly contributed to this situation.

FMR INCREASES HAVE OUTPACED CPI AND CONSTRUCTION COST INCREASES

Many of the people we talked to cited inflation and rising construction costs as the reason for the rapidly climbing FMRs. To find out just how much prices and construction costs have risen in relation to the FMRs, we analyzed data from the CPI and from two reputable construction cost indexes--Boeckh (Boeckh Division, The American Appraisal Company) and Dodge (Dodge Building Cost Services, McGraw-Hill Information Systems

Company). These indexes were available for 8 of our 17 sample cities and were suggested to us by HUD officials. We recognize that, individually, they may not account for all rental market conditions, time differences, and other factors which might have had an impact on the costs of constructing and operating housing (e.g., land and financing costs, insurance, utilities, etc.). We also recognize that they may not relate to the types of new or existing housing units within which the HUD program must operate. We believe, however, that the indexes do provide some gauge against which the rise in FMRs can be compared for the eight cities. As discussed in the sections which follow, FMR increases from 1974 to 1978 have outpaced CPI and construction cost increases in each of the eight cities we reviewed. HUD rents, however, can be judged to be too high only if they exceed the amounts needed to compete for vacancies in existing units or to construct new units that meet program guidelines.

Consumer Price Index

The CPI is a measure of price changes in typical goods and services which are paid for by urban wage earners, salaried clerical worker families, and single individuals. The index is prepared by the Department of Labor's Bureau of Labor Statistics (BLS), and its primary purpose is to measure the purchasing power of wage income. The 1974 through 1977 CPI reflected price changes taking place in over 400 fixed market basket goods and services. Beginning with the 1978 index, CPI prices were selected from 250 new, more general items.

We compared the average annual increases in the overall CPI and in the housing component of the CPI from 1974 to 1978 to FMR increases for each of the eight cities. As indicated above, the overall CPI is a composite of many diverse items and, in actuality, reflects little more than general inflationary trends in whatever location being observed. It is, however, a widely used and accepted measure against which many economic facets are compared.

The housing component is but one part of the CPI and is made up of the following expenditure items: shelter (66.5 percent), household furnishings (18.7 percent), and fuel and utilities (14.8 percent). Generally, the housing component of the CPI, or, for that matter, most costs of building new housing or renting vacant, existing housing, have consistently risen at faster rates than the overall CPI.

It should be pointed out that the CPI measures average housing costs and does not provide a measure of the costs faced by households trying to move into units meeting HUD criteria and, therefore, the following comparisons should be viewed with this in mind.

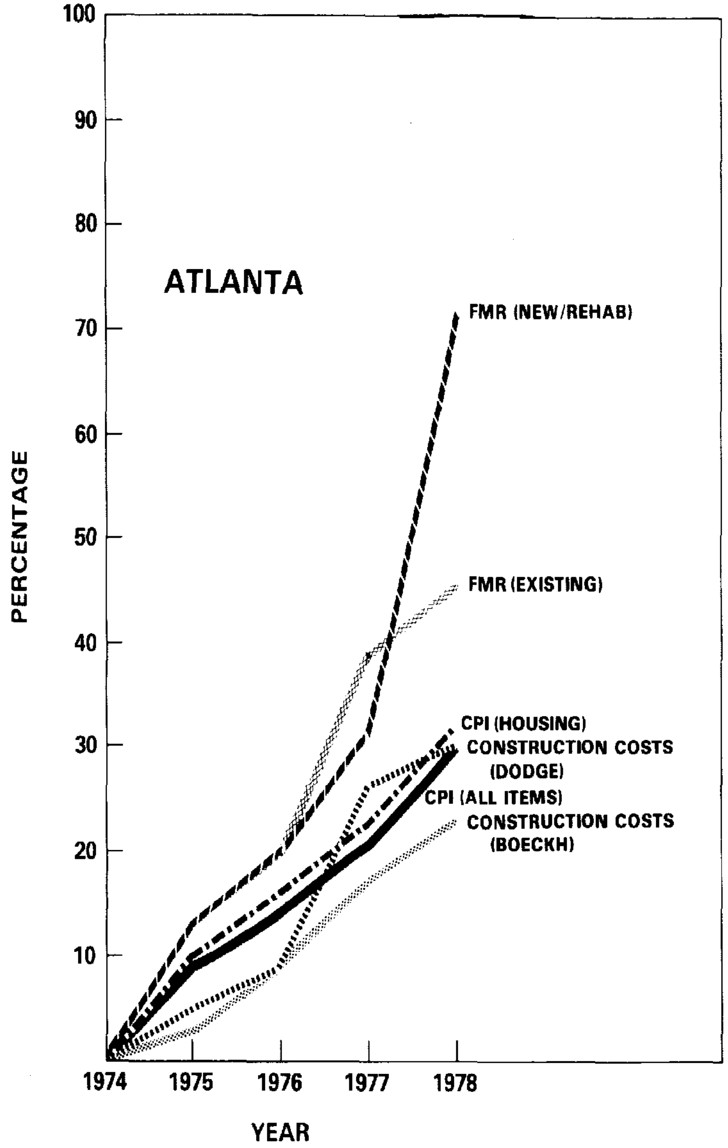
The graphs on pages 21 through 27 show that in each of the eight cities, increases in both new construction/ substantial rehabilitation and existing FMR levels have outdistanced increases in both the overall CPI and its housing component.

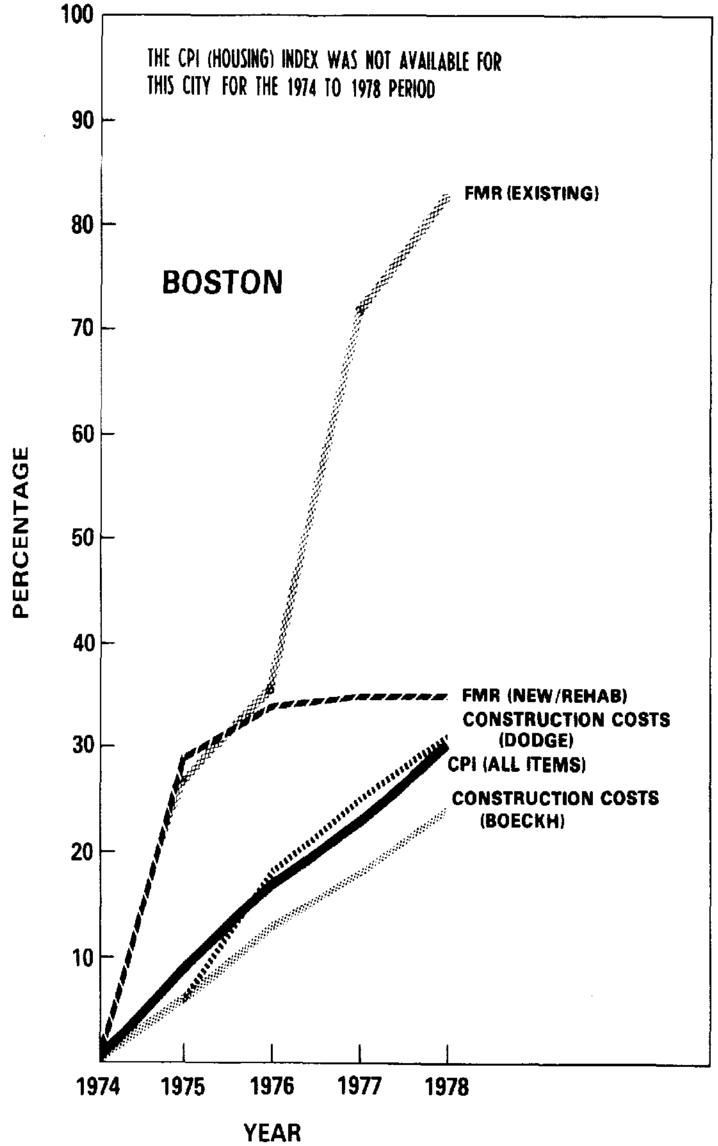
Construction cost indexes

The Boeckh index which measures the rise in construction costs reflects the material cost increases for a reinforced concrete frame, three to nine story, multifamily building. The Dodge index is a general construction cost index reflecting (1) buildings of all kinds above ground, (2) prices paid by builders for basic materials, and (3) locally prevailing wage scales.

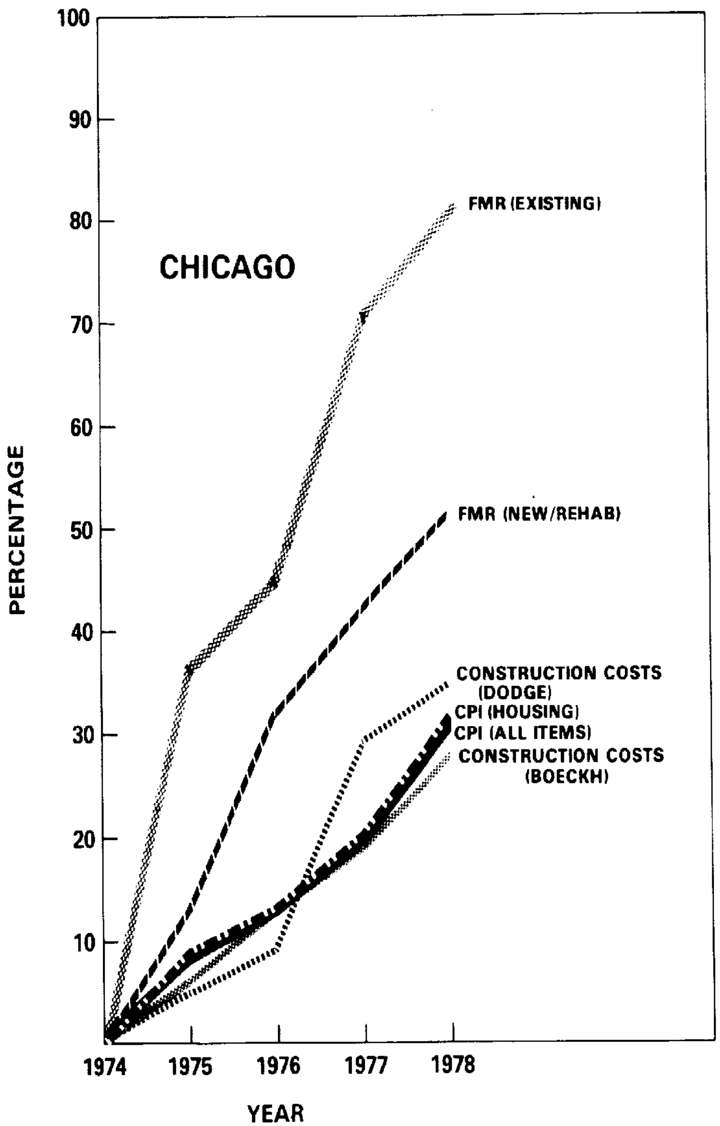
Our analysis showed that construction costs have increased from 1974 to 1978, but not at the pace of our eight city section 8 FMRs. The Boeckh index showed an average increase of 28 percent over the 4-year period for the eight cities we reviewed. The Dodge index reflected a higher rate of increase, 36 percent, over the same period and for the same cities.

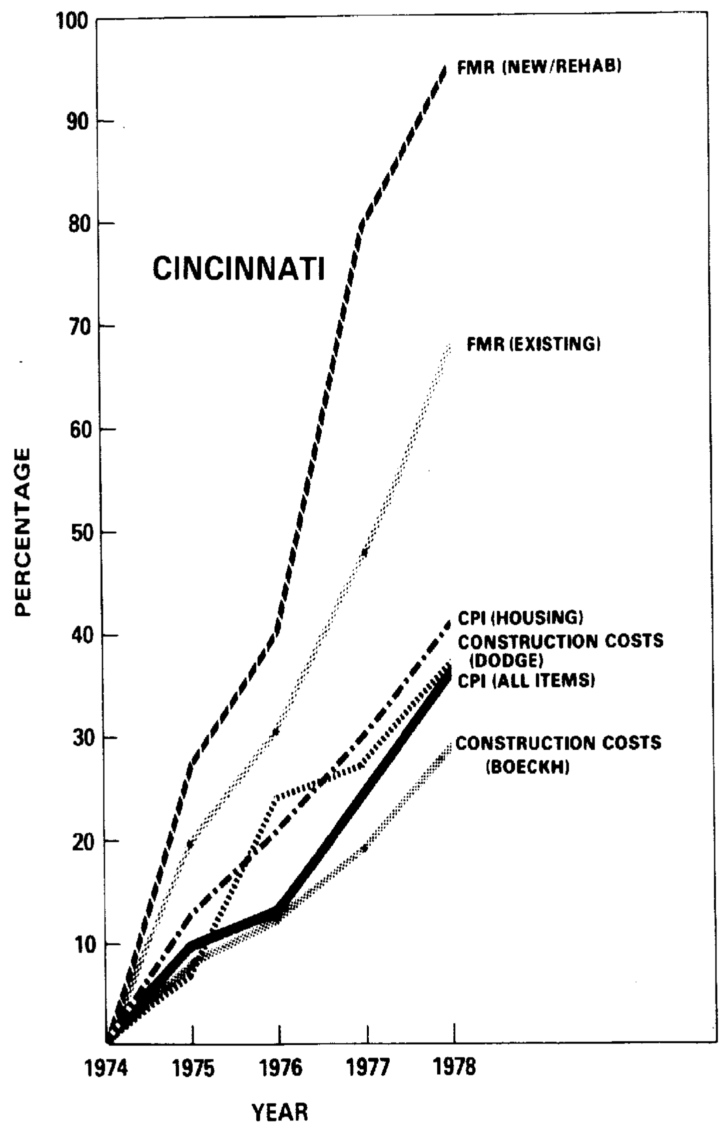
The following graphs depict the rate of FMR increases for newly constructed/substantially rehabilitated and existing 2-bedroom walkup units in the eight cities, as compared to increases in the CPI and construction cost indexes in each city.



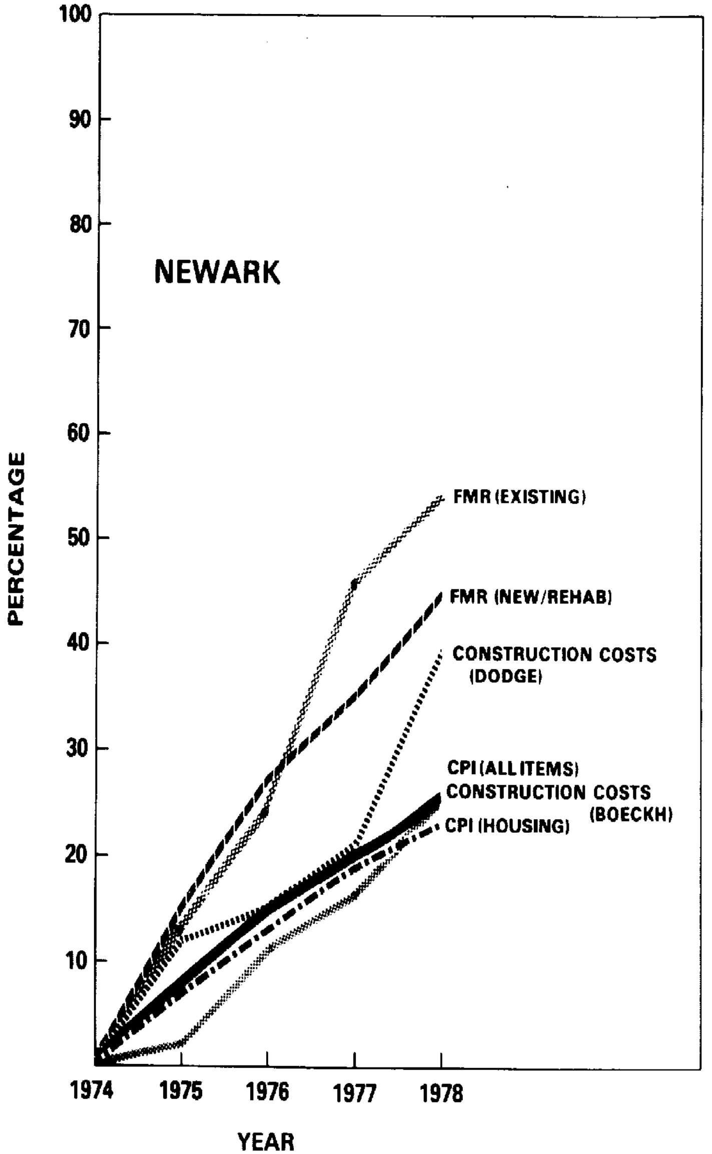


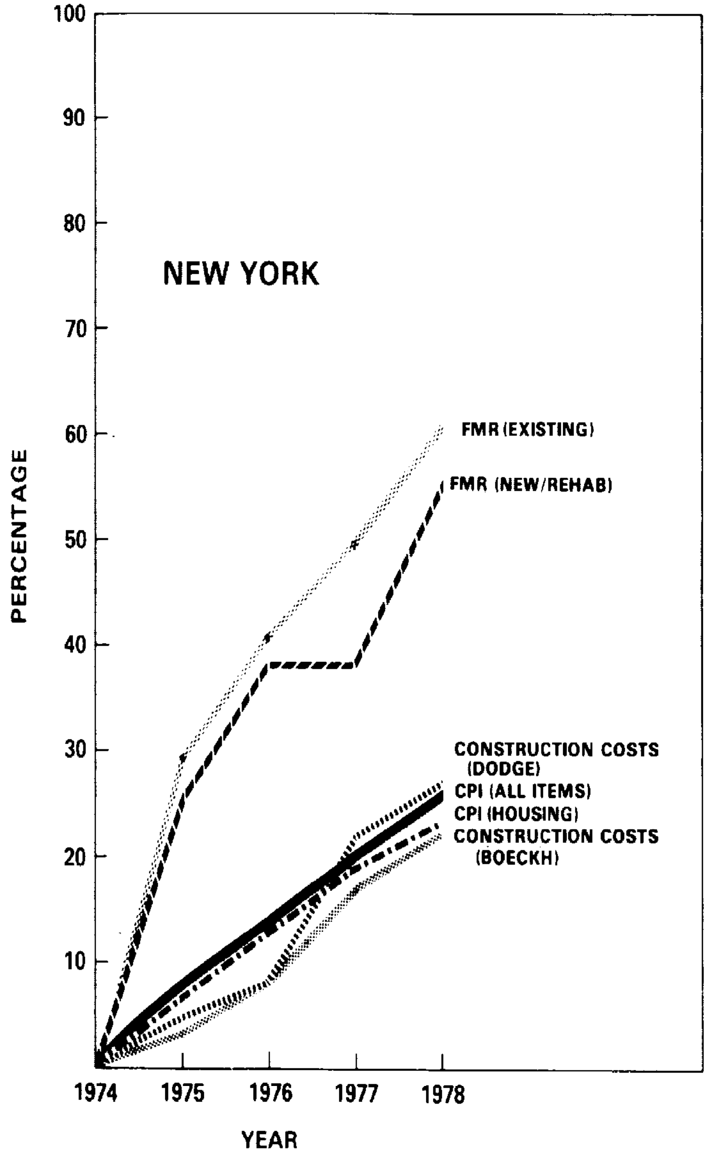
FMR(E) - FMR existing housing.
FMR(N/R) - FMR new construction/substantial rehabilitation.



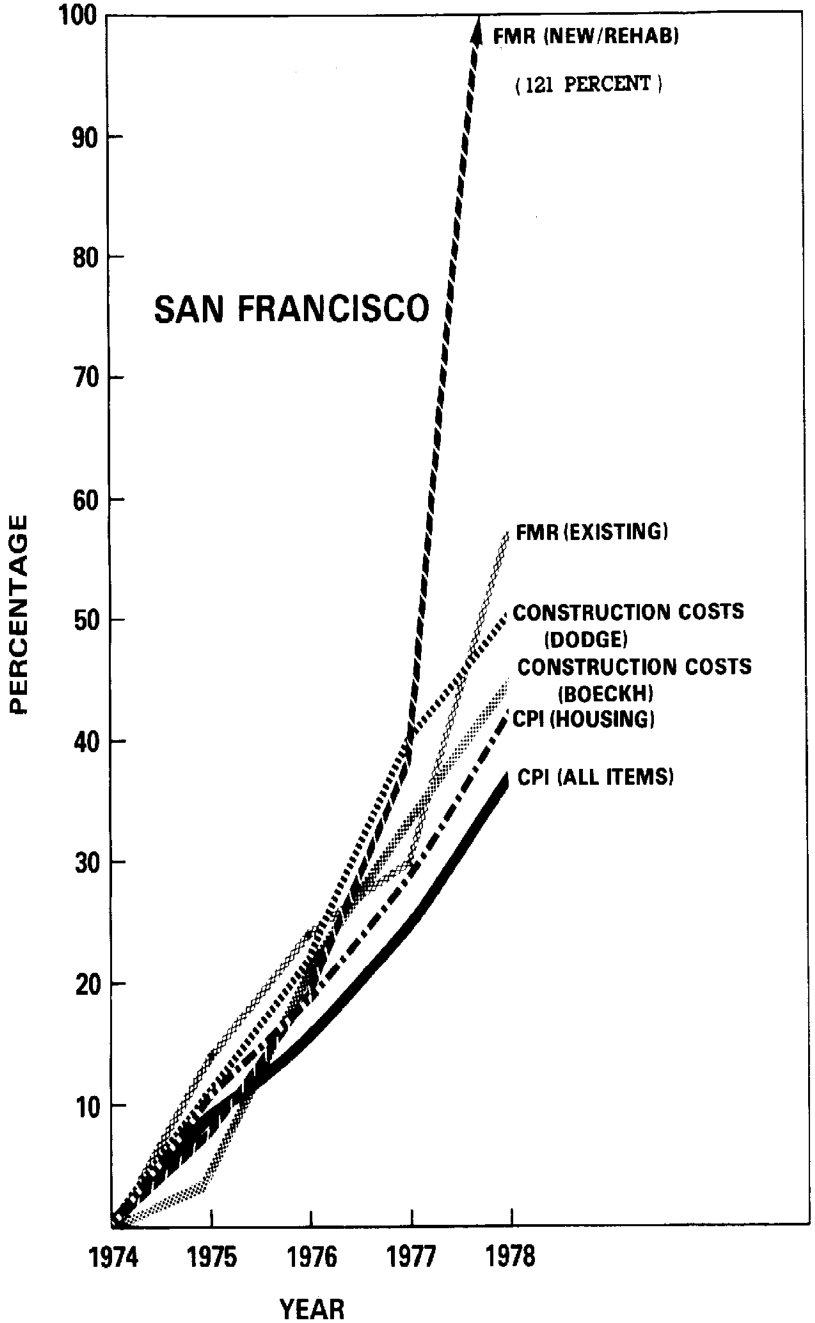


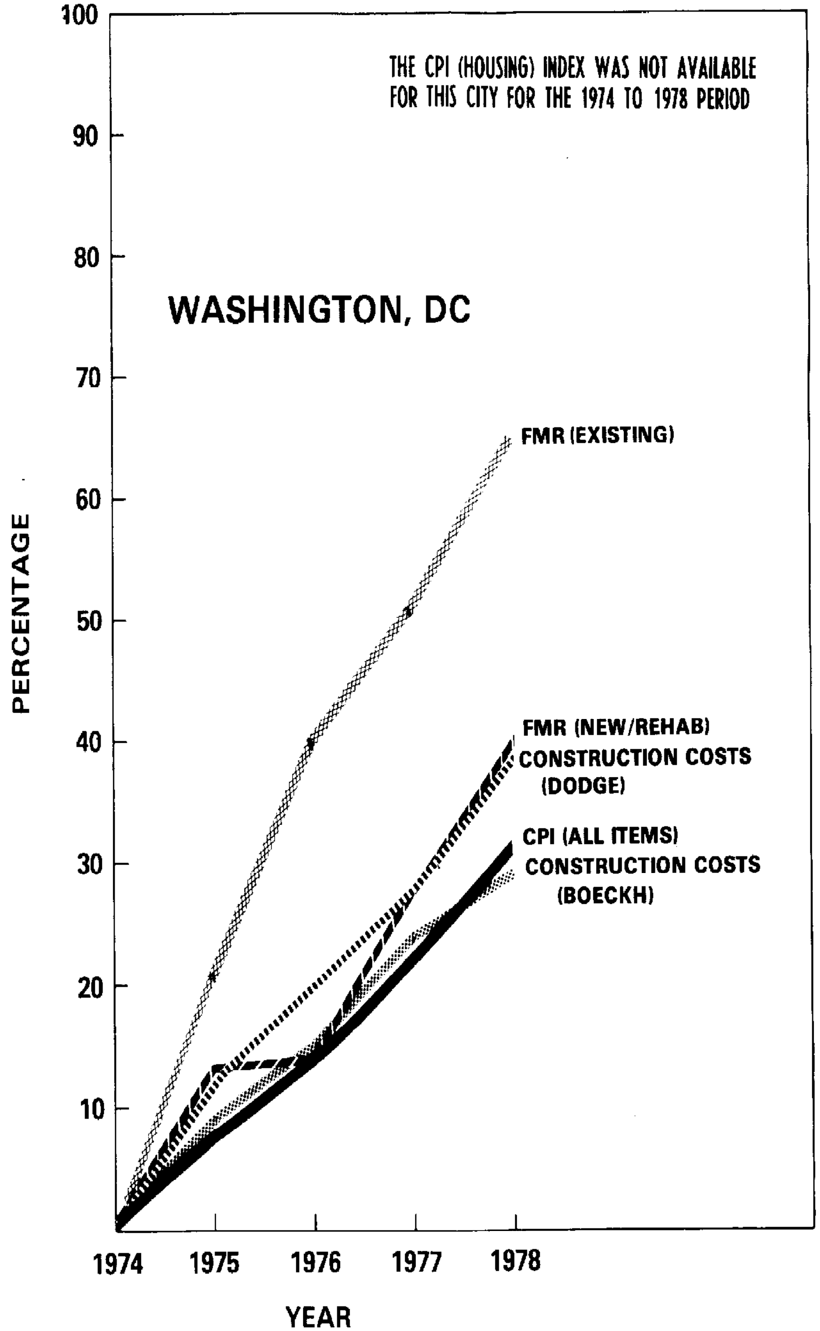
FMR (E) - FMR existing housing.
FMR (N/R) - FMR new construction/substantial rehabilitation.





FMR (E) - FMR existing housing.
FMR (N/R) - FMR new construction/substantial rehabilitation.





FMR (E) - FMR existing housing.
FMR (N/R) - FMR new construction/substantial rehabilitation.

FMRs PUBLISHED IN 1979-- THEIR RATES OF INCREASE AND LEVELS ATTAINED

Following our analyses of FMR increases from program inception through 1978, the FMRs were once again revised in 1979 for new construction/substantial rehabilitation and existing housing. While we made no attempt to redo our analyses based on the revised FMRs, we did look at them to see if they had continued to rise. In doing so, we compared 1979, 2-bedroom walkup FMRs with those for 1978 in the 17 cities we sampled. We found that the FMRs had continued to rise and that the average FMR for new construction/substantial rehabilitation rose from $377 to $411--a rise of $34, or 9 percent. FMRs for existing housing rose from an average of $240 in 1978 to an average $262 in 1979--a rise of $22, or 9 percent.

The increases in new construction/substantial rehabilitation FMRs from 1978 to 1979 for the 17 cities ranged from $0 and 0 percent in New York City to $87 and 19 percent in Newark.

For existing housing, increases in the FMRs for the 17 cities ranged from $0 and 0 percent in Boston, Chicago, and Pierre, South Dakota, to $67 and 33 percent in Norfolk, Virginia.

Nationally, levels to which FMRs had risen in 1979 were very high. For newly constructed/substantially rehabilitated housing, FMR levels for various sizes and types of units in a multitude of locations were in the $400 to $600 per month range. In some locations, the levels went even higher with Chicago, New York City, and San Francisco among the cities posting levels in the $600 plus range. In New York City, for example, the FMRs for 3- and 4-bedroom units in a 5 plus story building were set at $900 and $990, respectively. In San Francisco, the FMRs for 3- and 4-bedroom detached units ran $1,011 and $1,084, respectively.

FMR levels for existing housing were considerably less. They generally ranged from about $150 to $400 for various sizes and types of units in numerous locations. Except for Alaska and Hawaii where existing housing FMR levels were much higher, Suffolk, New York's FMR of $477 for a 4-bedroom unit was the highest.

SECTION 8 GROSS RENTS OFTEN EXCEED APPLICABLE FMR LIMITS

Legislation behind the Section 8 Program authorized the Secretary of HUD to enter into annual contribution contracts with PHAs. This enables the PHAs to, in turn, enter into contracts to make assistance payments to owners of existing dwelling units who are participating in the program. The legislation also authorizes the Secretary to make assistance payments to owners or prospective owners who agree to construct or substantially rehabilitate housing in which some or all of the units will be available for occupancy by lower income families. The legislation states that assistance contracts shall establish the maximum monthly rents (including utilities and all maintenance and management charges) to which the owner is entitled for each dwelling unit for which assistance payments are to be made. These rents are known as gross rents.

Gross rents are not to exceed FMRs except in special circumstances. Section 8 processing handbooks state that contract rents, plus utilities, may not exceed published FMRs except in some circumstances where higher rents are warranted and the higher rents meet a test of reasonableness. This means that the rents must be determined by HUD to be reasonable in relation to the quality, location, amenities, and management and maintenance services of the project.

HUD area office directors have authority to permit gross rents to exceed FMRs by up to 10 percent; HUD regional administrators must give the approval for rents in excess of FMRs by up to 20 percent.

Rents for units designed for occupancy by the elderly or handicapped are allowed a 5-percent leeway over the published FMR amounts.

House and Senate conferees to the Housing and Community Development Act of 1974 recognized in their conference report that since section 8 FMR's are reflective of local rental market conditions " * * * HUD should use its authority to set rentals at 20 percent above fair market rentals only in exceptional cases."

Our review disclosed that gross rents, rather than as an exception, often exceed applicable FMR limits. To determine how prevalent this was we asked six HUD area offices to send us rent payment vouchers for a number of their occupied projects whose construction or rehabilitation was completed during 1978. The projects were selected by the area offices. Vouchers were received for 27 projects, however, 8 of the 27 were for projects occupied before 1978. For the 19 projects occupied during 1978, the following schedule compares the gross rents at each project with the applicable FMRs and it also shows the HUD area offices from which the information was obtained.

Project (area office)	Elderly/ family	Number of bedrooms	Gross rents	Applicable published FMRs	Percent by which gross rents exceed FMRs
Terry Meeks (Atlanta)	F	3	231	255	-
Jewish Home Tower (Atlanta)	E	1	290	315	-
		2	348	378	-
Ralston Properties (Atlanta)	E	0	215	196	9.7
		1	251	228	10.1
Weymouth Commons East (Boston)	F	1	362	364	-
		2	433	410	5.6
		3	518	520	-
		4	570	575	-
Prospect Heights (Boston)	F	1	362	313	15.7
		2	450	394	14.2
St. Germain (Boston)	F	1	375	382	-
		2	445	447	-
Ridgewood (Cincinnati)	E	1	300	252	19.9
		2	346	288	20.1
Oakwood (Cincinnati)	F	3	373	311	19.9
New Community II (Newark)	E	0	366	366	-
		1	393	392	0.3
		2	495	496	-
Prospect Park (Newark)	E	0	388	392	6.0
		1	419	496	6.9
		2	526	573	6.0
Pueblo City (Newark)	F	1	356	392	-
		2	444	496	-
		3	506	573	-
Aspen- Stratford (Newark)	F	1	375	392	-
		2	457	496	-
		3	514	573	-
Palo Alto (San Francisco)	F	1	300	327	-
		2	389	375	3.7
		3	427	427	-
		4	461	460	0.2

Project (area office)	Elderly/ family	Number of bedrooms	Gross rents	Applicable published FMRs	Percent by which gross rents exceed FMRs
Chateau Lafayette (San Francisco)	E	1	332	302	9.9
Woodbridge (San Francisco)	E	1	306	278	10.1
		1	332	302	9.9
LaSalle (San Francisco)	E	1	327	273	19.8
		2	438	365	20.0
		3	542	452	19.9
		4	559	482	16.0
		5	578	482	19.9
Shoreview (San Francisco)	F	1	361	301	19.9
		2	438	365	20.0
		3	542	452	19.9
		4	578	482	19.9
Sutter (San Francisco)	E	1	355	459	-
		1	365	459	-
Logan Circle (Washington, D.C.)	F	1	359	326	10.1
		2	435	395	10.1
		3	510	464	9.9

This comparison shows that 13 out of the 19 projects, or 68 percent, had gross rents exceeding the applicable FMRs for each project's sizes and type of units. Of the 13 projects, 8 had gross rents which were more than 10 percent above the FMR limits. One of the projects had a gross rent which was more than 20 percent above the FMR limits. The Ridgewood project, in Cincinnati, had a gross rent for a 2-bedroom unit of 20.1 percent over the applicable FMR. This appears allowable since the project is for the elderly and, in such cases, gross rents may exceed FMR limits by up to 26 percent with proper authorization. As the comparison shows, five other projects for the elderly were among those with gross rents in excess of their respective FMRs.

Gross rents often exceeding applicable FMRs were also cited by two HUD OIG reports. These two reports dealt with the cost of section 8 new construction and substantial rehabilitation projects (1) in Cleveland, Akron, and Youngstown, Ohio, and Milwaukee, Madison, and Reedsville, Wisconsin, and (2) throughout the area serviced by HUD's Knoxville, Tennessee, area office. The OIG stated in its February 7, 1979, report dealing with the projects in Ohio and Wisconsin that:

> "* * * 12 of the 14 projects reviewed had gross rents which exceeded the published FMR for the applicable size and type of unit. Of the 12 projects, seven had gross rents of between 110 and 120 percent of the published FMRs."

A large number of the Knoxville area office projects OIG reviewed showed gross rents in excess of the FMRs. A November 27, 1978, OIG report stated that:

> "The approved HAP [housing assistance payment] contract rents exceeded the prescribed fair market rent (FMR) limitation for 22 of the 28 projects examined during our review. Although the regulations allow approval of such higher rents in special circumstances, the high frequency of occurrence (80 percent) does not appear to be in accord with the intent of the regulations and, in our opinion, raises a question as to the adequacy and quality of the KAO [Knoxville area office] reviews affecting the calculation of the contract rents."

SECTION 8 UNIT COSTS AND SUBSIDIES ARE AT HIGH LEVELS

As FMRs and contract rents have risen over the life of the program, so have the subsidies going to individual families and has the resulting cost of the program to the Federal Government.

HUD estimates of program costs

HUD presents in its annual budget submissions to the Congress section 8 cost data for past and estimates of costs for the current and subsequent years. This data, we were told, represents estimated amounts of funding reserved during initial project processing. HUD headquarters later attempts to update these early estimates based on reported increases in reservation amounts. From budget submissions, we tabulated the following unit cost information relating to the three main segments of the program.

Average Annual Unit Cost Estimates

	Fiscal years				
	1976	1977	1978	1979 (est.)	1980 (est.)
New construction					
Private developer	$3,584	$3,864	$4,325	$4,250	$4,440
State agency	4,049	4,495	4,929	4,300	4,470
Substantial rehabilitation					
Private developer	3,465	4,952	4,190	4,700	4,915
State agency	4,590	5,136	5,072	4,740	4,915
Existing					
Regular rental	2,198	2,033	2,553	2,670	2,670

Note 1: This table does not include data on section 8 activity relating to the Section 202 Program, Farmers Home Administration, moderate rehabilitation, property disposition, and loan management, since our review did not specifically touch on these activities.

Note 2: The above figures do not take into account the fact that tenant families contribute up to 25 percent of their incomes toward the cost of the housing. As a result, funds remaining at the end of a year for a given unit are placed in a reserve account from which future increases in contract rents can be paid. HUD anticipates that in the early years of a project or unit, funds would be available to place in the reserve account. Over the years, and as costs go up, funds in the reserve account would be used to pay for the increased costs. Theoretically, at least, the reserve balance would be drawn down to zero at the end of the contract period.

The table shows that average unit costs have generally increased over the years presented. It shows the existing segment of the program to be much less costly than either the new or rehabilitation segments. And, interestingly, it shows unit costs for substantial rehabilitation to generally be higher than unit costs for new construction.

Our analysis of program costs

Our analysis of the costs of section 8 units throughout the country generally confirmed the estimates of costs advanced by HUD for 1978 and particularly with regard to the new construction and existing housing program segments. From rent payment vouchers for 27 newly constructed or substantially rehabilitated projects located in Atlanta, Boston, Cincinnati, Newark, San Francisco, and Washington, D.C., the following data was tabulated.

New Construction/Substantial Rehabilitation
Program Costs at 27 Projects

	Number of Projects	Number of Units	Annual cost averages: Tenant contribution	Annual cost averages: Subsidy	Annual cost averages: Unit cost
New construction					
Private developer	12	906	$1,092	$3,250	$4,342
State agency	8	836	1,116	3,888	5,004
Substantial rehabilitation					
Private developer	6	299	732	2,556	3,288
State agency	1	183	1,356	3,432	4,788
Total	27	2,224			
Weighted averages			$1,074	$3,411	$4,485

For existing housing, we requested and received from eight PHAs (Atlanta, Boston, Chicago, Cincinnati, Newark, New York, San Francisco, and Washington, D.C.) information relating to the number of families being assisted in the existing segment of the program, average amounts of tenant family contributions and Federal subsidies, and data relating to the largest and smallest subsidies being paid at each PHA. The eight PHA's were assisting 25,286 families. On the average, these families were annually:

Contributing toward their rent	$ 852
Receiving a rental subsidy	1,656
	$2,508

The above figures represent amounts paid out for both new construction/substantial rehabilitation and existing housing during calendar years 1978 or early 1979. These figures are close to the 1978 figures HUD published in its budget justifications, particularly with regard to the new construction and existing housing program segments. They also point out the wide difference in cost of providing housing under the new construction/substantial rehabilitation versus existing housing segments of the overall Section 8 Program.

Some families receiving subsidies at much higher levels than the averages

Our review disclosed numerous examples of families receiving section 8 subsidies at much higher levels than the published averages. While these subsidies may or may not be justifiable on the basis of market and cost considerations in the locations where they were found, their amounts alone are enough to cause concern when considering that (1) there are millions of needy families for which there is no housing assistance available and (2) just 5 or 6 years ago the fact that some families were receiving subsidies of as much as $1,850 caused considerable alarm. In reviewing the new construction/substantial rehabilitation projects we looked at, we found:

--A family in the Boston area living in a 4-bedroom unit with a monthly contract rent of $604. The family pays $52 per month toward the rent, and the Federal Government pays $552 per month. The annual subsidy for this family is $6,624.

--A family in the San Francisco area renting a 3-bedroom walkup unit with a monthly contract rent of $520. The family pays $16 per month toward the rent, and the Government pays $504 per month. The annual subsidy for the family is $6,048.

--A family in the San Francisco area renting a 4-bedroom row unit with a monthly contract rent of $535. The family pays $36 per month, and the Federal Government pays $499 per month, an annual subsidy of $5,988.

--A family living in Newark renting a 3-bedroom elevator unit with a monthly contract rent of $486. The family pays $12 per month toward the rent, and the Government pays $474 per month, or $5,688 per year.

In the New York City and Chicago areas, we found section 8 subsidies to be very high. In New York City, for example, we reviewed four newly constructed and three substantially rehabilitated projects. Four of the projects were selected from among the section 8 projects thus far completed in that city. The remaining three projects--Taino Towers, Manhattan Plaza, and Aldus Green--were selected because of their high costs and publicity they have received. The following table shows the number of section 8 units, tenant payments, and subsidy costs for each of the seven projects.

	Number of section 8 units	Average tenant payment	Average Government subsidy
New construction			
Vernon Ave. houses	266	$1,632	$6,060
Bronxchester houses	207	1,218	7,186
Taino Towers	656	1,388	a/9,598
Manhattan Plaza	1,634	2,088	5,090
Substantial rehabilitation			
Aldus Green	384	1,084	6,515
311 West 94th St.	24	1,104	4,063
119 Ralph Avenue	7	1,419	2,823

a/Figures for Taino Towers were obtained in December 1979 and were somewhat tentative since all agreements between HUD and the project had not yet been finalized. The subsidy figure of $9,598 included a $3,739 section 236 mortgage interest reduction subsidy which was, in addition to section 8, being provided to the project (see pp. 60, 61, and 66 to 68.)

Our review of the high costs of the Section 8 Program centered around the new construction/substantial rehabilitation segments. Our work in the existing housing segment was mostly done for comparative, contrasting purposes. Regardless, we did note from the information we received from various PHAs that subsidies under that portion of the program can run quite high as well. For example, in both Boston and Washington, D.C., some existing housing tenant families are receiving annual subsidies as high as $5,256 and $4,836, respectively. This is considerably higher than the average subsidy of $1,656 we talked about earlier. We should also point out that at the other end of the scale, some existing housing families are receiving subsidies of as little as $12, $24, and $48 per year.

CONCLUSIONS

Section 8 rents were initially criticized for being too low and thereby retarding program activity. Over the life of the program, however, section 8 rents have risen significantly. Gross rents, rather than as an exception, often exceed applicable FMR limits. As these rents have risen, so have the amounts of individual subsidies paid out under the program with some families receiving annual subsidies of $6,000 and even higher.

The rapid rise in many of the section 8 rents may generally reflect market conditions for the type and location of housing that meets program guidelines. The increase also reflects the fact that the rents were low to begin with. However, the analysis in this chapter and our review of the establishment of both fair market and contract rents as discussed in chapter 4 discloses that in some instances the rents were allowed to rise at rates faster and to levels higher than can be justified. Chapter 4 discusses weaknesses we found and certain measures to be taken to insure that fair market and contract rents are appropriately set.

AGENCY COMMENTS AND OUR EVALUATION

HUD stated that what is at issue in this chapter is not whether FMRs have gone up quickly, but whether program costs have, and also whether FMRs have gone up too rapidly and to unreasonably high levels in light of market conditions. HUD offered its own analysis of trends in section 8 costs between 1976 and 1980 using as its data base preliminary reservations of funds based on information supplied by prospective section 8 developers in their initial applications to HUD. HUD's trend analysis showed a somewhat lesser rise in section 8 costs than our analysis of FMRs.

HUD was critical of the fact that we used 1974 section 23 FMRs as the starting point in our analysis and also questioned the propriety of comparing the CPI rental component with FMR increases.

HUD's management information system does not produce complete cost information on the Section 8 Program. In the absence of such information, various indicators may be used to show changing cost levels over time. None of these indicators, however, are as reliable as actual cost figures would be. All available indicators of the cost of the Section 8 Program which we reviewed showed rapidly rising costs for the program from its inception through the present time. One such indicator was the FMRs HUD established between 1974 and 1979. We believe that FMRs provide a reasonably good indication of the rising costs of the Section 8 Program. Our review disclosed that while FMRs do not exactly match section 8 rents, they were, in general, indicative of the trend of section 8 costs. As already noted in this chapter, for 68 percent of the projects we examined HUD had authorized section 8 rents up to 20 percent higher than the approved FMRs for the areas we reviewed.

We used section 23 FMRs as the starting point for our analysis because of the very close relationship between the Section 23 Program and section 8. Our analysis reflects what has happened to subsidized housing FMRs from 1974 to 1978 and into 1979. We believe that the rapid rates of increase and the high levels to which many rents and costs have reached are matters which will be of interest to the Congress. The high cost of providing housing assistance was a primary reason that various housing programs were suspended and terminated in 1973 and 1974.

We deleted from the report our comparison of the CPI rent component with FMR increases. In place of this comparison, we added on pages 19 through 27 a comparison of the CPI housing component with FMR increases for six of our sample cities for which such data was available.

We believe our report adequately acknowledges the limitations of comparing FMR rates of increase to rates of increases in the CPI and two construction indexes. We continue to believe that these indexes do provide some gauge against which the rise in FMRs can be compared. (See pp. 111 to 115 for HUD's comments and our responses.)

CHAPTER 4

IMPROVEMENTS NEEDED IN SETTING NEW

CONSTRUCTION/SUBSTANTIAL REHABILITATION

FAIR MARKET AND CONTRACT RENTS

Because of the substantial Federal subsidies inherent in the Section 8 Program, it is important that fair market and contract rents be established properly. We found, however, that in Chicago, New York City, and elsewhere this was not always being done and that rents established and correspondingly paid were sometimes too high. It appeared to us that there was little show of concern for the program's high rental and subsidy levels on the part of some HUD officials involved in the rent-setting processes. Apparently pressure from HUD headquarters to produce units and to meet production goals with secondary regard to cost contributed to this generous philosophy. The philosophy was reflected through a lack of administrative care and discipline. The rental determinations disclosed numerous errors and improper adjustments having been made. A lack of documentation for many of the determinations was also a problem. Finally, too few comparables to use in establishing the rents forced those making the determinations to use methods which were less refined and reliable.

In examining the establishment of fair market and contract rents, we concentrated on the new construction and substantial rehabilitation segments of the program. We did not examine the establishment of rents under the existing segment.

FMR ESTABLISHMENT PROCEDURES

Section 8 of the Housing and Community Development Act of 1974 requires that FMRs be established by the HUD Secretary periodically, but not less than annually. They are to cover rental dwelling units of various types and sizes, located in different market areas. Proposed FMRs for an area are to be published in the Federal Register with reasonable time for public comment. They become effective on the date specified at the time they are published in final form in the Federal Register. Separate sets of FMRs are published for (1) the existing segment and (2) new construction/substantial rehabilitation segments of the program--each set being calculated differently.

The table on page 4 of this report shows the dates FMRs were published up to the time of our review. More recently, new construction/substantial rehabilitation FMRs were updated on July 13, 1979, effective April 1, 1979, and existing FMRs were updated July 26, 1979, effective October 1, 1979, but retroactive to March 29, 1979.

Procedures for establishing new construction/substantial rehabilitation FMRs are in chapter 8 of HUD Handbooks 7420.1 and 7420.2. The responsibility for estimating FMRs for each unit size, structure type, and market area is given to the Valuation Branch or Section in the various HUD field offices. Estimating FMRs is done by obtaining samples of market rent comparables for each unit size and structure type. The samples should be representative of newly constructed units of modest design within the section 8 delineated market area. Each sample should consist of 12 or more conventionally financed or HUD-insured comparables from different projects or developments. Subsidized units are not to be used as rent comparables.

Once the sample is obtained for a particular unit size and structure type in a market area, adjustments are made to each comparable for differences between it and a HUD-defined hypothetical standard unit. Also a time and trend adjustment is made to account for the lapse in time from the effective date of the comparable rent to the current date, and a trend projected from the current date to a date 2 years past the date the Schedule of Fair Market Rents is expected to be published for effect in final form in the Federal Register.

Once the comparable rents are adjusted, they are ranked in ascending order. The desired rental limit within this range allows the rental of a substantial portion, but not all, of the units represented by the sample. The HUD handbooks state that the desired initial estimate is the adjusted comparable which is closest to the 75th percentile of the sample.

The initial FMR estimates derived from the above method are entered on a Schedule of Fair Market Rents in rows corresponding to structure types and in columns corresponding to unit sizes by bedroom count. Procedures for establishing FMRs require that the progression of rental values from bedroom size to bedroom size and from structure type to structure type are logical and reasonably consistent. All rentals that appear reasonable are identified. Those that do not fit the logical progression rule--thus, not appearing to be reasonable--are adjusted as necessary by interpolation.

Acceptable FMR schedules are expected to be sufficient to induce private entrepreneurs to produce units for lease under section 8, but not high enough to support the production cost of inefficient developers or to encourage the production of units that are not modest in design. Once the schedules have been put together in the Valuation Branch or Section, they are then fowarded for field and regional office and HUD headquarters review and approval.

Two additional points need to be made at this time. First, it is expected that every feasible effort will be made to collect the data, quantitatively and qualitatively, necessary to to establish FMRs for each unit size and type according to the procedures discussed above. Where such data does not exist (e.g., the nonavailability of comparables), interpolation, extrapolation, or other logical and defensible techniques are used to establish the FMR for the particular unit.

Secondly, the HUD handbooks do allow the Valuation Branches and Sections to use what would appear to be a less time-consuming and exacting "trend factors" method in revising estimates of FMRs not more often than every other year. Under this method, trend factors are applied to the FMRs for the particular market to reflect the expected changes in the rentals over the applicable time period. Generally the best data for estimating rental trend factors are the observed changes in the rent of newly constructed units over the past 1 or 2 years. The appraiser should additionally consider the rates of change in construction costs, utility expenses, financing charges, etc., and the effects they are likely to have on the rates of change of market rents.

WEAKNESSES IN ESTABLISHING RECENT FMRs

Our review disclosed several weaknesses in the ways in which recent FMR levels have been established. Generally, these weaknesses translated into higher rents than should otherwise have been set.

Too few comparables

The use of market rent comparables is the primary method for establishing FMRs. As discussed earlier, HUD guidelines require that samples of 12 or more comparables be used in establishing the rents for each unit size, structure type, and market area. The fact of the matter is, there are very few comparables.

An article in the May 20, 1978, "National Journal" tells why comparables are becoming increasingly difficult to find. The article stated that:

> "In the early 1970's, about half the units built each year were apartments. By 1977, that had dropped to one-fourth. Of the 2 million units started last year, only 285,000 were privately financed rental units * * *. (The rest of the multi-family units were either federally assisted apartments or condominiums.)"

In its August 25, 1976, report to HUD's Office of Policy Development, ICF Incorporated stated that

"All six of the HUD field offices we visited were having difficulties finding appropriate comparables in some market areas, particularly those areas in which little or no new construction has occurred in the past few years, and those areas in which there is no housing of the type proposed * * *. In many cases, it has been necessary for HUD appraisers to choose comparables from outside the market area * * *."

HUD's Assistant Secretary for Housing acknowledged in testimony before the Subcommittee on Manpower and Housing, House Committee on Government Operations, that "There are very few comparables." On another occasion, he was quoted as saying that

"To control program costs, some alternative to the fair market rent system may have to be developed. The rent comparability isn't working because there are no more comparables. There is no private market production."

Additional insight was provided by a former HUD official when he stated in comments prepared on proposed changes to the new construction regulations that:

"In practice the ability to fairly determine comparables for multi-family rents has become harder in recent years since more and more of the rental housing now being built is federally supported. Thus, to get private market comparables it is increasingly necessary to look to older projects and ones further away, making the adjustments an increasingly large part of the determination. An additional factor undermining the reliability of comparables has been the pressure applied by the Central Office since 1976 to be liberal in the determination of comparables for Section 8 projects. This has been necessary in order to meet production goals and is a reaction to the initial conservatism of FHA comparables."

Our review showed the lack of comparables to be a problem. A look at the 1978 determinations of FMRs in San Francisco, for example, disclosed that comparables were used in only 4 of the 18 determinations, and that in 1 of the 4 determinations, less than the prescribed 12 comparables were used. In the other 14 determinations, interpolation and historical trend methods were used. The documentation for these determinations indicated that current market surveys had not produced market comparables with which to develop realistic FMRs.

In New York City, the number of comparables used in the 1978 FMR determinations was very limited, and in one important case was very questionable. The Valuation Branch in the New York area office had obtained information on 20 rental projects scattered throughout four of the city's five boroughs. These 20 projects were used as comparables in determining the FMRs for 0-, 1-, and 2-bedroom units in 5 or more story structures with elevators. In each determination, 12 or 13 of the buildings were used as comparables. Also, the same project, located in Manhattan, was determined to fall in the 75th percentile for all three determinations. All other 1978 FMR determinations in New York were interpolated from the three comparable determinations.

In reviewing the 75th percentile project, we discovered that it was not a new, elevator, 5 or more story structure as it should have been. Instead, a market absorption report revealed it to be a rehabilitated, walkup-type structure. An actual visit to the project disclosed that it had no elevator.

When we questioned the Valuation Branch Chief regarding the use of this building, upon which all 1978 FMR determinations in New York City were predicated, he told us he had no idea why the building was used as a comparable. He agreed that it should not have been used. When asked why the market rent comparison basis had not been used more extensively in New York's 1978 FMR determinations, he said quite simply that there were no comparable housing units in New York City to use for this purpose. As indicated earlier, HUD procedures require that every feasible effort be made to collect the data necessary to establish FMRs using comparables. We did not look, however, to see what efforts the New York area office had taken to collect such market data.

The same holds true for Chicago. FMR determinations in Chicago in 1978 were made using the trend factors method. In 1979, the Chicago area office developed 13 of its 22 proposed FMRs using the market rent comparison method. For lack of comparables though, the remaining nine proposed FMRs were established through interpolation.

Lack of documentation, arithmetic errors, and improper adjustments in FMR establishment

In addition to there being too few comparables to aid in the proper establishment of FMRs, our Chicago and New York work disclosed numerous other problems in the setting of such rents in those locations.

For example, in both cities our review was somewhat limited because of the lack of documentation that was maintained by the HUD field offices supporting their FMR determinations. One New

York HUD official saw nothing wrong with the fact that his staff had not kept good records of the data supporting various rent adjustments. He told us that "the data was in his chiefs' heads." When the staff was questioned, however, regarding why something was or was not done, we frequently got an "I can't recall" kind of an answer.

Arithmetic errors were quite prevalent in both the Chicago and New York field offices. Errors were found relating to comparable rent adjustments and interpolation calculations which often resulted in higher rental levels than there would have otherwise been.

As stated earlier, adjustments are to be made to the various comparables for differences between them and HUD's hypothetical standard unit. We found that many improper and inconsistent adjustments were being made. In New York, for example, we found adjustment errors or adjustment omissions in 27 of 37, or 73 percent, of the comparable cases. As an example, one comparable unit's rent, used in determining a 0-bedroom FMR, included air conditioning and a dishwasher as standard items. HUD guidelines state, however, that adjustments should have been made for the two items, reducing the comparable's rent to a lower level.

A questionable adjustment the New York area office made in its 1978 FMR determinations involved parking allowances. We found that the Valuation Branch had added an $80 per month parking allowance to the rents of the comparables located in Manhattan and $40 per month to the rents of the comparables located in Queens, Brooklyn, and the Bronx. (There were no comparable projects included in the 1978 determinations for the borough of Staten Island.) Although HUD guidelines permit such a parking allowance, we questioned its application in a situation where, citywide, only 44 percent of the residents own automobiles. The percent of those owning automobiles is even lower in the specific boroughs of the Bronx, Brooklyn, and Manhattan--the percents being 39, 43, and 25, respectively. We also questioned the standard application of the $80 parking allowance when, later in the FMR determination process, the 75th percentile project turned out to be from Manhattan. Since all 1978 FMRs in New York City were based on this one project, either by comparison or interpolation, its $80 allowance would have had citywide impact.

Improper time and trend adjustments

HUD guidelines specify that a time and trend adjustment shall be made in determining FMRs. As discussed earlier, the adjustment accounts for the lapse in time from the date of the comparable rent to the current date, and a trend projected from the current date to a date 2 years past the expected effective date of the FMRs. The HUD appraiser making such an adjustment is to consider what has happened to rents in the past 1 or 2 years, as well as what is expected in the future.

In New York City, the time and trend adjustment used in the 1978 FMR determinations was too high; thus increasing the FMRs that were set. Rather than using a trend adjustment of 8.56 percent which had been determined by the Valuation Branch to be appropriate, a 10-percent factor was actually used. This resulted in the overstatement of FMRs for a 5 or more story, elevator structure as follows.

Bedroom size	FMR overstatement
0	$25
1	22
2	26

Its impact on the FMRs for other structure types in New York City would have been consistent with the overstatements cited above.

Discussions with the New York Valuation Branch Chief disclosed that he was unaware that a 10-percent trend adjustment had been used. After reviewing our findings, he agreed that the FMRs had been overstated because of the 10-percent adjustment.

Relative to the above, our review disclosed a December 14, 1978, letter from the New York area office manager to the Director, Office of Multifamily Development, HUD headquarters. The letter indicated that the trend of rents in New York City over the last year had been less than what they had anticipated; running at a factor of 6.1 percent. It stated that

> "This finding indicates that our previous 32 month trend factor of 22.103% (based on 8.56% per annum) was excessive and that no change should be made in the [FMR] schedules at this time."

Not only was the finding applicable to the New York City market area, but also to the Nassau, Suffolk, Westchester, Putnam, Rockland, and Orange market areas. The trend factor used to compute FMRs in the Poughkeepsie market area was also excessive.

In Chicago, 1978 FMR determinations were to be made by increasing all previously effective FMRs by 9 percent--a factor determined appropriate by the Chicago Valuation Branch. We found, however, that the 9-percent adjustment had not been consistently applied and that some FMRs had been determined using a trend factor of between 6 and 7 percent. The use of this lesser factor, of course, reduced the FMRs of those units against which it was applied. Valuation Branch personnel were unable to explain why a factor other than 9 percent had been used in some cases.

PROCEDURES FOR ESTABLISHING CONTRACT RENTS

HUD Handbooks 7420.1 and 7420.2 state that contract rents for new and rehabilitated dwellings must be in compliance with FMR limits. Additionally, HUD Valuation Branch or Section personnel are to determine whether contract rents are reasonable in relation to the quality, location, amenities, and management and maintenance services of the project. They do this at the time each preliminary proposal is placed in "technical processing," and by comparing

> "* * * the proposed unit rents with the rents obtainable in the market for comparable units, which provide equivalent living accommodations and services, without benefit of public housing assistance or other subsidy."

Five market rent comparables are preferred, but in no event is an estimate to be based on fewer than three market rent comparables. As in the determination of FMRs, adjustments are to be made in establishing contract rents for significant differences between each comparable unit and the proposed unit for such things as (1) location, (2) age, (3) condition, (4) size, (5) number and furnishability of rooms, (6) amenities, and (7) utilities and services. Time and trend adjustments are likewise made.

Contract rents are adjusted annually on the Housing Assistance Payments Contract's anniversary date. The amount of adjustment is based on HUD's earlier analysis and the resulting automatic annual adjustment factors which are published in the Federal Register.

WEAKNESSES IN ESTABLISHING CONTRACT RENTS

One way to control Section 8 Program costs is to set proper contract rents. The previous procedures encourage the setting of rents which comply with FMR limits and which are reasonable in terms of each particular rental unit's attributes. Failure to adhere to the stated procedures can and does result in contract rents which are overstated and which, correspondingly, add to the Government's program costs. Our review disclosed weaknesses in the contract rent-setting process in both Chicago and New York City. Some of the weaknesses found were similar to those we observed in the FMR determination process.

Contract rents being set on the basis of cost analysis, rather than comparability analysis

Undoubtedly because of a lack of comparables to use in setting contract rents, we found instances where contract rents were being established based on construction and maintenance costs, and other factors, rather than by the preferred method of comparing the proposed rents with the rents obtained in the market.

The contract rents of one of the projects we reviewed in New York City, for example, had been established based on construction and maintenance costs. This was a project being administered by the city's Department of Housing Preservation and Development. Departmental officials acknowledged that the project's contract rents had been established based on cost information from the project owner. They stated that the limited size of their staff restricted their efforts in developing market rent comparability data for each of the section 8 projects they administer.

The Chicago Housing Authority administers some section 8 projects. Officials from the authority also acknowledged that proposed unit rents are sometimes evaluated on the basis of cost, rather than comparability. The Executive Director stated that in doing so they consider such factors as operating costs, loan repayment costs, reserves, and inflation.

Incorrect information used, and improper adjustments made, in setting contract rents

Our work in Chicago and New York disclosed that, in some instances, incorrect information had been used and improper adjustments were made in setting contract rents, resulting in the approval of rents at levels different than what they should have been. Some of these instances are discussed below.

In New York City, for example, we reviewed one project which had its contract rents overstated $45, $74, and $12 for efficiency, 1-, and 2-bedroom units, respectively. In a visit to the project, we found each of the units to have one less room than the contract rent documentation had indicated. The Valuation Branch Chief gave no explanation for this error.

In Chicago, several of the contract rent evaluations we reviewed contained erroneous information. The documentation in support of the rents for one project, for example, failed to show air conditioning as an amenity in one of the comparables. As a result, no adjustment was made for the amenity and the rents of the project we reviewed were correspondingly overstated. The same was true with one of the projects we reviewed in New York City. One of its comparables had a balcony for which there was no adjustment made. The project's rents were thereby overstated.

We noted in both Chicago and New York that adjustments had improperly been made relative to the age of some comparables. Some of the comparables were listed as having been built in 1943 and adjustments were made on that basis. The comparables were, in fact, built much more recently and, therefore, any adjustment for age should have been smaller than the ones actually made.

Some inconsistencies were observed in Chicago concerning the adjustments made to comparable rents not only for age, but also for square footage, utility services, location, and livability factors. For instance, one 2-bedroom unit we reviewed had 500 square feet of living area. Although the three comparables used in the determination each had more square footage, the amounts of adjustment for the size differences were inconsistently applied. Further, while the three comparables were rated equally in terms of location and livability with that of the unit being reviewed, the rents of two of the comparables were nevertheless adjusted downward by $20 and $25.

ADDITIONAL COMMENTS FROM HUD FIELD OFFICE OFFICIALS REGARDING THE SETTING OF FAIR MARKET AND CONTRACT RENTS

At the conclusion of our work in Chicago and New York City regarding the setting of rents, we presented our findings to HUD officials responsible for administering the program in the two areas. These officials provided some explanation for what had been done, as well as insight into other problems in the rent-setting processes.

In New York City, for example, we noted that the HUD area office in 1977 did not compile new FMRs because the 1976 FMRs had proven to be too high and, therefore, needed no upward revision. We found the same situation existing in the 1978-79 period. Based on our analysis, the 1978 FMRs were too high in the year they were established and continued to be too high in 1979 when they were carried over. We discussed with New York area office officials the possibility of the rents being revised downward to levels supported by the facts. We received a negative reaction to this suggestion. We were told that such an action would create increased paperwork, that gross rents in excess of FMR limits would become more prevalent--thus requiring more area office approvals, and that subsidies being paid by HUD would really not be less if the FMRs were lowered.

One New York official said that pressure had been applied within the area office to establish high FMRs so that housing development would take place in the city. He also indicated that this was the reason New York City--made up of five distinctly different boroughs in terms of housing and housing costs--was treated as one market area. Another official echoed this comment stating that including Manhattan with the other four boroughs in establishing FMRs raises the overall levels. He said one market area for all five boroughs is used to insure high FMRs, thereby stimulating construction in lower income neighborhoods where private developers might otherwise have no incentive to build.

Chicago area office personnel gave us some of their views regarding the establishment of section 8 rents. The following are among the problems they cited in the way FMRs are now set.

--It is difficult and unreliable to project rental values 2 years in advance.

--The hypothetical standard unit of modest design is not specific enough.

--The Chicago market area is too broad.

--There is pressure from HUD headquarters to develop FMRs which are attractive to developers, thus, helping production goals to be met.

--FMRs are inaccurately perceived as the attainable rents, rather than as upper limits.

--FMRs are subject to inaccuracy because data needed to establish them is not always available.

One Chicago official felt that the only problem with FMRs is that there is too great a delay each year in publishing them for effect. This delay hinders developers, causing them to incur added costs while having to wait to award contracts and arrange project financing.

WEAKNESSES IN ESTABLISHING RENTS HAVE ALSO BEEN REPORTED BY HUD'S OIG

Recent HUD OIG reports have identified many of the same types of weaknesses in establishing fair market and contract rents. For example, in its February 7, 1979, report, the OIG noted several mistakes made in the establishment of FMRs by HUD's Cleveland and Milwaukee field offices. Some of these mistakes included:

--Arithmetic errors.

--Wrong type of comparable used.

--Comparable used was over 6 years old.

--Comparables used were located outside of the market area.

--Incorrect adjustments made.

--Adjustments which should have been made were not made.

The report stated that 12 mistakes or errors had been made in the determination of an FMR for a 1-bedroom walkup unit in the Madison, Wisconsin, market area. The cumulative effect of the errors increased the FMR by $24 over what it otherwise would have been. Twelve was the minimum number of errors the OIG found in the FMR determinations they reviewed. The most errors found in a single determination was 20. The Cleveland and Milwaukee field offices averaged 14 errors per FMR determination which the OIG considered to be unacceptable.

HUD's OIG has also found problems in the establishment of contract rents. In chapter 3, we mentioned two OIG reports which stated that contract rents were often being approved at levels in excess of the published FMRs. Additionally, one of the two reports disclosed that inaccuracies in the Cleveland and Milwaukee field offices' establishment of contract rents have resulted in the overcommitment of almost $18 million for 16 of 32 projects reviewed. The overcommitment of funds was said to result from "improper adjustments to market rents and approval of contract rents materially in excess of indicated market rents." The report also stated that

> "Inaccurate contract rents resulting from inconsistent adjustments and use of old comparables will likely result in additional overcommitment of funds or decreased production of Section 8 units."

The other report dealt, in part, with the setting of contract rents by HUD's Knoxville area office. The report noted (1) that there was very little documentation in the files regarding the special circumstances necessitating the approval of contract rents in excess of FMR limitations. The OIG estimated that contract rents in excess of FMR levels for 22 of 28 projects would require an increase of $18,033,000 in HUD budget authority over the contract periods of 20 to 30 years. The following statement also appeared in the report:

> "The Director, KAO Housing Development Division, stated that contract rents in excess of FMR were approved in many cases to make the projects feasible so they could be approved and built to meet HUD's housing production goals."

CONCLUSIONS

To help contain program costs, it is important that fair market and contract rents be properly established. Too often, however, administrative or system weaknesses were found to be contributing to high fair market and contract rents and program costs. Both our work and that of HUD's OIG disclosed numerous arithmetic and other kinds of errors, as well as improper and/or inconsistent adjustments made in the determinations. A lack of documentation made it difficult to ascertain the propriety of many determinations. An important underlying principle of the program is that rents are to be established on the basis of comparability with rents being charged in the local market, and on the basis of reasonableness in terms of the quality, location, amenities, and services of the project as compared to similar unassisted projects. In actuality, however, there were often few such comparables available in various market areas with the result that other less refined methods were used. An additional factor undermining the reliability of the rent-setting process was what we detected as a lack of concern on the part of some agency officials for the program's high rents and costs--an attitude or philosophy which may have been fostered by HUD headquarters' pressure on field offices to produce units and meet production goals.

RECOMMENDATIONS

To aid in the proper establishment of fair market and contract rents, we recommend that the Secretary of HUD strengthen agency procedures by requiring field offices to

--search for market rent comparables with which to use in setting rental levels,

--devise other appropriate methods for use in those instances where sufficient comparables do not exist,

--document rental determinations more completely regardless of the process(es) used, and

--provide for a higher level of monitoring and review to insure greater accuracy in the rent-setting processes.

To stimulate a higher degree of cost consciousness on behalf of all HUD personnel working in the Section 8 Program, we recommend that the Secretary issue a notice to all offices outlining the economic, social and political reasons why section 8 costs must be curbed and why greater equity and uniformity in the distribution of benefits is needed throughout the program. Recent changes instituted by HUD (see pp. 85 and 86) and any planned in the near future could be highlighted in the notice--serving both as examples of and emphasis for this change in philosophy.

AGENCY COMMENTS AND OUR EVALUATION

HUD denied that there has been a lack of concern on its part with high program rental and subsidy levels. HUD stated that it has already gone far beyond our recommendations in its attempts to control program costs. HUD said that the rent determining process is difficult and that errors may have been made. HUD stated that it has the responsibility to train and monitor staff to keep errors to a minimum and hold costs down and believes it is meeting this responsibility.

HUD offered no specifics to support its assertion that it has gone "far beyond" our recommendations. We found serious problems in HUD's setting of fair market and contract rents in both Chicago and New York City. We also found that in 68 percent of the projects we analyzed (in six locations) contract rent levels exceeded applicable FMRs by up to 20 percent. We believe that our specific recommendations warrant careful attention by HUD and that guidance and direction from HUD headquarters to its field offices on the need for greater attention to establishing fair market and contract rents is necessary. (See pp. 115 to 120 for HUD's comments and our responses.)

CHAPTER 5

OBSERVATIONS AT THE PROJECT LEVEL

CONCERNING THE QUALITY OF SECTION 8

HOUSING AND OTHER MATTERS

This chapter presents our observations of the Section 8 Program at the project and tenant family level and identifies some factors in addition to housing market conditions causing high program costs and inequities. We selected and examined 11 newly constructed or substantially rehabilitated projects in Chicago and New York City. Eight of the projects were selected from among those in the two cities which had most recently been completed and occupied. The remaining three projects--located in New York City--were selected for review because of their publicized high costs and unique backgrounds.

Based on our project visits, discussions, and reviews of project files, we found that the projects were having a positive impact on the neighborhoods in which they were located and were, indeed, providing adequate housing to the families who live in them. The projects were costly, however, as discussed in chapter 3, and while we did not identify all factors causing the high costs, we did note the following:

--Section 8 has been used to bail out, often at high cost, certain projects begun under other programs and, in some cases, by parties other than the Federal Government.

--There was a wide range in the design and amenity features of the projects we visited. While some closely fit the conventional image of subsidized housing, others appeared to be more than modest in design and amenity features.

--Tenant incomes and allowances were often not being properly verified; thus adding to the Government's costs of the program.

We also noted that the high cost of producing section 8 new and rehabilitated housing has kept the early program objective of promoting economic mix from being achieved.

Each of these matters is discussed below. First, however, is a brief description of program activity in Chicago and New York and some general information on the 11 projects included in our review.

PROGRAM ACTIVITY IN CHICAGO AND NEW YORK CITY

HUD's section 8 MIS showed the following units being occupied as of February 28, 1979, in the Chicago and New York area office jurisdictions.

	New construction		Substantial rehabilitation		Existing		Total	
	Projects	Units	Projects	Units	Projects	Units	Projects	Units
Chicago	51	4,749	5	430	93	11,790	149	16,969
New York	16	4,176	18	1,100	183	31,249	217	36,525

Of these numbers, we selected 11 newly constructed or substantially rehabilitated projects for review in the cities of Chicago and New York. Basic information relating to each of the projects is shown below.

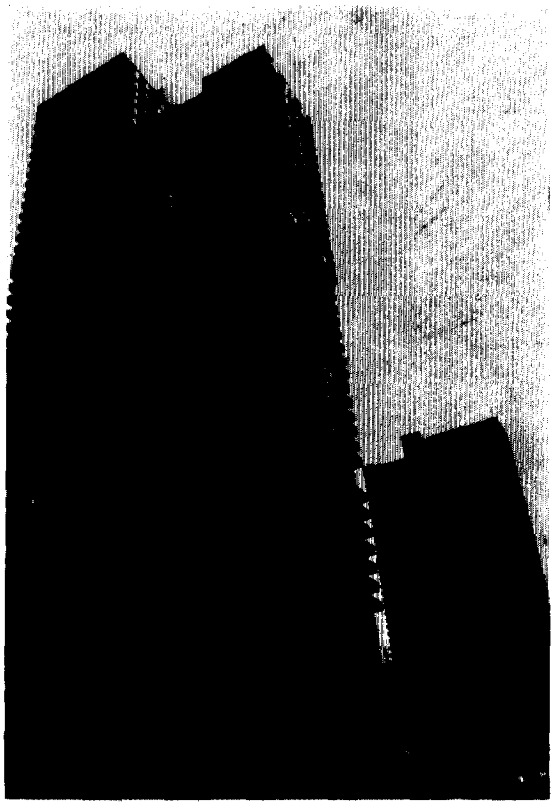
Projects	E-Elderly F-Family	Location	Project type	Effective date of a/HAP contract	Number of units Section 8	Total
Chicago						
Morningside	E	Chicago	New	11/78	201	201
Elm Street Plaza	E, F	Chicago	New	10/76	79	396
LeClaire Courts	F	Chicago	Rehab.	11/77	314	b/316
Crandon	E	Chicago	Rehab.	6/78	151	151
New York City						
Vernon Ave. houses	F	Brooklyn	New	9/77	266	c/267
Bronxchester houses	F	Bronx	New	9/78	207	c/208
311 West 94th Street	F	Manhattan	Rehab.	9/78	24	24
119 Ralph Avenue	F	Brooklyn	Rehab.	9/77	7	7
Taino Towers	F	Manhattan	New	(d)	656	656
Manhattan Plaza	E, F	Manhattan	New	1978	1,634	1,689
Aldus Green	E, F	Bronx	Rehab.	9/76	384	e/395

a/Housing assistance payment (HAP).
b/Includes two superintendent apartments.
c/Includes one superintendent apartment.
d/HAP contract had not been signed as of December 1979.
e/Includes 11 superintendent apartments.

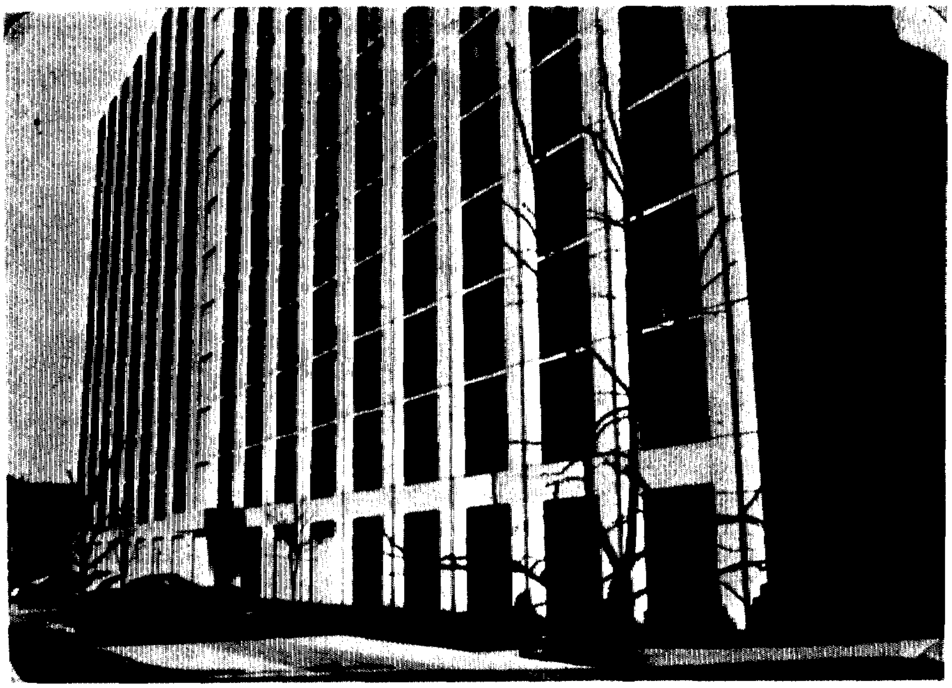
The table shows the 11 projects to be both newly constructed and substantially rehabilitated and both for the elderly and families. In addition, some of the projects were privately owned, others were State housing finance agency owned, and still others were owned by the local PHAs. All of the projects were occupied at the time of our review except for Taino Towers.

Occupancy in Taino Towers started in July 1979 with the first of four towers 95 percent occupied in December 1979. Occupancy in the second of four towers was expected to begin in early 1980.

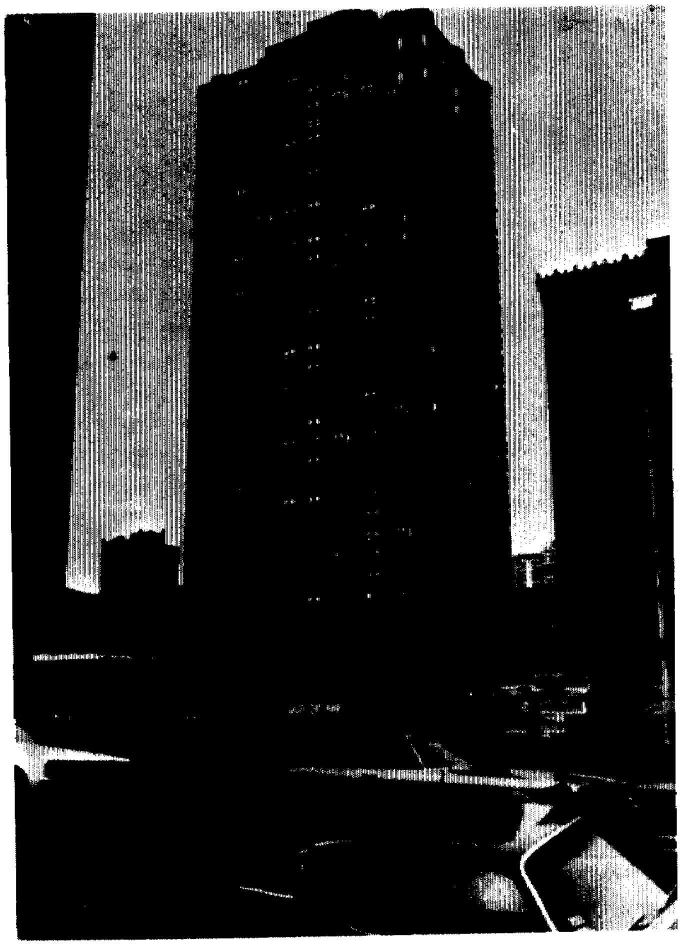
The pictures on the following three pages are exterior views of several projects we visited. Our visits disclosed each project to be an asset to its respective neighborhood and community, and that adequate housing was being provided through the new construction/substantial rehabilitation portions of the Section 8 Program. We found the projects to be clean and well-maintained. Many of the tenants we talked to expressed satisfaction with their units and with project management. The Morningside and Elm Street Plaza projects in Chicago had waiting lists of prospective tenants numbering in the hundreds. LeClair Courts, while not appearing as extravagant as some of the other projects, was described by Chicago Housing Authority officials as one of the most desirable housing complexes it operates and it, too, had a waiting list of prospective tenants. Manhattan Plaza, with 1,689 units, was initially occupied in June 1977. Since initial occupancy only 12 vacancies have occurred--some of these have been the result of death. Such a low turnover rate would seem to indicate a very high level of satisfaction by those living in the project.



MANHATTAN PLAZA NEW YORK CITY.

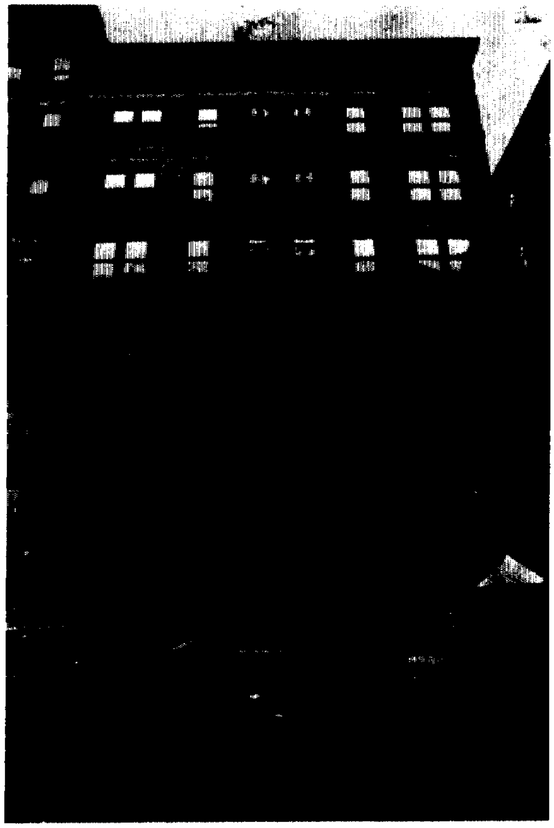


MORNINGSIDE APARTMENTS CHICAGO.



CHICAGO'S ELM STREET PLAZA PROJECT.

LeCLAIRE COURTS--CHICAGO.



REHABILITATED PROJECT AT 311 WEST 94TH STREET, NEW YORK CITY.

VERNON AVENUE PROJECT IN NEW YORK CITY.

SECTION 8 PROGRAM USED AS A BAIL OUT

The Section 8 Program has been frequently used in the past as a means of "bailing out" projects begun under other programs and which were experiencing financial difficulty. In March 1976, for example, HUD initiated what was known as the Section 8 Loan Management Set Aside Program to help improve financially troubled multifamily housing projects with HUD-insured or -held mortgages. The equivalent of 100,000 units of section 8 contract authority was set aside and by the end of September 30, 1976, 1,730 multifamily projects had been approved for assistance at an annual cost of approximately $175 million. The Set Aside Program continued through fiscal year 1979 at which time HUD established the Troubled Projects Operating Subsidy Program to take its place--this latter program being independent of section 8.

There was criticism of the use of the Section 8 Program as a bail out. In a study 1/ prepared for the Subcommittee on Priorities and Economy in Government, Joint Economic Committee, the point was made that section 8 has too often been used merely to prop up older forms of Government subsidization. The study stated that section 8, rather than being used as a replacement for the older programs as was intended, " * * * is increasingly used as a takeout mechanism for poorly conceived and/or financed governmental housing efforts of the past."

Our review disclosed the use of section 8 under the Loan Management Set Aside Program and, additionally, its use to bail out projects with no HUD-insured or -held mortgages. The three projects in New York City which we selected for review because of their publicized high costs had each been rescued by section 8. One of the projects involved HUD's Section 236 Program. The other two projects were conceived independently of the Federal Government, with New York City financial backing. While we are sure there are many arguments supporting what was done in each case, given the high costs of the three projects and their correspondingly high levels of rents, we question whether this was the wisest and most efficient use of the country's limited subsidized dollars. Some of the details behind each of the projects follow.

Taino Towers

The history of this project shows that in April 1965, the Federal Government issued a feasibility letter for a mortgage to be insured under the Section 221(d)(3) Program at a below

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1/"Multifamily Housing Demand: 1975-2000," (Nov. 14, 1978).

market interest rate. The mortgage amount was $18,650,000 and the project plans called for 460 units. The conditions established for mortgage insurance were not met and the funds set aside for the project were recaptured in April 1970.

In 1971, the project sponsor restructured the proposal and resubmitted it. Under the new proposal the project was to have 656 units with mortgages insured and subsidized under HUD's Section 236 Program. Commitments for mortgage insurance were issued in February 1972, and in October 1972 the mortgages were closed at $39 million.

Problems subsequently ensued between the owner and the contractor concerning the scope of work to be done. In February 1976, because of the numerous problems, it became evident that the mortgages would soon be in default. In July 1976, with the project about 85 percent complete, the mortgages were assigned to HUD.

Notwithstanding HUD precautions, the buildings were damaged by the winters of 1975/76 and 1976/77.

In August 1977 HUD entered into an agreement whereby the Secretary became mortgagee in possession until the project is completed. The Secretary's status as mortgagee in possession will terminate upon completion, at which time section 8 subsidies are to begin.

Estimated cost of Taino Towers at the time of our review was $54.7 million. The table on p. 68 shows the large increases in rents to be charged in 1979 versus those anticipated in 1971.

Manhattan Plaza

This project was originally built under New York City's Mitchell-Lama program for middle-income housing. It was intended to be an unsubsidized project, designed to attract middle-income tenants to a generally revitalized Times Square area. Because of the city's fiscal problems, plans for revitalization of the area were abandoned and sharp increases in costs raised the estimated rental rate per room to $165. Because the project could not be marketed at this level in the generally rundown area in which it was located, the city applied for and obtained section 8 funds from HUD for the project. This conversion raised considerable opposition because section 8 was generally associated with the lowest income groups and it was assumed that a high concentration of low-income tenants in Manhattan Plaza would contribute further to the decline of the neighborhood. In response, a plan was developed and approved by the Secretary of HUD whereby members of the performing arts would be given preference for admission to 70 percent of the units, up to 15 percent of the units would be made available to elderly residents of the neighborhood (many of whom were thought to be retired performers), and up to 15 percent would be made available to non-elderly neighborhood residents. The fact that preference was given to members of the performing arts reflects the project's close proximity to New York's Broadway theatrical district, and a belief that such tenants would have a professional interest in improving the neighborhood. In addition, approval was obtained from the HUD Secretary to raise section 8's income limits by 35 percent for approximately 30 percent of the units. This was considered necessary to bridge the gap between prospective tenants curently eligible for section 8 and those who could afford the market rate; thus reaching a broader range of the performing arts community.

Manhattan Plaza was initially occupied in June 1977. Rental and subsidy information for the project are presented beginning on p. 64.

Aldus Green

Aldus Green was the third and final project included in our review which had been bailed out by section 8. It was a substantially rehabilitated project, conceived in 1973, with New York City financial backing. As housing leadership in the city changed, and as the city's financial strings tightened, the project's developer sought and obtained help from the State of New York. One year later, with mortgage closing a week away, the State Housing Finance Agency lost its ability to float bonds. A Federal Housing Administration-insured loan was subsequently secured from a thrift association and, in the end, a contract with HUD under the Section 8 Program was entered into to provide rental subsidies.

The project was completed in 1977. It consisted of 11 buildings--each five or six stories high--containing a total of 395 units. Although the project and its units were attractive, clean, and well-maintained, they appeared to be no more than modest in design and amenities. Regardless, costs to the Federal Government at Aldus Green are high with each unit being subsidized an average $543 per month, or $6,515 annually. Tenants, on the average, were contributing an additional $90 per month, or $1,084 annually.

WIDE RANGE IN DESIGN AND AMENITY FEATURES

The projects we visited varied in terms of their quality, and also in terms of the quantity of design and amenity features which they possessed. The more lavish the project and its units, naturally, the higher the overall cost to build or rehabilitate and the higher the subsidized cost to the Federal Government.

Present regulations do not expressly exclude amenities or design features considered luxurious. They do state that FMRs should be set at levels required to obtain rental housing of modest (nonluxury) nature with suitable amenities and sound architectural design. In addition, HUD handbooks state that in estimating FMRs, the appraiser should

> "Assume dwelling units of modest design, suitable for the market and climate of the market areas. Modest in this context means non-luxury: If in a particular market area a facility or service is typically included in new projects whose rentals are moderate (not in the luxury range), that facility or service may be considered to be within the bounds of modest design. Too restrictive an interpretation of modest design will lead to the production of units that are only marketable to subsidized or assisted tenants. On the other hand, too liberal an interpretation will result in the imprudent expenditure of Federal funds."

Because of this vagueness or generality, fear has been expressed that luxury level projects could result under the program. CBO has written 1/ for example,

> "It is possible * * * that the absence of explicit development-cost ceilings in the Section 8 program encourages the construction of more expensive projects than are built for public housing."

HUD's Assistant Secretary for Housing has testified that this is generally not so. While denying that "Taj Mahals" were being built under section 8, he has stated that the level of amenities in a section 8 project reflects a decision of the Congress and HUD to build housing which will attract unsubsidized as well as subsidized tenants. He has commented that section 8 projects were being built to last. He has also commented that high FMRs are not necessarily the result of amenities. He said

> "It is the cost of construction and cost of interest rates and cost of maintenance. These buildings are paying new tax rates, new utility costs, and these are made up from the actual costs of these buildings. These are modest apartments. The comparables and reasonableness of these are measured against what would be termed modest apartments. They are not luxury apartments. The amenities are minimal in all these buildings."

1/CBO budget issue paper on "The Long-Term Costs of Lower-Income Housing Assistance Programs," (Mar. 1979).

Some of the projects we visited in Chicago and New York City were modest in nature. Others contained features and amenities characteristic of higher quality housing. A description of some of the projects follow.

Manhattan Plaza

This project is located at West 42nd Street in New York City. It consisted of 1,689 units located in two 45-story buildings. On January 15, 1980, 55, or approximately 3 percent, of the project's units were unsubsidized.

The project was originally conceived as being unsubsidized and designed to attract middle-income tenants. We found the project, as a whole, and its units to be very attractive and more than modest in design and amenities. For example:

--The units facing the outside walls had balconies.

--All units had individual thermostats for heat and air-conditioning control.

--All units had wood kitchen cabinets and wood-parquet floors.

--The 2-bedoom units had two baths, dining and living rooms, and were quite spacious.

In addition to the above, the project maintained a 24-hour security service, had attractive grounds, and at least one spacious community/meeting room. Also, all-season swimming and tennis, racquet ball, exercise, and indoor parking facilities were available on the premises. We were told that these latter facilities were privately operated and that Manhattan Plaza tenants, by virtue of their residency, received membership discounts. Many of the tenants were apparently taking advantage of the discounts and the facilities. For example, the Manhattan Plaza Swim and Health Club had approximately 1,800 members, of which about 1,000 were project tenants. Regarding the Manhattan Plaza Racquet Club, about 25 percent of the 1,632 members were project tenants.

In November 1978, contract rents at Manhattan Plaza were as follows.

Unit type	Contract rent
Studio	$518
1 bedroom	626
2 bedroom	723

SWIMMING AND TENNIS FACILITIES AT MANHATTAN PLAZA.

On the same date, the average annual subsidy at the project was $5,090. The tenants were contributing an average $2,088 annually.

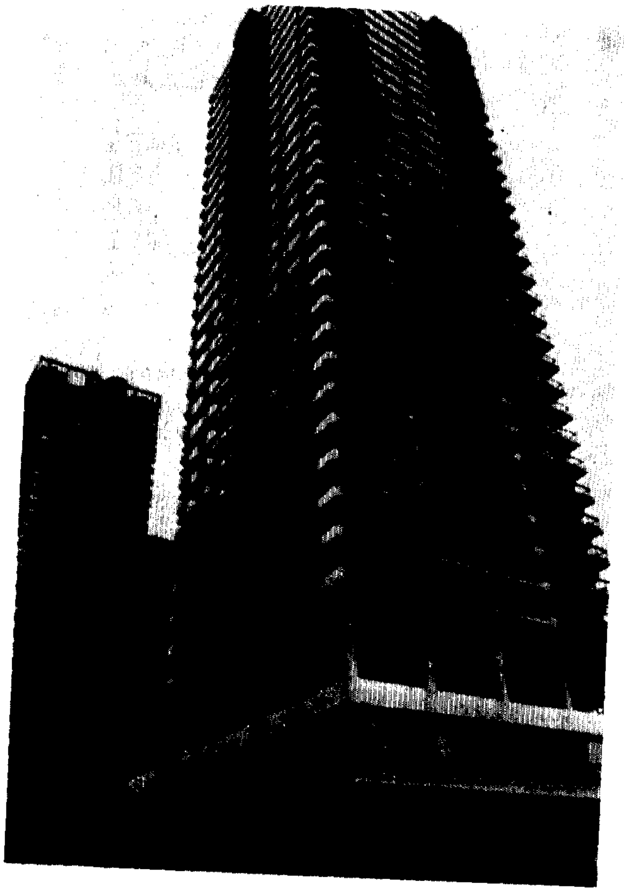
Taino Towers

Taino Towers is another project with a unique background. It is located in East Harlem, encompassing 1 square block, and consisting of 656 subsidized units in four 35-story towers. The towers also house a five-story Medical Day Care Center and a five-story Human Resources Center which includes a gymnasium, swimming pool, auditorium-theater, and greenhouse. There is also a 240-car underground garage, approximately 31,000 square feet of commercial space, and 24-hour security, featuring closed-circuit television and limited access to the interior.

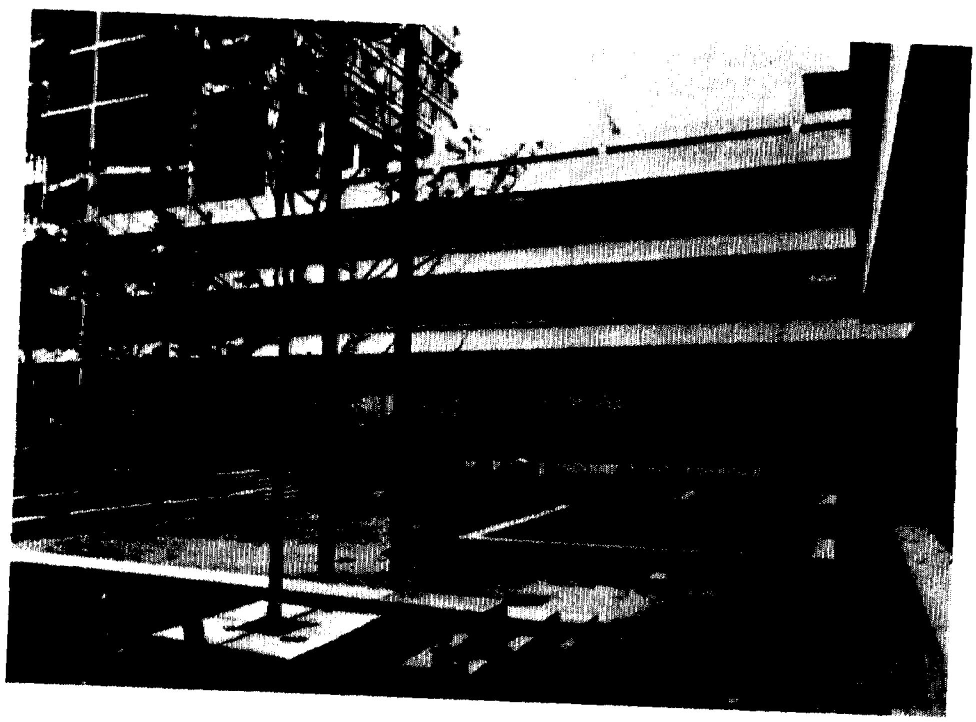
Although the rental units were not occupied at the time of our March 1979 visit, we found them to be modern and spacious, each having large glass windows covering much of the exterior wall. Each unit was to have a screen-enclosed balcony with a magnificent view. Air-conditioning was to be provided. Some units had as many as six bedrooms.

The estimated cost of this project, at the time of our review, was set at $54.7 million with residential development costs representing about 52 percent of the total. Since the Management Plan and Agreement for the project had not yet been approved by HUD, it was not entirely clear as to who was to cover the costs of the project's cultural and recreational facilities. We presumed that the commercial facilities would at least carry their share of the load. At the time we visited the project, however, only one commercial enterprise--a supermarket which will occupy 10,000 of the 31,000 square feet of commercial space--appeared definite. Other enterprises being discussed as possible tenants included a travel agency, variety store, apparel store, liquor store, bank, restaurant, stationery store, and sporting goods store.

The table which follows shows what rents were estimated to be in April 1971 versus those being charged in December 1979.



TAINO TOWERS—PICTURE DEPICTS TWO OF THE FOUR TOWERS.



COURTYARD AT TAINO TOWERS STILL UNDER CONSTRUCTION.

Bedroom size	Estimated monthly rent April 1971	Actual monthly rent December 1979
0	$ 75	$425
1	103	518
2	123	598
3	227	681
4	239	770
6	248	770

In April 1971 the annual subsidy per unit was estimated to be $2,926. At the time of our review, the annual subsidy per unit was $9,598; $5,869 for section 8 and $3,739 for the section 236 1/ first-year interest reduction payment.

Morningside

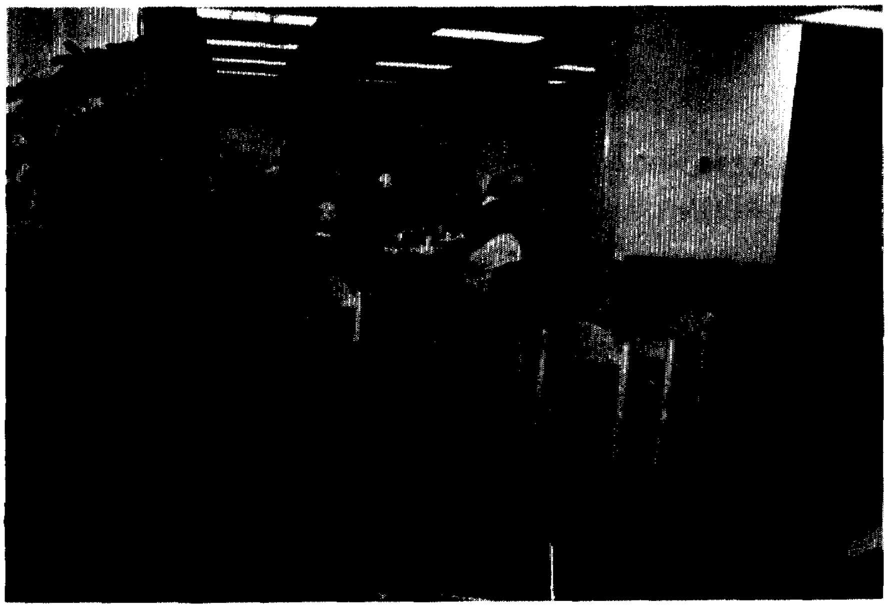
This newly constructed elevator project, comprised of about 200 one-bedroom units, was built for the elderly and was 100-percent assisted. It is located in Chicago, about 10 or 15 minutes from downtown via public transportation.

This project appeared to be of very high quality. Units in the project contained wall-to-wall carpeting, an emergency call system, color-coordinated electric ranges and refrigerator freezers, master TV antenna hookups, and air-conditioning. Project amenities included a library, billiard room, 24-hour security and answering system including guards, an arts and crafts room, a full-time social services director, free outdoor parking, fully furnished lobby and reception area, extra storage space, and a large community room with kitchen facilities.

Gross rents at Morningside averaged $405 per month, or $4,860 per year. Average annual subsidy was $3,626 with the tenants contributing an average $1,236.

1/A HUD-administered multifamily program which provided mortgage insurance and interest and operating subsidies so that project owners could reduce rents for lower income families.

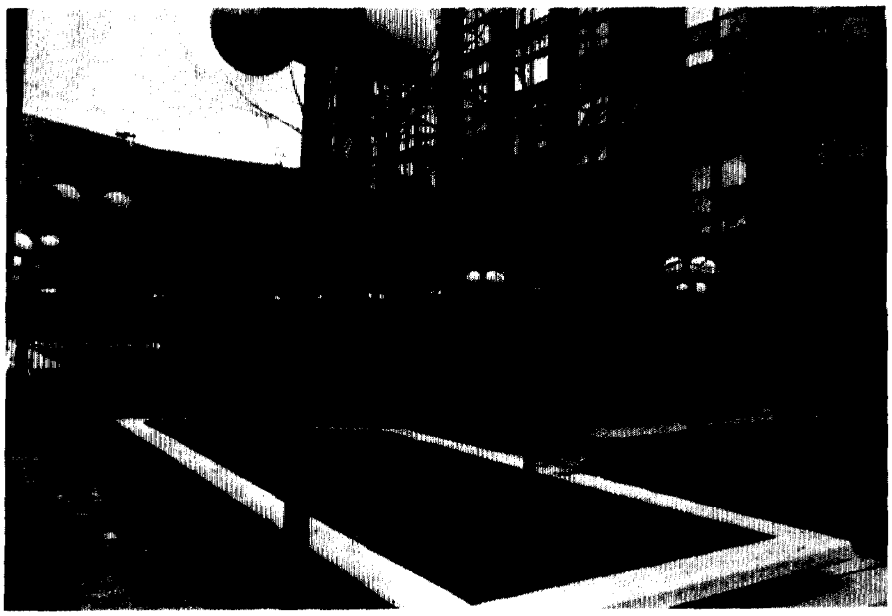
THIS BILLIARD ROOM IS BUT ONE OF SEVERAL AMENITIES AT MORNINGSIDE.



THE MORNINGSIDE COMMUNITY ROOM OFFERS A MODERN AND SPACIOUS AREA FOR VARIOUS SOCIAL EVENTS.

Elm Street Plaza

This project is located in Chicago. Like the Morningside project it was a newly constructed one with elevators. Seventy-nine of its 396 units were being assisted and about one-third of these were initially set aside for the elderly. Assisted units included zero-, one-, and two-bedrooms. Elm Street Plaza is located within several blocks of Morningside.



ELM STREET PLAZA,CHICAGO–COVERED PARKING AND HEATED SWIMMING POOL IN BACKGROUND.

Elm Street Plaza management advertised that their units included all the luxury amenities one would expect including forced air central heating and air-conditioning, frost-free electric refrigerators, electric ranges with continuous cleaning ovens, dishwashers (in the one- and two-bedroom units), and floor to ceiling windows. Project amenities include individual storage for each unit on each floor, a private garden, television security system, a doorman, master television antenna, and a lounge/hospitality room. Tenants must pay extra for covered parking and the use of a heated swimming pool. The project also includes a supermarket on the ground floor level.

Gross rents for the assisted units at Elm Street Plaza averaged $364 per month, or $4,368 per year. For those units, the average annual subsidy was $3,187. The tenants were contributing an average $1,176 per year.

LeClaire Courts

This project is located in Chicago and is owned by the Chicago Housing Authority. It represented but one of nine different sites which were undergoing substantial rehabilitation. LeClaire Courts has over 300 assisted family units made up of two-, three-, and four-bedrooms.

Units in this project were relatively more modest than some we found elsewhere, but were comfortable. Included in them were refrigerators, gas ranges, drapery rods, and shades. The project included an outdoor recreation area with swing sets and a swimming pool. Parking was ample and free.

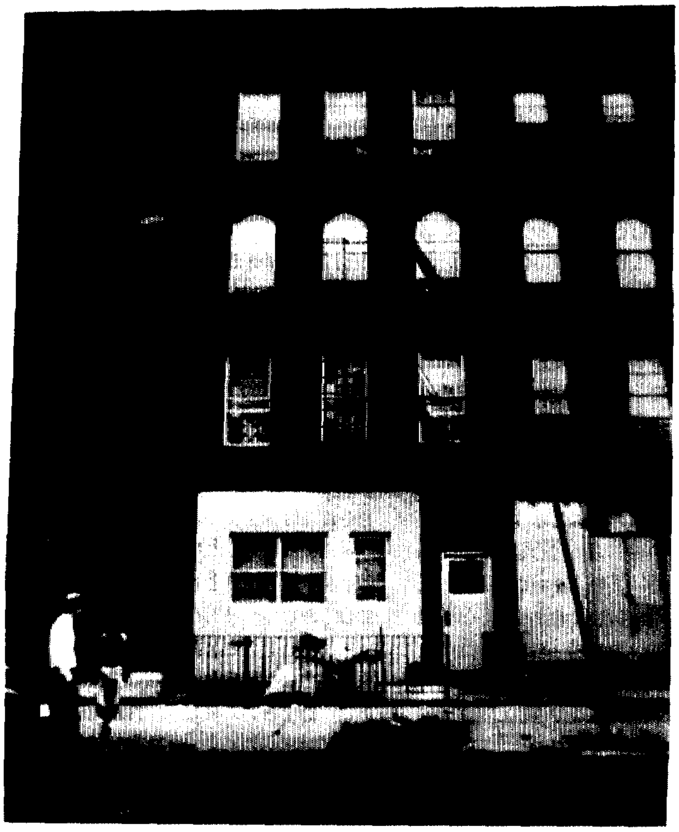
Gross rents at the project averaged $306 per month or $3,672 per year. Average annual subsidy per tenant was $2,364. Average annual tenant contribution was $1,116.

119 Ralph Avenue

This was a substantially rehabilitated project located in Brooklyn. It was a four-story walkup type building with seven units. Included in each unit was a refrigerator, range, heat, and hot and cold water. The project and its units were very modest in design and amenities. For example, in the one-bedroom unit we visited, the bedroom was nothing more than an alcove off of the living room--a blanket, hanging across the doorway, separated the two rooms. Rents at this project were as follows:

Bedroom size	Number of units	Monthly rent
1	6	$368
2	1	473

An exterior picture of the Ralph Avenue project follows. Note its austere look as compared to the looks of some of the other projects.



RALPH AVENUE PROJECT—BROOKLYN.

INADEQUATE VERIFICATION OF
TENANT INCOMES AND ALLOWANCES

Families participating in the Section 8 Program are to contribute between 15 and 25 percent of their income toward their rent, the actual percentage depending upon such factors as income level, family size, and extraordinary expenses. Section 8 regulations require that this income be reported to PHAs in the case of the existing segment of the program, or to the property owner or his managing agent in the new construction and substantial rehabilitation segments. It is up to the PHA or property owner/managing agent to determine family eligibility and to verify the sources and accuracy of income and other information affecting eligibility and the amount the family will be required to contribute.

To help minimize program costs, thereby maximizing the number of families the program can assist, it is important that only eligible families are assisted and that the level of assistance is properly calculated. In testimony before the Subcommittee on Housing and Community Development, House Committee on Banking, Finance and Urban Affairs, Congressman Andrew Maguire, in April 1979, stated:

> "The fact remains * * * that HUD (section 8) subsidy costs are bounded not only by the cost of producing the unit, but also the share paid by the tenant. * * * Given the limited number of eligible households that the Section 8 Program can aid, and the plight of many families who remain on waiting lists, I believe that HUD procedures should seek the payment of the tenant's allotted share as far as practicable to stretch program participation. At present, any person who fails to report his entire income essentially prevents others who need help from being able to make use of the program."

Congressman Maguire went on to state that

> "At the present time, Section 8 functions on the principle that a program recipient will in all cases totally divulge his assets and income in the verification process. Given the fact that any understatement of income will translate into a decreased rent payment, it does not seem unreasonable to assume that such reporting may occasionally be incomplete. Section 8 has no method to discover all sources of household income, if the household does not volunteer those sources."

He further mentioned that the Subcommittee on Manpower and Housing, House Committee on Government Operations, "* * * found that many project managers and public housing authorities, who act as HUD's Section 8 agents, feel little incentive to protect HUD's interests."

In Chicago and New York City we found problems in the verification of tenant incomes and allowances. In New York, for example, we reviewed 70 tenant files at four of the projects we visited. Because of missing or insufficient documentation, we were unable to determine family eligibility in 45, or 64 percent, of the files reviewed. We noted that:

- --Only 16, or 23 percent, of the 70 files contained adequate income documentation for determining tenant eligibility. Of the remaining files, 31 (44 percent) contained inadequate documentation while 23 (33 percent) had no documentation whatsoever.

- --Subsidies had been incorrectly computed in 22, or 31 percent, of the cases reviewed; they were correct in 16, or 23 percent, of the cases; we were unable to make such a determination in the remaining 32, or 46 percent.

--Although nine tenants had claimed medical or unusual expenses thereby reducing the amount of their incomes and correspondingly reducing their rent contributions, only one file contained related documentation and even it was inadequate. The other eight files contained no documentation at all.

--An independent verification of reported incomes for 7 of the 70 cases disclosed understatements in 4 cases resulting in the overstatement of monthly subsidies of from $9 to $38; the reported income in 2 of the cases was correct; and in the remaining case the stated employer had no record of the alleged employee.

The property manager at one of the projects we reviewed stated she was confused over some aspects of administering the Section 8 Program, particularly in terms of what income and allowance documentation should be obtained and how subsidies should be calculated. She stated she was unsure of how aggressive her approach should be in obtaining sufficient documentation, and that she believed many tenants were understating their household income. Due to insufficient staff, the management of this particular project was at least 4 months late in performing its annual tenant recertification.

At another project, the manager stated that although income and allowance documentation is initially requested, no follow up action is taken to obtain it. Documentation which is obtained is given only a cursory review and, often, a tenant's word is accepted for current or anticipated income. The manager further stated that the Section 8 Program places too much administrative burden on the landlord. He would like to see a system which places the burden on the tenant to provide adequate documentation in support of eligibility.

At a third project, the manager stated that while he annually receives employer letters from tenants listing incomes, he does nothing to verify the information. He said he was not obtaining allowance documentation because he was unaware of such a requirement.

At a fourth project, administered by the local PHA, there was almost a total absence of income and allowance documentation. It was this PHA's policy not to maintain such documentation in tenant files, but rather to rely on records of interviews with tenants which were maintained. Officials at the PHA stated that income omission was the major problem they face, not the verification of wages and employment. The two officials we talked to indicated that neither had received any HUD-sponsored section 8 training.

In Chicago, inadequate verification of tenant incomes and allowances was also found to be a problem. Of 65 tenant files we sampled in the four Chicago projects in our review, 28, or 43 percent, did not contain evidence supporting incomes and allowances. For example, documentation supporting social security benefits, pensions, interest income, employment income, etc., was either not on file or inadequate.

We found tenant files to generally be more complete at the Crandon project which was privately owned and the LeClaire Courts project which the Chicago Housing Authority owned, than we did at either Morningside or Elm Street Plaza which are State agency projects. We do not know the reason why, except that management personnel at Morningside and Elm Street Plaza thought that they may have attempted to process too quickly tenant income and allowance data because of the large number of tenants to be processed during initial rent-up. They indicated, in effect, that there was no one looking over their shoulders and that they may not have been as careful as they should have been.

Personnel at the projects in Chicago generally told us that it is unreported income and resources that is the problem. Morningside and Elm Street Plaza personnel indicated that they rely heavily on statements by prospective tenants, that they try to corroborate what is reported, but that they make little attempt to detect undisclosed resources. Personnel at Crandon stated that there is no reasonable method for detecting nonreported income.

A provision of the Housing and Community Development Amendments of 1979 legislation, which was signed into law on December 21, 1979, provides for HUD to establish procedures to assure that income data provided by tenants under the Section 8 Program is complete and accurate. To verify reported tenant incomes, it provides for the use of data concerning unemployment compensation and 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 United States Code.

HIGH COST OF NEW AND SUBSTANTIALLY REHABILITATED HOUSING BLOCKING ATTAINMENT OF ECONOMIC MIX GOAL

As was stated in chapter 1, the Section 8 Program was established for the purpose of aiding lower income families in obtaining a decent place to live and of promoting economically mixed housing. Because of the high costs of producing new and rehabilitated housing, the goal of promoting an economical mix in those program segments is generally not being achieved. Housing thus produced often is so costly that moderate- and even middle-income unassisted households cannot afford to live in it.

Some believe that a subsidized housing project which houses tenants with varied income levels is a healthier project from both economic and sociological standpoints. Through such a mix it is hoped that problems experienced previously by other subsidized housing programs as a result of concentrating a large number of low-income persons in a single project could be avoided. Former HUD Secretary Patricia Harris argued that the agency should not be legislatively restricted in terms of being able to mingle lower income families with higher income families. The Secretary stated that it was important to not house all problem families together. She suggested that, through mingling, families from different income levels can learn from each other.

Several provisions in the section 8 regulations were intended to support the objective of economic integration. First, a priority was given to proposals for projects of 50 or more units where no more than 20 percent of the units were to be subsidized. Second, in determining the reasonableness of section 8 rents, an attempt was to be made to avoid rents higher than what the unsubsidized market would bear so that the project would be able to attract unsubsidized as well as subsidized tenants. It was recognized that contract rents which were too high would scare off unsubsidized tenants.

FMRs and contract rents have, in fact, risen significantly since program inception as was discussed in chapter 3. As a result, a year-long probe by the Subcommittee on Manpower and Housing, House Committee on Government Operations, disclosed in 1978 that many section 8 projects were so expensive that only the poor could afford to live in them. The subcommittee found some income dispersion in the existing segments of the Section 8 Program, but little or no income dispersion in the new construction/substantial rehabilitation segments.

In an earlier study done for HUD's Office of Policy Development, ICF Incorporated had similar findings. ICF concluded that the objective of economic integration was not being achieved. They found that:

> "Only five of the 354 proposed projects which were selected in the six field offices we visited will be less than 100-percent assisted. Most developers as well as HUD field office personnel with whom we talked do not feel that the objective of economic integration is attainable on a large scale * * *. The rents required to support construction of new family units are generally higher than unsubsidized tenants can or will pay. Further, most developers view the existence of subsidized tentants [sic] in a project as a disadvantage when attempting to rent other units in the project to unsubsidized tenants."

Our review of new and rehabilitated projects in Chicago and New York City disclosed little economic mix. In New York, for example, only one out of the seven projects reviewed was less than 100 percent subsidized. This was the Manhattan Plaza project in which 55 out of its 1,689 units were unsubsidized.

In Chicago the record was no better. One of the four projects we reviewed was less than 100 percent subsidized. At Elm Street Plaza, for example, 317 of its 396 units were unsubsidized.

The high cost of producing newly constructed/substantially rehabilitated section 8 housing and the corresponding high rents that must be charged do limit the mixing of unsubsidized and subsidized tenants in many of the projects. For example, the president of the corporation managing Taino Towers told us in March 1979 that the expected contract rents at the project will be too high to attract anyone but the subsidized. He said that "A project of this type is doomed to be only low-income housing," and that the only way economic mix at the project could be achieved is if the Government forgave the mortgage; thus freeing them of their debt service and allowing them to lower their contract rents.

Considering the rents being charged at the projects we reviewed in Chicago and New York, it is little wonder more of them were not attracting unsubsidized tenants. A number of the projects would have required annual incomes of $20,000 to $40,000 for unsubsidized families to live in the projects while paying no more than 25 percent of their incomes for rent.

CONCLUSIONS

Our review of specific projects and tenant families in Chicago and New York City disclosed additional reasons for the high costs of section 8 and its resulting inability to serve more people. Program criteria, for example, relating to the caliber of housing provided by section 8 has been rather general and subject to a wide range of interpretation. This has resulted in housing being produced, particularly under the new construction segment of the program, which is of high caliber containing features and amenities not normally expected in subsidized housing. Such construction naturally leads to high project rents and correspondingly high costs to the Federal Government through the subsidies that are paid. The high rents and quality of this housing invite resentment on the part of the taxpaying public who see their subsidized neighbors living in better accommodations than they themselves can afford. The purpose of recent revisions to the regulations prohibiting the inclusion of amenities or design which would exceed the standard of modest quality is to temper this type of situation in the future (see chapter 6 for a discussion of the regulation changes).

Section 8's use as a bail out mechanism has apparently diminished as a result of the demise of the Loan Management Set Aside Program and the institution of the Troubled Projects Program. Its use as such a mechanism in the past, however, was significant with a considerable portion of today's section 8 production statistics being made up of housing brought into the program under these circumstances. Our work disclosed some of this housing to be very costly--perhaps serving as a warning against such use in the future.

The program lacks incentive for owners and PHAs to properly verify tenant income and allowances; thus, such verification is not always properly done and some families pay less for their rent than they should. Legislation recently signed into law should provide better data to owners and PHAs for use in their verification efforts. There are some actions which can be taken to further help in this regard.

Finally, new and substantially rehabilitated housing is often so costly that moderate-and even middle-income unassisted households cannot afford to live in it. The high cost of this housing has, in many instances, effectively blocked the achievement of a Section 8 Program goal of promoting economically mixed housing.

RECOMMENDATIONS

We recommend that the Secretary of HUD strengthen the procedures used in verifying tenant income and allowances by

--highlighting to all Section 8 Program administrators and beneficiaries the serious regard HUD places on this matter;

--reaffirming and restating as necessary the duties and responsibilities of HUD field offices, housing owners, and PHAs in carrying out this important function;

--monitoring more aggressively the verification efforts of housing owners and PHAs, and

--devising appropriate penalties for owners and PHAs who fail to adequately perform their verification duties and responsibilities, and tenant families who willfully attempt to defraud the Federal Government by inaccurately reporting income and allowances.

AGENCY COMMENTS AND OUR EVALUATION

HUD took issue with the fact that we included in our discussion of amenities two projects which were not built under section 8 (specifically Manhattan Plaza and Taino Towers).

HUD agreed that the early program objective of promoting economic mix was not being achieved. HUD said that it is not the high section 8 rents that keep moderate-income tenants out of section 8 projects, but the high rent situation in general.

HUD agreed that various section 8 "bail-outs" can be questioned, and that the whole Section 8 Loan Management Program raises serious policy questions, but pointed out that the program has preserved as low-cost housing perhaps hundreds of projects that might otherwise have been lost, and saved the Federal Housing Administration insurance fund millions of dollars in avoided claims.

HUD stated that the report raises an issue of legitimate concern with regard to the verification of tenant incomes. HUD stated it has developed, or is in the process of developing, several procedures, notices, and training courses that respond to our findings and recommendations.

With regard to Manhattan Plaza and Taino Towers, these were 2 of 11 projects we visited. We have discussed them in our report to demonstrate the high quality of some section 8 housing. We recognize in the report that they are unique cases and that they became part of the Section 8 Program in an atypical manner. We do not believe that this diminishes the fact that they do exist and are very much a part of the program.

While the efforts HUD has taken or is taking to strengthen the verification of tenants income and allowances are generally responsive to our recommendations, we believe its verification efforts would be strengthened even more if it devised appropriate penalties for owners and PHAs who failed to perform their verification responsibilities and tenant families who inaccurately reported income and allowances. (See pp. 120 to 128 for HUD's comments and our response.)

CHAPTER 6

SOME ALTERNATIVES TO, AND RECENT DEVELOPMENTS IN, THE WAY SUBSIDIZED HOUSING IS PROVIDED

Because the Section 8 Program has proven to be very costly and serves only a fraction of the poor, we actively solicited answers to the problem from numerous governmental officials and from other housing experts from academia, housing and real estate associations, financial institutions, and professional groups.

The responses and ideas obtained were extremely varied. While most experts said that the Section 8 Program costs too much and serves too few, there was little consensus on what should be done alternatively. The bulk of the ideas concerned making improvements within the section 8 framework which now exists. Others, however, went further and suggested more substantive, radical changes to the issue of subsidized housing.

WAYS SUGGESTED TO IMPROVE THE EXISTING SECTION 8 FRAMEWORK

The comments summarized below are those which suggested greater economy, efficiency, and effectiveness in the way subsidized housing is now provided.

Terminate the new construction and substantial rehabilitation segments of the Section 8 Program, but continue the existing housing segment

This suggestion was the one advocated most often by the housing experts we contacted. Their reasons included:

--The existing housing segment works better in theory and in practice. It preserves the existing housing stock, preserves neighborhoods by letting families choose where they want to live, and provides a shallower subsidy which enables available funds to reach more people.

--The problem is not one of "housing," but one of "poverty."

--Public housing was and is a better and more efficient program with which to provide new housing. It is less costly and better managed.

--Substantially rehabilitated housing is too costly. Moderate rehabilitation should be used to complement the existing housing segment.

Not everyone agreed with the suggestion to terminate the new construction/substantial rehabilitation segments. HUD's Chicago area office deputy manager, for instance, said that to do so would be impractical because the approach fails to provide needed replacement housing for that which is lost to fire, demolition, or other causes.

Others, while not proposing that the new construction/ substantial rehabilitation segments be terminated, did suggest that increased reliance be placed on existing housing. CBO, for example, in its March 1979 budget issue paper on "The Long Term Costs of Lower-Income Housing Assistance Programs," stated that:

> "Because of the substantial difference in rents between new and existing housing, housing assistance costs could be reduced appreciably by directing a larger share of all housing aid to programs that make use of the existing rental stock."

CBO has also stated that "The resulting shift toward assistance for existing housing would increase the number of families assisted and reduce the average subsidy cost per family * * *."

Not everyone agreed with this approach either. In April 1979 testimony before the Subcommittee on Housing and Urban Affairs, Senate Committee on Banking, Housing and Urban Affairs, the National Association of Counties stated that the requirements of the 1976 Housing Act should not be overturned by the Congress mandating a fixed percentage of funds for construction of new units versus the utilization of existing units. The association testified that "the unit mix should continue to be derived from the needs set forth in local housing assistance plans."

The fact that there are few available existing rental units was the essence of a report we issued on November 8, 1979, entitled "Rental Housing: A National Problem That Needs Immediate Attention" (CED-80-11). Today's rental vacancy rate of 5 percent is considered dangerously low and may well negate any attempt to shift emphasis from section 8 new construction/ substantial rehabilitation to existing housing.

<u>Increase the share of income that tenants are required to pay for rent</u>

This was another popular suggestion, however, it, too, has met with considerable opposition. CBO, again, was one of those suggesting it as a way of reducing overall housing assistance costs. CBO stated in its budget issue paper that

"The cost of housing assistance programs could be reduced significantly by raising the rental charges to a level above the current standard but still below what tenants would have to pay in the private market for comparable housing. Lower-income renters not receiving housing assistance are now paying an average of 39 percent of their incomes for housing, * * * and fewer than one-fourth of all eligible renters now receive Federal aid. To alleviate the hardship that such a change might cause for the lowest-income families a sliding scale of payments could be established, setting a lower rent-to-income standard for the poorest persons, while imposing somewhat higher rates on better-off tenants."

The Director of the Center for Urban Policy Research, Rutgers University, has stated that section 8 provides too large a subsidy which has created a major problem of equity. He was sympathetic to the idea of increasing tenant contributions as a means of lowering Federal outlays per assisted household.

Again, there were many who did not favor these approaches. Edwin Mills, an economist at Princeton University, cautioned that raising the tenant's contribution above 25 percent of income would impose a harsh burden on program participants. Former Senator Edward Brooke, who was instrumental in passing the legislation which limited the amount subsidized tenants would pay for their housing to no more than 25 percent, categorically rejected the idea of raising tenant rent payments. Testifying as Chairperson of the National Low Income Housing Coalition in April 1979, he stated that

"The whole reason for enacting the Brooke Amendment was to assure that low income housing programs in fact served their intended purpose by providing low income families with decent housing at rents they could afford. If there is any valid criticism which can be made of the provisions, it is that the ceiling is too high, not that it is too low."

Take measures to reduce construction rehabilitation, and administrative costs under section 8

Numerous sources in the New York area told us there were few incentives for section 8 builders to keep costs low. We were told that the greater profit a builder might realize by keeping costs low is outweighed by the tax benefit of building to the very last dollar. Two officials from a New York lending institution told us that section 8 developers are allowed to "back into" high contract rents without regard to rent comparability or other accepted basis, that there is little or no HUD control over this, and that development costs under the program are much higher than they should be.

HUD's Minimum Property Standards were said to be too restrictive and a contributing factor behind the program's high costs. It was said that the standards allow for little innovation, they exist for HUD's convenience, and that they ignore economic reality.

Problems of a bureaucratic nature were blamed for contributing to high program costs. One HUD official in Chicago believed the program could be improved if

--the paperwork requirements of project processing could be reduced,

--FMRs could be published more timely and expeditiously,

--HUD field offices were given more authority to act without having to go through HUD headquarters, and

--communities would relax their strict building codes.

The National Leased Housing Association pointed out in April 1979 testimony that it is not surprising that subsidized housing costs are high when one considers the social responsibilities the Congress and HUD have placed on it such as prevailing wages for labor, equal employment opportunity, environmental protection as well as protection of historic structures and clean air and water. The association labeled each of these as laudable goals, but stated that they did, indeed, add to the costs of subsidized housing.

Some additional suggestions regarding ways to cut costs included:

--Developing an explicit definition of a hypothetical section 8 unit of modest design, and publishing maximum property standards to eliminate present inequities in amenities and design features of different units.

--Experimenting with new low-cost building materials and methods.

--Reusing building designs.

--Streamlining processing procedures and timeframes.

Increase the number of family units produced under section 8

Much of the program's new construction and substantial rehabilitation has been designed for, and subsequently occupied by, the elderly. The chief economist for the National Association of Home Builders in March 1979 estimated that 73 percent of all new completed units and 44 percent of the rehabilitated units have been for the elderly. The economist stated that the reason for this was because senior citizens are considered better tenants than families.

The fact that much of section 8's new and rehabilitated housing is going to the elderly results in a higher program cost per person than if more family units were being provided. For example, a section 8 unit which rents monthly for $300 and houses one elderly person has a cost per person of $300. Another unit renting for say $400 per month, but which houses four, has a cost per person of only $100. In terms of costs per person assisted, section 8 must rank way ahead of the earlier subsidized programs which catered more to the family.

In commenting on our draft report, HUD stated that the proportion of section 8 family housing is steadily increasing as a result of its efforts. HUD indicated that 58 percent of the fiscal year 1978 reservations and 44 percent of the fiscal year 1979 reservations were for the elderly.

Other suggestions

Two other suggestions which were made to improve the program, but which have little impact on program costs, included:

--Redefining HUD's definition of a "family." As it stands now, the definition is rather open-ended and allows most anyone, including single persons and those not related by blood or marriage, to be eligible for section 8 housing.

--Reducing the number of eligible program participants by changing the eligibility criteria. The Urban Institute has estimated that 11 million renter households and 18 million homeowner households qualify for the section 8 subsidy. One housing expert commented that

> "It's hard to imagine a rental aid program that covers that many people. Not only does it run counter to stated policies in favor of homeownership, it would be impossible to pay for."

RECENT HOUSING LEGISLATION AFFECTING THE SECTION 8 PROGRAM

The Housing and Community Development Amendments of 1979, signed into law on December 21, 1979, contained a provision which relates to one of the actions suggested above. The provision authorized raising the maximum amount subsidized families could be required to pay toward their rent from 25 to 30 percent of income. Large families and those with very low-incomes (i.e., those families whose incomes do not exceed 50 percent of median income for the area) were to continue to pay between 15 and 25 percent of their incomes for rent. Other families would be required to pay between 20 and 30 percent of their incomes for rent, taking into consideration income levels and other factors. This provision became effective on January 1, 1980, and was to apply to those who lease units on or after that date. Those families leasing units before January 1, 1980, were to be governed by the requirements in effect before then. Subsequent to passage of the legislation, however, HUD officials informed us--and the Congress through testimony--that they view this provision of the legislation as discretionary and have rejected the idea of requiring subsidized housing tenants to pay more than 25 percent of their income toward rent because it places too much burden on lower income tenants.

As indicated on page 75, this same legislation also contained a provision designed to strengthen income verification procedures.

RECENT REVISIONS TO THE REGULATIONS GOVERNING SECTION 8 NEW CONSTRUCTION

Recent actions taken by HUD and statements made by its officials demonstrate an increasing concern about Section 8 Program costs and a desire to better control these costs. For example, revisions to the regulations governing the new construction segment of the Section 8 Program were published in final on October 15, 1979, in the Federal Register. Effective November 5, 1979, the changes were designed to: (1) simplify language and format--making the regulations easier to read, (2) reduce program costs, and (3) improve the quality and efficiency of processing. Among the principal changes were those with a purpose of containing or curbing costs. They included changes:

--Restricting the amount of rental income that can be kept as profit. For elderly projects, the rate is 6 percent of the developer's equity investment; for family projects, it is 10 percent.

--Placing specific dollar limitations on project development costs similar to those in mortgage insurance programs.

--Limiting the amenities that may be included in a project--thus insuring that projects developed under section 8 do not exceed standards of modest design.

--Retaining the use of rent comparability and permitting adjustments only where cost and expense documentation show them to be necessary for project feasibility.

HUD's Assistant Secretary for Housing commented in a news briefing that

> "* * * while these changes will give the Department better control on costs, we do not expect overall program costs to drop. The costs of producing housing under the Section 8 program are very much in line with the costs of producing similar unassisted housing units. Housing costs are going up and Section 8 costs will follow."

The Assistant Secretary also commented that a major control on Section 8 Program costs is the comparison of rents for assisted units to rents for unassisted housing units in the local market. He said that the rents approved for a specific project must meet the test of "reasonableness," and that benchmarks have been used since 1978 to measure and control cost increases over the previous year's actual cost experience. He pointed out that:

> "* * * most of the units assisted to date through the Section 8 program have had mortgages insured by the Department (or direct loans from the Department). In these cases full cost justification and cost certification have always been required. Thus a number of effective cost and program control measures have been in place since the program was originally implemented. These controls are now being supplemented to further assure that costs incurred are legitimate and necessary expenditures in the construction of low and moderate income housing."

ALTERNATIVE WAYS OF PROVIDING HOUSING ASSISTANCE

Other more radical ways have been suggested as answers to the problem of providing housing assistance to the poor. For example:

--In 1976 former HUD Secretary Carla Hills suggested providing block grants for housing to communities. Local officials would then decide on the appropriate mix of new, rehabilitated, or existing housing as determined in their housing assistance plans. HUD's role under such a plan would be confined to one of oversight and of keeping the Congress advised of the program.

--Another idea being considered during this same timeframe was one which would require localities to share in the cost of federally assisted housing programs. It was believed that this would: (1) demonstrate a locality's commitment to lower income housing, (2) relieve to some extent the Federal Government's lower income housing financial burden, and (3) stimulate closer supervision and better management on the part of the locality since it had some of its own money invested in the activity.

--In 1977 an OMB option paper surfaced suggesting that current housing programs be "cashed out." The paper stated that there was convincing evidence that housing deprivation is caused by inadequate income, rather than by the industry's inability to produce enough housing. It concluded that such deprivation can be overcome by raising incomes for the housing-poor. The paper proposed a welfare system that would serve all households with incomes under certain amounts. The average subsidy per recipient under such a system would be reduced, however, OMB believed that such a plan would be more equitable and would leave the greater majority of poverty-level households much better off.

--More recently, Edwin Mills suggested to us the replacement of the Section 8 Program with a Federal tax credit system for both renters and homeowners, regardless of income. Mr. Mills, a professor of economics at Princeton University, outlined the tax credit system as one that would allow the taxpayer to deduct a percentage of his or her housing costs against his or her Federal income tax liability. He indicated that the cost of the system would be about one-half of its gross cost, since the system would replace current subsidized housing programs and would eliminate depreciation now claimed on rental housing. The expert argued that income tax provisions now benefit property owners to the exclusion of renters who generally have much lower incomes. The tax credit system he proposed would eliminate this and other inequities.

--Increased use of homeownership programs for lower income families has some backing. One author, for example, wrote that

"* * * five families can be provided with new houses of their own in the Farmers Home program for less than the total subsidy needed to put one family in a new apartment in New York under Section 8."

The National Low Income Housing Coalition, in February 1979, supported an increased Section 235 Program--HUD's lower income homeownership program. The coalition suggested that the Section 235 Program be modeled after Farmers Home's homeownership program in that the agency's assistance would cover the difference between 25 percent of household income and the total estimated cost of principal, interest, taxes, insurance, utilities, and maintenance. The coalition stated that

"Enabling low income families to purchase existing housing on these terms will prove far less expensive than constructing or rehabilitating Section 8 units, if three or more bedrooms are required, and few rental units of this size are available on the existing market."

The preceding discussion certainly does not include all of the ideas and thoughts which exist relative to finding better ways to provide housing assistance to the poor. Further, it does not in most cases portray both the pros and cons related to each suggestion. There simply was not the time for us to do this during our review and, accordingly we do not take sides with regard to most of them. The thoughts and ideas presented in this chapter illustrate the possible ways by which housing assistance might better be provided. It is incumbent on HUD to check these and other ways out in what should be its continual attempt to get the "biggest bang" with its subsidized housing dollars.

CONCLUSIONS

The problem of providing Federal housing assistance to the poor is a large and complex one involving millions of households and billions of dollars. It is a problem for which there are no easy or inexpensive solutions. While experts agree that the

Government's primary means of providing housing assistance to the poor--the Section 8 Program--costs too much and serves too few, they do not seem to agree on any one or two things that should be done alternatively. Suggested actions that could be taken to improve the way in which housing aid is given to the poor ranged from slight modification in the way the aid is now provided to more drastic measures. While we did not examine the merits of each suggestion, we believe it is in HUD's charter to examine these and any other possibilities which would make the program less costly and more equitable.

HUD has recently revised its new construction regulations in an attempt to improve the program and curb costs. We see these changes as steps in the right direction. Additionally, recent legislation contained a provision to increase the maximum rent income ratio from 25 to 30 percent and to strengthen income verification procedures related to subsidized housing. HUD, however, has rejected the idea of increasing the maximum rent income ratio since it is believed it places too much burden on those tenants who would be required to pay an increased amount. We believe that HUD's position tends to ignore the large number of needy households for which there are currently no subsidized housing dollars. We believe that by spreading thinner what dollars are available as authorized by the Housing and Community Development Amendments of 1979, more households could ultimately be served. (See our comments on pp. 130 and 131 of app. I.)

We believe, that the issue of providing assistance to the poor warrants further thought and study by HUD. The large number of families in need versus the limited Federal dollars with which to respond to that need mandate a continuing effort on the part of HUD to find ways to get the largest possible benefit from its subsidized housing dollars.

RECOMMENDATIONS

We recommend that the Secretary of HUD increase tenant contributions toward rents as authorized by the 1979 legislation. We also recommend that the Secretary establish a task force or designate a group within the agency to conduct socioeconomic research directed to finding ways in which section 8 and other federally subsidized housing programs' costs can be held down and a greater degree of equity achieved among the many households determined to be in need. Such research should examine incentives that might be used to hold down program costs and encourage families to become less dependent on federally provided housing assistance. It should also examine the feasibility of using various suggestions and alternatives (some of which are mentioned in this report) which offer some hope for less costly, more equitable subsidized housing.

AGENCY COMMENTS AND OUR EVALUATION

HUD stated that while this section of our report is useful in giving some indication of the breadth of thinking regarding housing assistance, it by no means represents a comprehensive survey of such thinking, nor are the ideas of the quoted experts explored in context or depth.

HUD noted that housing issues are both complex and important and stated that they were continually undergoing the type of policy analysis within the agency which we recommend.

We do not believe that HUD has adequately recognized the potential which exists for better containing the costs of the Section 8 Program through more effective administration nor of the need for more intensive research of ways to achieve both cost reductions and a more equitable distribution of the benefits of the program.

Our recommendation that HUD increase tenant contributions toward rents as authorized by the 1979 legislation was added to the report subsequent to HUD's review and comment on an earlier draft. We had initially expected HUD to take this action. When it became clear that HUD was not going to do so, the recommendation was added.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

February 22, 1980

OFFICE OF THE ASSISTANT SECRETARY FOR
HOUSING–FEDERAL HOUSING COMMISSIONER

IN REPLY REFER TO:

Mr. Henry Eschwege
Director, Community and Economic
Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

Your letter of January 23, 1980, addressed to the Secretary of Housing and Urban Development, transmitting a proposed report to the Congress entitled: "Section 8 Subsidized Housing -- Some Observations On Its High Rents, Costs, and Inequities," has been referred to me for reply.

Before responding to the report's specific conclusions and recommendations, I would like to make some general observations.

This report raises a critical question for those concerned with Federal housing policy: Is a program which combines a production subsidy for new housing construction with a rent subsidy to enable low income families to live in that new housing too costly and troublesome to be politically and socially desirable? The corollary question for this Department, the Administration and the Congress is whether consideration should be given to separating the production subsidy from the income subsidy and changing the manner in which resources are allocated between these purposes.

Unfortunately, these basic questions are not raised cleanly by the report. Instead, it creates a false and misleading impression about the Section 8 program that obscures these issues. The report invites the reader to believe that Section 8 is expensive because it is somehow mismanaged, because it is designed and operated with insufficient concern for cost control, rather than because of the high cost of building new housing today and subsidizing low income people to live in that housing. Thus, the report invites the reader to believe that if Congress had somehow written the program differently, if HUD would administer it more tightly, with greater attention to costs, things would be different.

[GAO COMMENTS: We believe HUD seriously misconstrues the basic message and purpose of our report. We do not question the combination of a production subsidy with a rent subsidy under the Section 8 Program, nor do we advocate a separation of these two subsidies merely to avoid, or make more difficult, a full disclosure of program costs.

We believe that both Federal policymakers and program administrators need to be provided with relevant and timely information on program costs, program effectiveness, and the economy and efficiency of program operations, and that decisionmaking whether on policy formulation or program administration should be enhanced by such information. Our report is meant to contribute to this body of information.

HUD correctly notes that we invite the reader's attention to the fact that the Section 8 Program is expensive. HUD refuses to concede, however, here and throughout its comments that it bears any responsibility for the high costs of the program. We disagree. We believe our report amply demonstrates that a share of the high cost of the Section 8 Program is the result of deficient management by HUD in a variety of areas.]

While the responses to the report's conclusions and recommendations below illustrate in some detail the report's biases and misrepresentations, it is useful at this point to note how the general impression of high cost due to poor administration is constructed:

1. <u>Use of growth in fair market rent (FMR) levels to imply unreasonable growth in program costs</u>.

   The report cites high rates of growth in fair market rents from the 1974 FMRs in the Section 23 program to 1978 FMRs in Section 8, painstakingly comparing these rates of growth to various indices of increase in rents, construction costs, etc. The growth rate comparison made by the report, however, is highly selective and invalid, being based upon initial rents that were acknowledged as too low and not relevant to the Section 8 program. Thus, after several pages of creating the impression that FMRs have risen out of all proportion to need, the report confesses that these increases "may be justified" and only that "in some instances" they "may have been" too rapid (p. 29-30). This brief admission does not erase the picture drawn at much greater length in the preceding 17 pages.

[GAO COMMENTS: We disagree with HUD that our FMR growth rate comparison is highly selective and invalid. Our analysis involved a good representation of both large and small cities geographically located throughout the country. We used 1974 FMRs from the Section 23 Program as the starting point for our analysis because of the similarities between the Section 8 Program and section 23--the latter program having been characterized by the Congress as a modified follow-on of the former one. To do otherwise--for example, to start our analysis later in 1975 as HUD suggests in its comments--would result in a significant period of time being left out of the analysis.

Our further comments on the use of trends in FMRs as an indicator of the rising costs of the Section 8 Program are at the end of chapter 3 and on the following two pages.]

More significantly, since FMRs are only one of three possible devices to limit individual project rents, they do not illustrate much about program costs. Regardless of the rate of growth in FMRs, program costs have grown at generally reasonable rates and generally more slowly than inflation. The following table shows Section 8 unit costs (contract authority):

	FY 1976 Actual	FY 1977 Actual	FY 1978 Actual	FY 1979 Actual	FY 1980 Estimated
New Construction :					
Private Developer.....	3,350	3,864	4,125	4,561	4,820
All Weighted Average.	3,702	3,978	4,289	4,618	4,870
Substantial Rehab:					
Private Developer.....	3,324	4,952	4,144	5,370	5,720
All Weighted Average.	3,680	4,844	4,610	5,298	5,630
Existing:					
Total Existing*.......	1,850	2,033	2,364	2,485	2,730

* Includes Section 8 Loan Management and Section 23 conversion units.

Note, for example, that in 1979, a year of 13 percent inflation, overall Section 8 New Construction costs rose by 7.7 percent and private developer new construction costs rose by 10.6 percent.

The GAO does publish a similar table (p.26) but fails to analyze the rate of growth in these items—a rate which would reflect the actual cost increases the program experienced. Instead, GAO chooses to emphasize growth in FMRs, which are less relevant, less useful, but considerably more dramatic and prejudicial.

[GAO COMMENTS: HUD minimizes the relevance of the sharp rise in FMRs from 1974 to 1979 and introduces so-called unit cost figures which show less growth in 1979 than the overall inflation rate. The "cost figures" HUD uses actually represent preliminary reservations of funds based on information supplied by prospective section 8 developers in their initial applications to HUD. Whether or not these amounts will ultimately coincide with actual program costs cannot be known for some time in the future, perhaps years, when the related projects are built and actual costs have been incurred. Thus, HUD misrepresents its figures in characterizing them as "actual" unit costs.

Notwithstanding the questionable relevance of HUD's so-called unit costs, even they show a substantial rise from 1976 to 1979. For example:

	FY 1976 actual	FY 1979 actual	Percent increase
New Construction:			
Private Developer	3,350	4,561	36
Substantial Rehab:			
Private Developer	3,324	5,370	62
Existing:			
Total Existing	1,850	2,485	34

In a broader sense, the sharp rise in Federal housing subsidies can be illustrated by reference to HUD's budget submission for fiscal year 1974. Annual subsidy costs in the Section 236 Program in 1974 were running at $1,026--a time when the subsidized housing moratorium was in effect and high subsidy costs were a serious issue. By comparing the subsidy costs of the Section 236 Program in 1974 with the 1978 subsidy costs of the Section 8 Program as disclosed during our review of 27 new and rehabilitated projects in six different parts of the country, (see the table on p. 35 of our report), we found that subsidy costs in our sample were 232 percent higher than the average subsidy costs of section 236 in 1974. Even more dramatic is a comparison of the average 1974 subsidy cost to some of the high subsidies disclosed by our review--see pages 36 and 37. Such comparisons show some of these subsidies to be 400 to 600 percent higher than the average subsidies experienced only 4 years earlier. Subsidy costs under the Section 8 Program are significantly higher than the subsidy costs experienced prior to the program, and the rates of increase in subsidy costs over the 1974 to 1978 time period are, in fact, much higher than the rates of increase shown in our FMR analysis.

HUD states that FMRs are only one of three devices used to limit individual project rents and do not illustrate much about program costs. In 68 percent of the projects we analyzed from six different market areas, contract rents exceeded applicable FMR levels. HUD's OIG found similar results in its work.

The other two devices HUD states it uses to limit project rents (see p. 118 of this appendix) include (1) determining whether rents are "reasonable" in relation to comparables in the area and (2) setting the rents on the basis of project costs. Chapter 4 of our report discusses the fact that frequently there are few comparables with which to make the reasonable determination and that HUD has only recently used costs as a means to set rents; and these costs were not being used to any extent during the time of our review.]

2. Use of biased illustrations to imply FMRs are too high.

The report chooses to examine in detail several projects in New York City and Chicago, locations and projects which were chosen, the report acknowledges, for their high costs. It is the rents for these projects and FMR levels for these cities which are cited repeatedly, inviting the reader to believe that they represent the norm rather than the extreme. Note, too, that the most costly (and therefore most dramatic) of the cited projects were not even built under the Section 8 program; they were so-called "bail-outs," difficult choices faced by the Department with regard to saving projects built under other programs. While the circumstances of these projects raise questions about "bail-out" actions generally (a policy the report manages to question without bothering to analyze), they illustrate nothing about normal Section 8 projects.

[GAO COMMENTS: Our analysis of FMRs involved newly constructed/substantially rehabilitated and existing housing FMRs for 2-bedroom walkup units in 17 cities--both large and small--geographically located throughout the country. While Chicago and New York City were 2 of the 17 cities, the rates of FMR increase at those two locations were in fact lower than the rates of increase at other locations such as San Francisco; Cincinnati; Atlanta; Pierre, South Dakota; St. Petersburg, Florida; Tyler, Texas; and Boston. It is from this broad analysis we conclude that FMRs have risen significantly and that many are now at high levels.

While our work in Chicago and New York City supported the above analysis, it basically dealt with matters other than how fast and how high FMRs have risen. Contrary to HUD's assertion, Chicago and New York City are not cited repeatedly in the report to imply that FMRs are too high.]

As with its speculations about rates of FMR growth, the report fails to assert outright that the FMRs or contract rents are generally too high or out of line with comparable unsubsidized costs. The report makes no such assertion, because the facts would not sustain it. Instead the report notes that "justifiable or not," (p.30) the program's rent levels create concern. I submit that if the report cannot determine whether or not the program's rent levels are justifiable, it ought not suggest at such great length that they are too high.

[GAO COMMENTS: Chapter 4 asserts that fair market and contract rents were frequently established improperly and that rents paid accordingly were also too high. The chapter indicates that weaknesses in the establishment of fair market and contract rents generally translate into higher rents than might otherwise have been paid. We believe that rental levels are in many instances not justifiable. In view of HUD's comments, we have added on page 106 of this appendix additional analysis which shows that from 1976 to 1979, section 8 rental levels have each year been higher than the median rental levels of nonsubsidized multifamily housing constructed by private developers.]

3. <u>Use of amenities in extraordinary cases to imply waste</u>.

The report explores the amenities available at the projects it has selected to review. It even provides photographs. Noting my testimony to a House Government Operations Subcommittee, that the program seeks to build "modest apartments," the report follows immediately with a description of the amenities at Manhattan Plaza and Taino Towers.

These projects are, of course, the special cases noted earlier, unusual projects with extraordinary facilities. They were not built under the Section 8 program. To use these projects to illustrate any general point about Section 8 is misleading; to use them to suggest the general level of amenities in the program is simply dishonest.

[GAO COMMENTS: The essence of our discussion in chapter 5 (see pp. 54 and 62 through 72) regarding amenities has to do with the fact that the 11 projects we visited in Chicago and New York City varied in terms of their overall quality and the design and amenity features of each project. It seems obvious to us that the more lavish a project and its units, the more costly it would have been to build or rehabilitate and the higher the subsidized cost to the Federal Government. Manhattan Plaza and Taino Towers are two of four projects we use to illustrate one end of the section 8 "quality" scale. LeClaire Courts in Chicago and 119 Ralph Avenue in Brooklyn, discussed on pages 71 and 72, are projects which might typify the quality of housing at the other end of the scale.

We point out in the report that Manhattan Plaza and Taino Towers are unique cases and that they were not brought into the program in the typical manner. That this is so, however, does not erase the fact that the two projects do exist and are indeed a part of the program.

We disagree with HUD's implication that we have used Manhattan Plaza and Taino Towers to illustrate general points about the Section 8 Program. We believe sufficient background information is provided in the report to alert the reader concerning the nature of the two projects. Further, our discussion of them is made in conjunction with that of other projects. Any conclusions drawn are based on the total picture, rather than on these two isolated incidents.]

The issue of amenities is a difficult one. We seek to produce housing that is an asset to a community, that will last, that will be respected by those who live in it and those who live near it, and that reflects current building standards and technology. Many so-called "amenities," such as community rooms or play facilities, are low cost on a per unit basis, yet contribute immeasurably to the success of a project. At the same time, we recognize that people who do not live in new housing may resent the <u>normal</u> conditions of new housing as "luxury" items for their own units; e.g. air conditioning, wall-to-wall carpeting. We have changed our regulations to reemphasize the need for modest design and to sensitize our field offices to the high visibility of the amenities issue. Yet the GAO report acknowledges little of these complexities or concerns, instead choosing to imply (again not stating because it cannot prove) that if only HUD would crack down on luxuries, the program would not be as expensive.

[GAO COMMENTS: The amenities issue is indeed a difficult one. We have made no attempt to suggest what criteria should be followed to justify particular amenities at particular projects. However, we did point out that (1) there was a wide range of design and amenity features at some projects we visited, (2) there was a vagueness and generality in HUD's regulations governing the inclusion of amenities in section 8 new construction, and (3) certain projects contained amenities and required rents considerably above what we considered reasonable and modest. HUD's recent revision of its regulations emphasizing the need for modest design and sensitizing its field offices to the high visibility of the amenities issue indicates a commendable concern about this matter.]

4. Repeated assertions of Department indifference.

The reader is not only invited to believe that the Department has mismanaged the Section 8 program into a costly nightmare, he is told that the Department does not care. HUD "indifference," "inadequate attention to cost," "production pressures" are repeatedly cited as leading to higher program costs.

This Administration has been deeply concerned about the cost of the Section 8 program, as our success in holding the growth in program costs below the rate of inflation indicates. Major cost control initiatives include:

a. The Section 8 Task Force, formed in 1978, to review all Section 8 policies and procedures. Its recommendations led to the reforms made in 1979 and 1980.

b. The "benchmark cost" system, instituted in FY 1979, in which each field office was given a benchmark unit cost for every Section 8 subprogram, and had to justify variations from those benchmarks. Note that in FY 1979, private developer Section 8 new construction costs lagged inflation by 2.5 percent despite (1) record high interest rates, utility and construction costs and (2) a one-third increase in the proportion of family units built. I believe the benchmark cost system played a major role in this success.

c. Complete revision for FY 1980 of the Section 8 new construction and substantial rehabilitation regulations, handbooks and procedures. The report notes that these revisions should reduce costs and speed processing, but it does not alter its general assertion of indifference.

d. Revision in 1979 of method for computing Section 8 Existing FMRs and attempted revision of rent increase procedures in the new construction program.

Each of the foregoing initiatives involved substantial discussion and controversy within HUD headquarters, between headquarters and field staff, with the industry, the Congress and the general public. In each case, we were accused of being too hard on field staff or on developers. It is odd that GAO encountered none of this concern in its review.

[GAO COMMENTS: The actions noted above and those discussed on pages 85 and 86 of the report reflect the agency's concern for the high costs of section 8. Aside from these actions, which have generally taken place 4 or 5 years after program inception, we found very little other evidence suggesting that this concern has been long standing and that its impact had yet been felt at lower levels in the agency. Our work in the Chicago and New York City area offices disclosed little pressure to limit program rents or costs. Even at the headquarters level we questioned the seriousness of how the cost issue was being taken. For example, in July 1979 at a seminar in New York City where the topic of discussion was the proposed section 8 new construction regulations with about 150 participants who were mostly section 8 developers, one high ranking HUD official told the participants not to worry about the effects of the new regulations. They were told that the changes were in response to pressure from the Congress to do something about the high costs of section 8. He intimated that the changes would create a perception of something being done, but that they were really more "cosmetic" than of real substance.]

By the foregoing, I do not mean to suggest that Section 8 has been a perfectly administered program. There have been mistakes and missteps. There have been the normal difficulties involved in teaching several thousand field staff how to administer a complex program which produces from 200,000 to 350,000 units per year. There have been and remain systemic problems, some of which are identified by GAO, problems which we must take action to remedy. This Administration has had to walk a line between opening the program wide enough to encourage industry acceptance and holding it tight enough to avoid waste. But we believe that the overall record of the Section 8 program is a good one and one that is grossly distorted and misrepresented by the GAO report.

[GAO COMMENTS: We recognize that a number of households are being served by the Section 8 Program, and that the program offers advantages over its predecessor programs. Also, we note that the projects we visited appeared to be having a positive impact on the neighborhoods in which they were located and were, indeed, providing adequate housing to the families who live in them. Our primary concern in this report, however, was with the high costs and inequities of the program, and although we recognize that there are factors over which HUD has little control, to the extent HUD can control program rents and costs and make the program more equitable, it should do so.]

The fundamental questions remain: Is it too costly to build new housing for poor people? Would we be served better by a program which provides a production subsidy and another which provides an income-based housing allowance? Are we striking the proper balance (are local governments striking the proper balance) between production needs and the need for subsidy for existing housing? These are questions which Congress, the Administration and the public must answer. But this consideration is not at all furthered by the report's repeated implication that everything would be less costly and more equitable, if HUD made a decent effort to hold down costs. This is nonsense and it invites the continued misconception that housing can be built for the poor "on the cheap."

[GAO COMMENTS: Our report does not imply that all would be well with section 8 and the entire issue of providing housing assistance to the poor if <u>only</u> HUD would make "a decent effort to hold down costs." We state repeatedly that the problem of providing such assistance is a large and complex one with no easy or inexpensive solutions. We further recognize that many factors contribute to the high costs of producing housing over which HUD has little control. In a number of areas, however, significant opportunities exist for HUD to improve its administration of the Section 8 Program.

We agree with HUD's assertion that the high costs of providing housing assistance pose certain fundamental questions which warrant consideration by the Congress, the Administration, and the public. Chapter 6 in the report attempts to stimulate some thinking along the lines of how the Federal Government's limited subsidized housing dollars can be best spent and the greatest results realized.]

If there is one lesson we should have learned from the public housing, 221(d)(3), and 236 programs, it is that low-income housing must be decently built and adequately subsidized. The GAO report ignores this basic lesson and thus does a serious disservice to the issue it purports to consider.

[GAO COMMENTS: We have not suggested that subsidized housing should be less than decently built or adequately subsidized, nor do we suggest a return to those programs with their accompanying problems. In fact, our report gives the Section 8 Program credit for overcoming many of these problems.]

I will now review the report's specific conclusions and recommendations.

Chapter 1

This chapter contains no conclusions or recommendations. Nonetheless several points deserve comment.

The report begins by accepting at face value the stated justification for the 1973 moratorium on Federal housing programs; i.e. that the programs were costly, ineffective and inequitable. While it was not necessary that GAO refute this rationale in detail, the report clearly should have noted that there was another side to the issue, and that the moratorium was the most vehemently debated subject in Federal housing policy in the early 1970's. Had it wanted to go further, the report might have suggested that many believed the moratorium to have been motivated by reasons of partisanship and ideology, that subsequent analyses (including a GAO study of the 236 program) found the terminated programs to have been successful in many ways, and that some of the programs' problems stemmed from an unwillingness to provide adequate levels of subsidy where needed.

[GAO COMMENTS: Although we believe it unnecessary to go into extensive detail on all of the reasons for the 1973 moratorium, based on the information we gathered, we would agree with HUD that the moratorium was hotly debated and that it had partisan, political, and ideological ramifications. With regard to the Administration's stated justification for the moratorium that the programs were costly, ineffective, and inequitable, we would point out that these views were shared by many others both inside and outside the Government.]

This chapter also notes the selection for review of projects in New York and Chicago on the basis of their high cost. The Department believes that neither the specific projects selected nor the method of analysis used offer any basis for making valid predictions about general conditions in the Section 8 program.

[GAO COMMENTS: In chapter 1, page 6, we indicate that much of our field work was performed in Chicago and New York City and that these two locations were chosen because of their known high levels of program activity and high costs. In chapter 5, page 54, we state that we reviewed 11 newly constructed or substantially rehabilitated projects in the two locations; 8 of which were selected from among the projects in the two cities which had most recently been completed and occupied. The remaining three projects--located in New York City--were picked for review because of their high costs and unique backgrounds.

In addition to our work in Chicago and New York City we:

--Discussed and obtained documentation regarding the setting of FMRs in San Francisco.

--Analyzed FMR data for 17 cities, both large and small, located throughout the country. (See p. 17 for a listing of the cities.)

--Compared our FMR findings with the increases in the overall CPI, the CPI-housing component, and two construction indexes.

--Obtained and analyzed rent payment vouchers for 27 projects from the following six HUD area offices: Atlanta; Boston; Cincinnati; Newark; San Francisco; and Washington, D.C. HUD personnel selected the projects for which the vouchers were furnished to us.

--Obtained section 8 existing housing information from eight PHAs located in the above six cities plus Chicago and New York City.

--Obtained and used copies of HUD OIG section 8 reports which dealt with Cleveland, Akron, and Youngstown, Ohio; Milwaukee, Madison, and Reedsville, Wisconsin; and the area serviced by HUD's Knoxville, Tennessee area office.

--Noted that some of our findings in New York City were also true of other New York market areas including Nassau, Suffolk, Westchester, Putnam, Rockland, Orange, and Poughkeepsie.

This work is cited in the report. HUD, in its comments, however, tends to ignore it and implies that our findings on the Section 8 Program are based solely on a few high-cost projects in Chicago and New York City. We believe the sum total of our work was sufficiently broad to support our conclusions about the program.]

Finally, the report notes instances "where program rents and costs were greater than they should have been," and asserts "it is this layer of costs with which we are concerned and which we believe affords opportunity to HUD to reduce costs and thereby improve its ability to serve more people with the funds available." The subsequent chapters contain no analysis to support this assertion. The chapters on FMR growth rates and levels imply but carefully refuse to charge that these levels are too high. The GAO offers no comparison, specific or general, to justify an allegation of unnecessarily high rents. In specific cases, of course, GAO finds mistakes, but mistakes that themselves could also produce low rents or could be offset by mistakes on the low side.

In summary, GAO never finds its "layer of costs," or suggests what portion of program expenditures it might constitute.

[GAO COMMENTS: Our report discusses a variety of conditions which have led to high program rents and/or costs. It was not possible, however, to total the effect of these variables as HUD suggests. There quite simply are too many market areas, structure types, unit sizes, and other variables to permit a calculation of the precise dollar amount by which the program is too costly. Dollar estimates can be made regarding small facets of the program, but in terms of the overall program, such estimates are rather meaningless. For these reasons we have generally not attempted to attach dollar effects to the many errors we found in the setting of both fair market and contract rents, to the fact that some projects and units appeared to be more than modest in design and amenity features, to the fact that tenant incomes and allowances were not always being properly verified, and so forth.

A national perspective on the relative cost of the Section 8 Program is provided by a Market Absorbtion of Apartments report published jointly by the Department of Commerce's Bureau of the Census and HUD. The report shows monthly median asking rents of privately financed, nonsubsidized, unfurnished apartments completed from 1976 through the first two quarters of 1979. Against these rents, we compared monthly costs of privately developed, newly constructed section 8 units as shown in HUD budget submissions. The results of our comparison follows.

Year	Section 8 average monthly unit cost	Median monthly rent of private, non-subsidized apartments	Monthly difference $	Monthly difference %
1976	$299	$220	79	36
1977	322	231	91	39
1978	360	250	110	44
1979 (2 quarters)	354	263	91	35

As shown, section 8 unit costs ranged from $79 to $110, or from 35 to 44 percent, more costly than the nonsubsidized units completed and rented during the 3-1/2 year period.

We recognize that the monthly differences may be slightly exaggerated due to the comparison of "average" monthly costs to "median" monthly rents. Also, section 8 costs generally contain utility costs over and above any that might be reflected in the median rents column. These two items, however, are offset to some extent by generally higher quality of housing expected in the private, nonsubsidized market, as contrasted with the modest, nonluxurious type of housing which is supposed to be provided under section 8.]

Chapter 2

GAO Conclusions

"The section 8 program is the most recent in a long series of Federal programs seeking solutions to the problems of providing housing assistance to the poor. Initially believed to be an answer to many of the subsidized housing problems of the past, this program is likewise plagued by high costs and an inability to serve more than but a small fraction of the households defined to be in need. There are disparities in the type of housing and level of benefits provided to program participants. Additionally, there is a lack of certain incentives which would help control costs and encourage participating families to work themselves up and out of the program.

"These problems are interrelated in many ways. The problems, and some of their causes, are discussed more fully in the remaining chapters of this report. The chapters also contain recommendations to HUD which will help to (1) reduce program and individual unit costs, (2) improve program equity, and (3) create a more acceptable image of section 8 and subsidized housing programs in general."

HUD Comment

Based on its acceptance of the moratorium rationale, the report infers (p.7) that Section 8 "was to be a program less costly and more helpful to a larger proportion of the needy than the programs which preceded it." In fact, Section 8 was always predicated upon a deeper subsidy than previous programs, and as GAO notes approvingly, a subsidy that would grow as costs increase.

[GAO COMMENT: The wording on page 8 of the report has been changed to eliminate the implication that the program was to be less costly and more helpful to a larger proportion of the needy.]

The Department in 1973 and 1974 may have expected to save money on the program, but this was because of the intended emphasis on the use of existing rather than newly constructed housing. This intention was thwarted by the Congress, which insisted that the Department comply with the proportions of new, rehabilitated and existing housing as expressed in local Housing Assistance Plans (HAPs), and by the steadily shrinking supply of rental housing in the later 1970's. Given these factors, as well as the general increase in construction, financing and operating costs, it is not surprising to find Section 8 "plagued" by high costs, as is all of housing today.

The disparities in type of housing and level of benefits noted by the report are the function of (1) the 15 percent to 25 percent of income payment formula which means that poorer families pay less and receive higher subsidies, (2) the decision to base tenant payments upon a percentage of income rather than rent, and (3) the availability of both new and existing housing, meaning that occupants of new units will generally have nicer units at higher rents than those in older units. None of this is surprising, and to the extent that it reveals a disparity, it is because of the new vs. existing question noted earlier.

[GAO COMMENTS: We do not take issue with the fact that the poorest of families pay a lesser percentage of their incomes for housing than do those families who are a little better off financially. Nor are we concerned with the fact that tenant payments are based on a percentage of income rather than rent. Our point of concern is the disparities in the types of housing being provided and the resulting differences in levels of benefits. HUD suggests that this is solely due to the fact that occupants of new units generally have nicer units at higher rents than those in older units. We agree with this contention, but additionally point out that there are also differences in the types of housing and levels of benefits being provided within a given program segment. That is, some new units are better than other new units; some rehabilitated units are better than other rehabilitated units; and undoubtedly, some existing units are better than other existing units. The reasons for these differences are many and varied. They are due in part to the general nature of the program guidelines which are discussed on page 63 of the report. HUD's recent revision of its regulations to reemphasize the need for modest design and to sensitize its field offices to the high visibility of the amenities issue may help to reduce the disparities with which we are concerned.]

In a small, but illustrative point, the report notes the Department's unit cost estimates for FY 1979 ($2,670 for existing units, $4,300 for new construction and $4,700 for sub rehab) as representing true program costs. While the subsequent sentence notes that these amounts should be reduced by tenant contributions, those contributions are not stated and the higher figure is what the reader is invited to compare with the "alarming" $1,850 cost of earlier programs.

[GAO COMMENTS: Chapter 2 recognizes that earlier housing subsidy programs were criticized for being restrictive, inequitable, counterproductive, and costly. Additionally, various housing experts, including former HUD Secretary Romney, charged that high subsidy costs were proving a great financial burden. HUD's Region II Administrator, in defending the housing suspension of 1973, noted that low-income housing subsidies in New York State then cost on the average about $1,850 a year. On page 9 of the report we invite the reader to not only compare the $1,850 cost of the earlier programs to the estimated fiscal year 1979 average annual unit costs (which, as we point out, do not consider the amount tenant families pay toward their rent), but more importantly to the annual subsidies in excess of $5,000 we found which are exclusive of any tenant contribution.]

Federal housing programs can be viewed as serving "a small fraction" of needy households only if they are viewed separately and if the need is substantially overstated. Under all of its subsidized programs, the Department serves 3.5 million households, roughly 23 percent of the 15.6 million households in need below 80 percent of median income. If over the next decade, the Department can assist another 3.5 million units, this will account for a highly significant improvement. Federal housing programs may not meet all of the nation's housing need, but they account for far more than "a small fraction."

[GAO COMMENTS: The best information we have been able to obtain indicates that between about one-tenth and one-fifth of the Nation's households in need are being served by Federal housing subsidy programs. The 18 million estimate we use on page 1 of the report is HUD's own estimate (used during prior appropriations hearings) of the number of families living in substandard or overcrowded housing, or which are paying a disproportionate share of their incomes for housing. Later, on page 11, we cite a corroborating CBO estimate of 18.3 million.

The most recent estimates which we obtained from HUD's Policy Development and Research staff show 23.4 million households in need of housing assistance as of 1976, of which 2.8 million, or 12 percent, were being serviced in 1978 by HUD subsidy programs. An official on the Policy Development and Research staff told us that HUD's 3.5 million estimate of households served was an extrapolation to bring the above-cited 2.8 million to the present time. He also said that HUD had incorrectly calculated its 23 percent by stating 3.5 million as a percentage of 15.6 million. The 3.5 million must be added to the 15.6 million before a percent is calculated. This process results in a percentage of households served of about 18 percent.

Lastly, HUD suggests that in the next 10 years its subsidized housing production will equal the total production of the previous 40 years. This is highly speculative and, based on past performance and the current economic outlook, we believe very optimistic.]

In addition, these conclusions are unbalanced, because they refer only to the inequities involved in assisting a relatively small number of households in a given year. The discussion needs to be offset by a description of the overall benefits induced by the programs, such as: housing market externalities; neighborhood impacts; rehab initiatives; the fostering of a housing rehab industry; the forging of community development and housing planning strategies to achieve local and national development objectives; etc.

[GAO COMMENTS: Our conclusions on page 12 were reworded to recognize the advantages and benefits of the Section 8 Program. These advantages and benefits are discussed on pages 8, 9, and 54 of the report.]

Finally, there is no basis for suggesting that there are insufficient incentives to encourage families to work out of the program. Families are indeed encouraged to work out of the program by the 25 percent of income formula, which enables them to keep 75 percent of any increase in income they earn. A family can work its way out of the program, while remaining in its apartment and paying 25 percent of income in rent. In this connection, the fact that the elderly are not upwardly mobile, as the report notes, and cannot be expected to work out of the program, can hardly be viewed as a program defect.

[GAO COMMENTS: Of some 14,806 families moving into the Section 8 Program during the 6 months ending June 30, 1979, 6,788, or 45.8 percent, had annual incomes ranging from $2,000 to $3,999. The median annual income of all 14,806 families was $4,000. From the information in our report, it is apparent that the value of much of the housing the program provides is equal to or exceeds the incomes of many of the families being served.

Given these facts, it appears highly optimistic to assume that a high percentage of section 8 families will ever be able to work themselves up and out of the program. We agree with HUD that there is an incentive for families to increase their incomes since they can keep 75 percent of the increase. However, for a family receiving housing assistance already approximately equal to its income, a quadrupling of income would be required before that family could pay its rent with no more than 25 percent of its income.

That many section 8 families, particularly the elderly, are not upwardly mobile is stated as fact in the report. While we do not view this circumstance as a program defect, we are concerned about the captivating effect of a program which so often provides assistance at values equal to or more than the income of the families receiving the assistance.]

Chapter 3

GAO Conclusions

"Section 8 rents were initially criticized for being too low and thereby retarding program activity. Over the life of the program, however, they have risen significantly and in most instances have outpaced the increases consumer price and construction cost indices have experienced over similar periods. Gross rents, rather than as an exception, often exceed applicable FMR limits. As these rents have risen, so have the amounts of individual subsidies paid out under the program with some families receiving annual subsidies of $6,000 and even higher.

"While the rapid rise in many of the section 8 rents may be justified to some extent from the standpoint that they were too low to begin with and that we are undergoing some rather inflationary times, the analysis in this chapter and our review of the establishment of both fair market and contract rents as discussed in chapter 4 suggests that in some instances the rents may have been allowed to rise at rates faster and to levels higher than can be justified. Chapter 4 discusses weaknesses we found and calls for certain measures to be taken to ensure that fair market and contract rents are appropriately set.

"Justifiable or not, the levels to which many of the program's rents and individual subsidy costs have risen are enough to cause concern and, undoubtedly, provoke mounting challenges regarding continuation of the program."

HUD Comment

As noted at the outset, the issue is not whether FMRs have gone up quickly, but whether program costs have. In fact, the table above shows unit costs in the new construction program to lag inflation in FY 1978, 1979 and 1980. Substantial rehabilitation provides a less clear pattern, since it is based on a small sample, highly susceptible to influence by geographic distribution. In the Existing program, increases for FY 1979 and 1980 lag inflation.

Moreover, the issue is not whether FMRs have gone up quickly, but whether they have gone up too rapidly and to unreasonably high levels, in light of market conditions. The report gives this impression, although it backs away from the outright statement. The facts demonstrate otherwise.

The GAO analysis is distorted by the use of Section 23 FMRs for 1974, as one element of the analytical function. Section 23 FMRs were not prepared in the same manner and for the same purposes as the subsequent Section 8 FMRs. A more accurate indicator of the increases in the FMRs is reflected in the following table which compares the FMRs having effective dates of March 31, 1975 and April 1, 1978 respectively. The Section 8 rents were developed and trended using the instructions and procedures applicable to Section 8 alone. Accordingly, such an analysis is significantly more relevant than the analysis conducted by the GAO using Section 23 rents.

NEW CONSTRUCTION/SUBSTANTIAL REHABILITATION

City	FAIR MARKET RENTS Sec. 8 3/31/75 HUD	Sec. 23 7/8/74 GAO	Sec. FMRs (4-1-78) HUD/GAO	Dollar Increase HUD	GAO	Percent Increase HUD	GAO
Atlanta, GA	$211	$186	$320	$109	$134	52%	72%
Bettendorf, IA.	$284	$255	$343	$ 59	$ 88	21%	72%
Boston, Mass.	$385	$299	$404	$ 19	$105	05%	35%
Chicago, IL.	$324	$288	$435	$111	$147	34%	51
Cincinnati, O.	$229	$180	$351	$122	$171	53%	95%
Concord, N.H.	$300	$246	$357	$ 57	$111	19%	45%
Flint, Mich.	$280	$254	$344	$ 64	$ 90	23%	35%
Fresno, Ca.	$230	$230	$325	$ 95	$ 95	41%	41%
N.Y.C., N.Y.	$446	$357	$555	$109	$198	24%	55%
Newark, N.J.	$370	$321	$464	$ 94	$143	25%	45%
Norfolk, Va.	$233	$207	$310	$ 77	$103	33%	50%
Pierre, S.D.	$205	$216	$320	$115	$104	56%	48%
Pt. Angeles, Wa.	$244	$193	$296	$ 52	$103	21%	53%
San Fran., Ca.	$309	$285	$631	$322	$346	1.04%	121%
St. Pete., Fla.	$272	$195	$281	$ 9	$ 86	03%	44%
Tyler, Texas	$193	$180	$248	$ 55	$ 68	28%	38%
Wash., D.C.	$348	$309	$434	$ 86	$125	25%	40%
Totals	$4863	$4201	$8418	$1555 *	$2217 **	567% *	903% **
Averages (Totals/17)	$286	$247	$378	$91	$130	33%	53%
Average (Per Year)	NA	NA	NA	$30.33	$32.50	11%	13.25%

*3 Year Period

** 4 Year Period

A second point is that since it is acknowledged in the report that Fair Market Rents were initially too low to meet program objectives, it should not be surprising that increases in the FMR schedules have outpaced increases in the CPI or construction cost indices. Given the percentage basis used by GAO to measure the magnitude of an increase, this factor can have a dramatic impact. For example, if the FMR for a unit type in 1974 should have been $200, but was 25 percent too low at $150, when that rent rises over 4 years to $300, the increase would be shown as 100 percent. In fact, it would amount to an increase of 50 percent over the justified 1974 level, equal to less than 11 percent per year.

[GAO COMMENTS: See page 93 of this appendix for our comments regarding the use in our analysis of 1974 section 23 FMRs and the fact that they were acknowledged to be too low.]

Finally, the rental component of the Consumer Price Index has no relevance to increases in FMRs for Section 8 New/Rehab and little relevance to Section 8 Existing rents. The CPI measures the rate of growth in older existing units, units whose rents increase particularly slowly because of tenants in long occupancy and generally low tenant incomes. Annual increases in new construction rents relate to units entering the market in a particular area, and are thus dependent upon increases in construction and financing costs, as well as expectations of future operating costs. In the Existing program, growth in rents relates to increases upon new occupancy. The Annual Housing Survey (now the basis for computing Existing FMRs, a fact which the report ignores) reflects a higher rate of increase in this area than the rental component of the CPI.

[GAO COMMENTS: Our report adequately acknowledges the limitations of not only the CPI but also the construction cost indexes. Notwithstanding these limitations, however, the indexes do provide bases upon which the rapidly rising rents of the Section 8 Program can be compared.

The Annual Housing Survey HUD mentions as the new basis for computing existing FMRs is a relatively recent innovation. According to HUD, there is no data available from survey as yet which would show rental increases during the 1974 to 1978 period of our analysis.]

In this segment of the report, GAO notes the annual subsidy cost issue mentioned above (p.26), without attempting to draw the obvious conclusion--which contradicts all of its other analysis--that program costs have not risen unreasonably. The report does, however, make the inference that costs for substantial rehabilitation exceed those for new construction. While this is correct on an average, annual basis, it primarily reflects that substantial rehabilitation is done in more costly areas than new construction. In fact, in any given area, the new construction FMR is a cap for rents in a substantial rehabilitation project.

[GAO COMMENTS: Our comments and analysis on page 95 of this appendix, demonstrate quite clearly the fact that annual subsidized housing costs have risen since inception of the Section 8 Program at very rapid rates to some very high levels. These rates of increase and cost levels contrast with the cost-consciousness that existed at the time of the 1973 moratorium. We recognize in our report that many increases are beyond HUD's control. On the other hand, we believe that HUD must accept some responsibility for the increases and, in the future, make greater efforts to control and manage effectively those facets of the program with which it can have an impact.

On page 34 of the report we state that unit costs for substantial rehabilitation are generally higher than unit costs for new construction. This is stated as fact with no "inference" intended.]

Chapter 4

GAO Conclusions

"To help contain program costs, it is important that fair market and contract rents be properly established. Too often, however, administrative or system weaknesses were found to be contributing to high fair market and contract rents and program costs. Both our work and that of HUD's OIG disclosed numerous arithmetic and other kinds of errors, as well as improper and/or inconsistent adjustments made in the determinations. A lack of documentation made it difficult to ascertain the propriety of many determinations. An important underlying principle of the program is that rents are to be established on the basis of comparability with rents being charged in the local market, and on the basis of reasonableness in terms of quality, location, amenities, and services of the project as compared to similar unassisted projects. In actuality, however, there were often few such comparables available in various market areas with the result that other less refined methods were used. An additional factor undermining the reliability of the rent setting process was what we detected as a lack of concern on the part of some agency officials for the program's high rents and costs--an attitude or philosophy which may have been fostered by HUD headquarters' pressure on field offices to produce units and meet production goals."

GAO Recommendations

"To aid in the proper establishment of fair market and contract rents, we recommend that the Secretary of HUD strengthen agency procedures by requiring field offices to:

(1) search diligently for market rent comparables with which to use in setting rental levels,

(2) devise other appropriate methods for use in those instances where sufficient comparables do not exist,

(3) document rental determinations more completely regardless of the process(es) used, and

(4) provide for a higher level of monitoring and review to insure greater accuracy in the rent-setting processes.

"To stimulate a higher degree of cost consciousness on behalf of all HUD personnel working in the section 8 program, we recommend that the Secretary issue a pronouncement to all offices outlining the economic, social and political reasons why section 8 costs must be curbed and why greater equity and uniformity in the distribution of benefits is needed throughout the program. Recent changes instituted by HUD (discussed on pp. 74 and 75) and any planned in the near future could be highlighted in the pronouncement--serving both as examples of and emphasis for this change in philosophy."

HUD Reply

As noted above, the Department categorically denies the assertion of "lack of concern." In fact, the paucity of the GAO's recommendations and the fact that the Department has already gone far beyond the recommendations made indicate our serious and continuing concern for program costs.

[GAO COMMENTS: See page 100 of this appendix for our previous comments regarding some HUD officials' lack of concern and indifference toward the program's high rents and costs. HUD has not responded to our recommendations in its comments, nor in our opinion, has it shown that it has gone "far beyond" these recommendations to indicate a serious and continuing concern for program costs.]

Companion to the indifference argument is the suggestion of "pressure" from headquarters to achieve production goals at the expense of costs (p. 34). There has been and will continue to be pressure on field offices to process projects promptly and see that local areas receive the assisted housing to which they are entitled. There has not been and will not be pressure to circumvent instructions and disregard regulations in order to achieve production goals.

[GAO COMMENTS: Our review disclosed various indications that HUD headquarters had exerted pressure on its field offices to achieve production goals and that there were perceptions in these offices that high costs were not a prime consideration. These indications are presented in various sections of our report, but notably on pages 40, 43, 49, 50, and 51.

Whether HUD headquarters intended that its production goals be met regardless of cost may be arguable, but various HUD field personnel clearly perceived it to be that way.]

The report accurately notes the difficulty and complexity of some elements of the rent setting process. For example, comparable rents are hard to obtain in some instances, particularly in older declining urban areas and in outlying small non-urban communities. However, in many instances it simply requires a greater effort to gather such data, or as mentioned in the first paragraph on Page 34 of the subject report, use of some technique such as comparables from another similar market area. Other valid valuation techniques such as "Interpolation" and "Proper Progression" are available and when properly used provide reasonable and acceptable estimates.

This report, however, ignores a critical third "cap" on project rents, upon which the Department is relying increasingly. This cap is based upon the HUD/FHA "rent formula," under which rents are computed for FHA-insured projects based upon actual construction and financing costs and anticipated operating costs. Thus, the final rent for a given project is limited by (1) the FMR for the area, (2) the "reasonable" (comparable) rent for the project, and (3) rent based upon the project's costs. This three cap system helps to offset the necessarily conjectural and imprecise nature of some elements of the rent determination.

[GAO COMMENT: Our comments regarding HUD's three cap system for limiting project rents have already been presented on page 95 of this appendix.]

While finding some errors in rent setting procedures -- errors that would not have been unexpected in the early years of the program when rents for the studied projects would have been set -- GAO also neglected several relevant factors. On page 36, the report sharply criticizes HUD for permitting a parking allowance in its FMRs in New York, a city in which "only 44 percent of the residents own automobiles." The report failed to note, however, that New York City requires that parking space be provided with new construction projects, and thus, that FMRs had to be designed to accommodate this requirement. If no parking had been provided for a particular project, the comparable rent determination would have required a lower rent level than the FMR.

The report also implies that HUD uses market areas that are too large or diverse to permit appropriate FMRs. The Department and OMB have considered the possibility of going to county-based FMRs, but this would multiply five to tenfold the complexity of the FMR determination. In addition, just because a project is built in an area with a high FMR does not mean that its rent will be high. The comparability test, based upon similarly built and located projects, would hold rents down.

[GAO COMMENTS: Regarding HUD's comments on its rationale for including a parking allowance in its FMRs in New York City, the facts are these:

--Parking spaces are not required for all multifamily housing units constructed in New York; the requirement ranges from a low of 40 percent in certain sections of Manhattan to a high of 100 percent in sections of the Bronx.

--HUD determined that a monthly parking allowance of $80 per housing unit was required for units built in Manhattan, and $40 for the city's other four boroughs.

--HUD included $80 in the FMRs for all five boroughs of New York City even though (1) this amount was double the amount already determined to be applicable to the four boroughs outside of Manhattan and (2) of the persons living in Manhattan and the total New York City area only 25 and 44 percent, respectively, own automobiles.

We believe that HUD's actions in setting FMRs for New York City, as illustrated by the above facts regarding its inclusion of an across-the-board, $80 parking space allowance, demonstrates both the inadequacy of its FMR analyses and a lack of concern for the level of the FMRs.

Regarding the two paragraphs above, HUD suggests that the levels at which FMRs are set really do not matter since the subsequent comparability test, based upon similarly built and located projects, would hold rents down to their reasonable and proper levels. Our review disclosed, however, that comparables do not always exist and that project rents are often set on the basis of project costs and other factors thereby making the reasonableness of the rents very difficult to determine. HUD officials told us that FMRs are sometimes perceived as the attainable rents, rather than as upper limits, and that developers are allowed to "back into" high contract rents without regard to comparability or other accepted basis. Under such circumstances, and in those instances where FMRs are set too high, it is clear that the ensuing project rents may indeed be set at levels higher than warranted.

We agree with HUD that the complexities of the FMR determination would be multiplied many times if the number of market areas were increased. For that reason, the report contains no recommendation for HUD to reduce the sizes, and increase the number, of the market areas.]

Note that some of the projects explored by GAO were built by the Chicago Housing Authority or the New York City Department of Housing Preservation and Development. Such projects would have their rents set by these agencies in accordance with the slightly different rules for State Agency financed or PHA-owned projects, and HUD would rely upon the Agency certification.

In summary, the Department does not question that the rent determining process is a difficult one, and that there are errors made. It is our responsibility to train and monitor staff to keep these errors to a minimum and hold costs down. We believe, however, that we are meeting that responsibility, and that in doing so we have already gone far beyond the remedies suggested by GAO.

[GAO COMMENT: Further responses on these comments are included at the end of chapter 4.]

<u>Chapter 5</u>

<u>GAO Conclusions</u>

"Our review of specific projects and tenant families in Chicago and New York City disclosed additional reasons for the high costs of section 8 and its resulting inability to serve more people. Program criteria, for example, relating to the caliber of housing provided by section 8 has been rather general and subject to a wide range of interpretation. This has resulted in housing being produced, particularly under the new construction segment of the program, which is of high caliber containing features and amenities not normally expected in subsidized housing. Such construction naturally leads to high project rents and correspondingly high costs to the Federal Government through the subsidies that are paid. The high rents and quality of this housing invites resentment on the part of the taxpaying public who see their subsidized neighbors living in better accommodations than they themselves can afford. The purpose of recent revisions to the regulations prohibiting the inclusion of amenities or design which would exceed the standard of modest quality or design is to temper this type of situation in the future (see Chapter 6 for a discussion of the regulation changes).

"Section 8's use as a "bail out" mechanism has apparently diminished as a result of the demise of the loan management set aside program and the institution of the troubled projects program. Its use as such a mechanism in the past, however, was significant with a considerable portion of today's section 8 production statistics being made up of housing brought into the program under these circumstances. Our work disclosed some of this housing to be very costly—perhaps serving as a warning against such use in the future.

"The program lacks incentive for owners and PHAs to properly verify tenant income and allowances; thus, such verification is not always properly done and some families pay less for their rent than they should. Legislation recently signed into law should provide better data to owners and PHAs for use in their verification efforts. There are some actions which can be taken to further help in this regard.

"Finally, new and substantially rehabilitated housing is often so costly that moderate and even middle income unassisted households cannot afford to live in it. The high cost of this housing has, in many instances, effectively blocked the achievement of a section 8 program goal of promoting economically mixed housing."

GAO Recommendations

"We recommend that the Secretary of HUD strengthen the proecedures used in verifying tenant income and allowances by:

1. highlighting to all section 8 program administrators and beneficiaries the serious regard HUD places on this matter;

2. reaffirming and restating as necessary the duties and responsibiities of HUD field offices, housing owners, and PHAs in carrying out this important function;

3. monitoring more agressively the verification efforts of housing owners and PHAs, and

4. devising appropriate penalties for owners and PHAs who fail to adequately perform their verification duties and responsibilities, and tenant families who willfully attempt to defraud the Federal Government by inaccurately reporting income and allowances."

HUD Reply

Under the title "Observations at the Project Level," this chapter offers a veritable grab bag of distortions, misrepresentations and false impressions of the Section 8 program, as well as one or two legitimate items of concern.

The most serious misrepresentation is the amenities issue, noted earlier, in which the reader is invited to believe that projects which were not built under the Section 8 program and which were selected for review because of their notoriety and high cost are in some way illustrative of the amenities provided under the program. This is false.

The Department's standard for amenities is based upon what is normally available in newly constructed units of modest design within the area. The recently revised Section 8 New Construction regulations make this point clearly, and instructions to the field will provide further guidance in this regard.

Stripped of the extreme examples, however, the report's concern appears actually to be directed at amenities normally supplied in new housing. Newly-constructed units do contain things not found in the housing stock built even 10-15 years ago. The report describes several projects and their "amenities." Excluding Manhattan Plaza and Taino Towers, unique projects not built under Section 8, the report notes that certain projects have wall-to-wall carpeting (Morningside), have "all the luxury amenities one would expect" (Elm Street) or include "refrigerators, gas ranges, drapery rods and shades" (Le Claire Courts). Aside from the fact the report restricts its examples to large high-cost cities with large projects that often have certain elements of self-contained communities, the implication seems to be that the GAO prefers stripped down housing, with a "government project look," containing nothing that was invented in the last 15 years in order to reduce public resentment of assisted housing. We disagree and feel strongly that one of the most positive aspects of the Section 8 program is the ability of the typical project (i.e., - a 70 unit garden project in a small or medium-sized community) to blend in with the neighborhood without stigma. We also note that Elm Street is a partially-assisted project (20 percent or less assisted) and its advertising, which GAO cites, would naturally be directed at the unsubsidized rental market. Note that in this case, the "amenities" with which the report is concerned did not make the units too expensive for unsubsidized tenants.

Also on the question of amenities is the report's discovery that rehabilitated projects look different from new ones, more "austere." This should not be particularly surprising since the intent of the subrehab program is to rehabilitate older, deteriorated buildings, maintaining their appearance and consistency with their neighborhoods. New projects, on the other hand, tend to look like new projects.

[GAO COMMENTS: Our comments on pages 97 through 99 discuss the matter of amenities. We do not advocate stripped down housing with a "government project look." We agree with HUD that one of the positive aspects of section 8 is its attempt to provide housing which blends in with the community. We believe, however, that the subsidized nature of the program should not be forgotten and that this "blending" effect should be achieved with attention to costs and recognizing that many Americans cannot afford to live in the caliber of housing the Section 8 Program provides.]

The report raises the question of partially assisted projects. One of the original hopes for the Section 8 program was to encourage an economic mix within individual projects. As noted, several provisions in the Section 8 regulations were intended to support this objective of economic integration. The report states that this objective of partially assisted projects was not achieved because of the high rents in Section 8 projects. We agree that there have been few partially subsidized projects built, but the primary reason for this is that there have been very few unsubsidized multifamily rental units built at all in the past several years. As GAO noted last November, unsubsidized rental construction for moderate income households has virtually disappeared. Thus, it is not the Section 8 rents that keep out moderate income tenants, but rather the high rents that are generally needed to sustain new construction.

[GAO COMMENT: The analysis we present on p. 106 of this appendix shows section 8 rents to be higher than the rents being charged for privately built, nonsubsidized housing.]

Incidentally, we did see an increase in partially subsidized construction in FY 1979. This is because of the extreme tightness of the rental market generally, and the availability of 7-1/2 percent Tandem financing for the "unsubsidized" units in partially subsidized projects. In addition, the revised Section 8 regulations contain further incentives for small and partially assisted projects which are summarized in the following chart:

INCENTIVES FOR SMALL AND PARTIALLY-ASSISTED PROJECTS

SMALL PROJECTS

- Exemption from Limitation on Distributions
- Rents may exceed comparables by up to 10% without cost justification
- Preference points at selection of Technical Processing
- Preference points in ranking

PARTIALLY-ASSISTED PROJECTS

- Exemption from Limitation on Distributions
- Rents may exceed comparables by up to 10% without cost justification
- Exemption from Replacement Cost Limitations
- Exemption from Limitation on Amenities
- Preference points at selection of Technical Processing
- Preference points in ranking

Note that the location of subsidized projects in areas where little or no subsidized housing exists is also a means of obtaining an economic mix, especially when projects are not large. One of the positive aspects of the Section 8 program has been the location of projects in areas previously unserved by assisted housing - small and medium-sized cities, suburban jurisdictions, rural areas, etc. The quality of Section 8 housing makes this possible.

The report criticizes, in passing, the use of Section 8 to rescue projects built under a variety of older housing programs. The Department agrees that various "bail-outs" can be questioned, and that the whole Section 8 Loan Management (LM) program raises serious policy questions. Indeed, in FY 1978 the Department discontinued the LM program and sought Congressional approval for the Troubled Projects Operating Subsidy (Flexible Subsidy) program because we believed this latter approach to be preferable.

At the same time, the Section 8 LM program preserved as low cost housing perhaps hundreds of projects that might otherwise have been lost and saved the FHA insurance fund millions of dollars in avoided claims.

The majority of activity in this program was between May 1976 and June 1978. In that time, the Department's inventory of projects assigned to the Secretary was reduced from 473 to 147. During this two year period the only significant addition to assistance programs funded by HUD to reduce operating deficits and inordinately high rent-to-income ratios was the Section 8 Loan Management program. In fact, the major purpose of the program was to reduce claims against the insurance fund. Thus, there is strong circumstantial evidence that the Loan Management program was instrumental in bringing about this major decline in the rate of assignments.

The Department acquired 326 fewer projects in the 12 months ending June 1978 than in the 12 months ending June 1976. The average principal balance paid on each mortgage for a claim during this period was $1,900,000. For the 326 projects, that would have been approximately $619,000,000 saved to the insurance fund. Subtracting out contract authority for Section 8 Loan Management for the 326 projects, the difference between the amount of potential claims to be paid and the Section 8 assistance paid out equals a $311,000,000 savings to the Department.

The point is not whether the Section 8 Loan Management program was a good one or a wasteful one, or whether specific "bail-out" decisions, such as Manhattan Plaza or Taino Towers, were wise or unwise. That can only be determined by a responsible, knowledgeable analysis of the options available to HUD and the relevant local governments, and of the costs and benefits of each of those options. The point, rather, is that the GAO report manages to attack the LM program and these projects without performing any such responsible analysis, and that the report uses these projects in an effort to discredit the entire Section 8 program when they are totally irrelevant to the normal operation of that program.

[GAO COMMENTS: The purpose of our review was not to assess the merits of the loan management program. This program was covered in our review only because it produced some of the most costly housing in the section 8 inventory. We believe that some of the high costs of the Section 8 Program are due to the fact that section 8 has been used to bail out projects from other programs which were in financial difficulty and which involved many extenuating circumstances. The rights and wrongs of doing this can be argued. Regardless, such an argument would not dismiss the fact that the Section 8 Program does involve many of these bailed-out projects; some of which were done so at high cost to the program.

Given the considerable numbers of section 8 projects and units which were bailed out, we disagree with HUD's conclusion that they are totally irrelevant to the normal operation of the program. They are, in fact, very much a part of the program. They are somewhat unique and we have identified them as such in our report.]

Finally, this chapter raises an issue of legitimate concern with regard to the verification of tenant incomes. HUD has developed, or is in the processing of developing, several procedures, notices, training courses, etc. that answer GAO's problems and recommendations. These include the following:

1. The Office of Multifamly Housing Management and Occupancy has in clearance an "Occupancy Guide for Section 8 Housing Assistance Payments Program," a guidebook designed to apprise HUD Area Office and Section 8 project personnel of the purposes of the Section 8 program and necessary procedures to be followed in administering the occupancy portions of the program. This guide includes sections specifically addressing the verification process and recertification and interim adjustments. It states the sources the owner/manager should contact to verify employment and salary, and the proofs the owner may require to document age, unusual expenses, etc. This guide also gives examples on the correct way to determine the eligibility, adjusted income, and subsidy for each tenant or tenant family.

   HUD intends to provide training on the material presented in this guidebook to HUD staff through Occupancy training courses, and to project personnel through training provided by a private contractor.

2. HUD now has legislation that may provide us with greater access to unemployment, income tax, and other federally assisted program information for use in vertification of tenant income. This legislation was approved in the Housing and Community Development Amendments of 1979. We are in the process of developing regulations and instructions on how to implement this section of the legislation, and will notify all pertinent parties when the procedures are put into effect.

3. HUD has scheduled courses for HUD field personnel on occupancy requirements of HUD programs, including the Section 8 program. This training will include sections on tenant certification and verification of tenant income and allowances. The importance of full and accurate verification and documentation will be emphasized in this course. This training is scheduled for the second half of calendar year 1980. The above mentioned guidebook will be part of that training.

4. HUD has requirements for on-site reviews of all Section 8 projects at least annually and at any other time that HUD may determine necessary. This management review includes a section specifically devoted to occupancy matters, containing questions on application processing (income adjustment and verification), tenant recertifications, and tenant files and records. This management review also requires the HUD review staff to examine approximately 15 percent of the tenant files at each project for completeness and accuracy.

5. The Offices of Housing and Administration are developing a data system that will automatically compute tenant adjusted income and rent-to-income ratios, and authorize payment (or non-payment) of Section 8 vouchers.

6. The Office of Policy Development and Research is conducting an evaluation of the extent and frequency of errors in the income verification process (the GAO data does not purport to be a statistically valid projection). This study will determine the need for additional, cost-effective measures to improve verification.

7. HUD serves on the President's Eligibility Simplification Project, and we have recommended that the Project consider interagency approaches to income certification and verification. Such approaches could sharply increase cost-effectiveness and reduce duplication of effort.

I believe these efforts respond fully to the concerns raised by GAO.

[GAO COMMENTS: These efforts should strengthen HUD's income and allowance verification efforts. With the exception of penalizing project owners, PHAs, and/or tenant families who fail to perform their assigned responsibilities or who attempt to defraud the Government by inaccurately reporting income and allowances, we see the efforts as being responsive to our recommendations. HUD should devise appropriate penalties as we have recommended to further strengthen its verification efforts and to ensure the accurate reporting of income and allowances.]

Chapter 6

GAO Conclusion

"The problem of providing Federal housing assistance to the poor is a large and complex one involving millions of households and billions of dollars. It is a problem for which there are no easy or inexpensive solutions. While experts agree that the Government's primary means of providing housing assistance to the poor -- the Section 8 program -- costs too much and serves too few, they do not seem to agree on any one or two things that should be done alternatively. Suggested actions that could be taken to improve the way in which housing aid is given to the poor ranged from slight modification in the way the aid is now provided to more drastic measures. While we made little attempt to examine the merits of each suggestion, we certainly believe it is in HUD's charter to examine these and any other possibilities which offer hope for making the program less costly and more equitable.

"HUD has recently revised its new construction regulations in an attempt to improve the program and curb costs. Additionally, recent legislation contained provisions to increase the maximum rent-income ratio from 25 to 30 percent and to strengthen income verification procedures related to subsidized housing. We see these changes as steps in the right direction. We believe, additionally, that the issue of providing assistance to the poor warrants further thought and study by HUD. The large number of families in need versus the limited Federal dollars with which to respond to that need mandate a continuing effort on the part of HUD to find ways to get the largest possible benefit from its subsidized housing dollars."

GAO Recommendations

"Accordingly, we recommend that the Secretary of HUD establish a task force or designate a group within the agency to conduct socioeconomic research directed to finding ways in which Section 8 and other federally subsidized housing programs costs can be reduced and a greater degree of equity can be achieved among the many households determined to be in need. Such research should examine incentives that might be used to hold down program costs and encourage families to become less dependent on federally provided housing assistance. It should also examine the feasibility of using various suggestions and alternatives (some of which are mentioned in this report) which offer some hope for less costly, more equitable subsidized housing."

HUD Reply

This chapter contains a haphazard, largely anonymous culling of opinions about housing assistance from a variety of sources. It is useful in that gives some indication of the breadth of thinking on this question, although it is by no means a comprehensive survey, nor are the ideas of the quoted experts explored in context or in depth.

I would offer brief comments on the following specific suggestions for controlling costs:

1. Terminate Section 8 New Construction, keeping the Existing program.

   This suggestion, or its less extreme variant of placing less emphasis on new construction and greater emphasis on existing housing, surfaces with great regularity as an appealing way to cut costs. The major problem with this approach is that it produces no new housing and, therefore, does nothing to alleviate a shortage of rental housing which GAO acknowledges to be critical. New housing would only be produced when the rents everyone pays, subsidized and unsubsidized, rise so high as to make new rental construction economically feasible. This would represent a level of inflation in rents which I believe to be intolerable and totally unnecessary.

   As for shifting emphasis from new to existing housing, this split is determined by local governments on the basis of their own needs as expressed in their HAPs. The increased emphasis on new construction which HAPs have shown in the past several years reflects accurately, we believe, the steadily tighter state of rental markets around the country. The Department has sought to assure that local governments make the maximum use of existing housing before seeking new construction by (a) requiring in regulations that new construction may be used only in areas where HUD determines that the use of existing stock cannot meet the needs of eligible families, (b) emphasizing to local governments that the housing assistance funds available to them will go further if used for existing housing, and (c) creating the Section 8 Moderate Rehabilitation program to upgrade and preserve existing housing.

As I noted at the outset, it would be possible to separate the income support/housing allowance function from the housing supply subsidy. This is an issue that the Department and the Congress must consider.

2. Increase the tenant's share of income paid to rent.

The Department has been reluctant, in the face of record inflation, to add to the burden which lower income Americans must bear. Increasing a tenant's contribution from 25 percent of income to 30 percent or from 15 percent to 20 percent is equivalent to a 20 percent or a 33 percent rent increase. In a time of 13 percent inflation, this Department should not force such an increase upon the poor and the elderly. The Department, of course, shall institute the changes in tenant contributions required by the 1979 Act.

Interestingly, the manner in which Section 8 is budgeted would prevent any increase in tenant contribution from providing additional units. This is because Section 8 unit costs do not consider tenant contributions, assuming instead that they will go into a "project reserve" to offset rent increases needed in the future. Thus, whether a tenant contributes 5 percent of income or 30 percent, \$500 per year or \$3,000, the contract and budget authority required for a Section 8 unit is the same.

[GAO COMMENTS: HUD ignores the impact that the tenant's contribution has to the reserve account which is to be used to offset rent increases needed in the future. Based on the way HUD budgets its section 8 contract and budget authority, we agree that in the short run no additional units are produced if tenants are required to contribute a larger percentage of income than they are now contributing. We believe it does, however, make a difference on the future viability of the reserve account. To the extent the account is sufficient in the future means that subsidies available during any given year can be used to fund additional units, rather than being drained off to help support units inadequately funded earlier. (See our comments and the additional recommendation we have added on pages 85 and 89 of the report.)]

3. Reduce costs.

The Department will continue its efforts to hold construction costs to reasonable levels and to reduce administrative requirements. As I noted earlier, however, it is unreasonable to expect that major additional cost savings can be achieved in this area without substantial sacrifices in terms of project quality and durability. Some savings could be achieved by sacrificing environmental, fair housing or labor protection objectives, but this would be, in my judgment, an unacceptable trade-off.

4. Increase the number of family units.

This has, in fact, happened, although the report fails to note it. The report cites an estimate that 73 percent of completed new units (as of March 1979) were elderly occupied. The report omitted the fact that 58 percent of FY 1978 reservations and 44 percent of FY 1979 reservations were for the elderly. Thus, the GAO ignored the central fact that the proportion of family housing is increasing steadily, as a result of local HAPs and Department effort.

This paragraph is also instructive in the example it uses. It talks of "a Section 8 rental unit with a contract rent of $600," pointing out that if that unit is occupied by an elderly person it can cost as much as $600 per person per month. The report then argues that if three people occupy the unit, its cost would be one-third on a per person basis. I frankly doubt that there is a single Section 8 unit in the country renting at $600, occupied by an elderly person paying no rent; certainly there are no more than a handful. A more responsible example would have compared a $300 unit occupied by an elderly person with a $400 unit occupied by a family of 3 or 4, but such an example would have been less sensational and prejudicial.

[GAO COMMENT: Discussion on page 84 of the report was changed to reflect HUD's comments.]

The study also poses several alternative means of providing housing assistance. Most of these have been discussed at great length elsewhere, and I will only note them briefly.

1. Housing Block Grants. The Section 8 program in its current form, combined with the Community Development Block Grant program and other housing programs, provide a broad and flexible range of tools to local governments. These programs, working chiefly through the HAP, allow local government to do what it does best -- assess needs, set priorities, make basic siting decisions, adapt general programs to local conditions. The Department has worked and will continue to work to strengthen this relationship, increasing the discretion given to local government over siting and development decisions. At the same time, we will retain authority over functions which HUD can perform best, such as underwriting, setting development standards, and assuring that adequate long term subsidy is provided. It is this last point, the provision of sufficient subsidy to protect a unit and a household over a long term commitment, which accounts for the cost of Section 8, but this is an authority which we cannot surrender without jeopardizing either the interest of the family or the condition of the unit.

2. Local Cost Sharing. The Department does not believe that increasing the costs borne by local governments for assisted housing is justified at this time. The heaviest burden would, of course, fall on the older, declining urban areas, which have the greatest need for assisted housing and the most severe fiscal problems. Indeed, one substantial advantage which Section 8 offers these cities, as opposed to public housing, is that Section 8 projects can pay full real estate taxes.

3. "Cash Out" of Housing Programs. Various cashing out options have been suggested, ranging from a simple increment to welfare payments to a specific housing allowance. These options have been considered unsatisfactory because (a) they do nothing to stimulate production of housing, (b) they do not contribute to urban or community development goals, (c) they provide no assurance to the building industry, its workers and suppliers, of adequate levels of activity, (d) they do not contribute to environmental, minority businesses or other special objectives, and (e) the government's experience in administering income maintenance programs is not so encouraging as to make this a clearly preferable alternative.

   Looking on the income support side alone, a specifically designated housing allowance, such as is provided by the Section 8 Existing program, is clearly preferable to an untargeted increase in welfare payments generally (a) because it assures a certain quality standard for the housing occupied and (b) because it helps to preserve the housing in decent condition for subsequent occupants. Such income support does not, of course, deal with the need for new housing.

4. Tax Incentives. The field of tax credits and incentives is a promising area for exploration. It offers most hope for redressing the present imbalance, in terms of tax benefits, between rental housing and homeownership. This nation's biggest housing program is the $20 billion it spends annually, through mortgage interest and real estate tax deductions, to subsidize homeownership for middle and upper income households. This subsidy is growing at the rate of $2-3 billion per year.

   As for low-income housing, tax benefits can provide some of the incentive or subsidy for development, for the supply of housing. They cannot answer the long term income needs of occupants.

All of these issues are complex and important, and we should be happy to explore them further with the Congress. In addition, we (as well as GAO) are constantly challenging and re-evaluating our programs in light of their objectives and their success in achieving those objectives. Thus, we are continually undergoing the type of policy analysis which GAO recommends be conducted by a special task force.

In conclusion, I would note that in my three years as Assistant Secretary for Housing, I have come to respect the work of the General Accounting Office, and to value your analyses and recommendations. For this reason particularly, I regret the unfortunate nature of this report. The Section 8 program and HUD administration of it continue to raise a number of serious policy questions for the Congress and the Administration. I am confident that GAO's subsequent studies of these issues will be more in accordance with the customary quality of its work.

Sincerely,

Lawrence B. Simons
Assistant Secretary

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