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GAO

Briefing Report to the Chairman, Special Committee on Aging, U.S. Senate

December 1985

ELDERLY HOUSING

Successes/Problems in Implementing HUD's Cost Containment Requirements

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

RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

December 4, 1985

B-221121

The Honorable John Heinz
Chairman, Special
Committee on Aging
United States Senate

Dear Mr. Chairman:

In June 1984 we began a review of the Department of Housing and Urban Development's (HUD) section 202 elderly housing program. This review was initiated at your request; and, on the basis of agreements reached with your office in September 1984, we focused our review on (1) the extent to which HUD's efforts to control costs through its cost containment requirements were working, (2) additional opportunities for reducing program costs, and (3) who is benefiting from the program.

On November 5, 1985, we briefed your office on the results of our review and your office requested that we provide you with the enclosed briefing report. The information in this report is based on our review of HUD records for 179 projects at 10 HUD field offices, visits to 47 of these projects, and data on 802 section 202 projects obtained from HUD's Computer Underwriting and Processing System. The data on program beneficiaries cover almost 12,000 tenants from our statistical sample of 142 of the 1,274 section 202/8 projects constructed between February 1975 and January 1985. The report's information is limited to projects primarily serving the elderly; as agreed with your office, handicapped projects financed by the program were excluded from our review.

In summary, our review of HUD data showed that projects built under cost containment had smaller units, fewer amenities and construction costs that averaged 16 percent less than the projects built before cost containment. Without cost containment, we estimate that section 202/8 program costs would have been increased by about $100 million to finance the 12,400 units HUD approved for funding in fiscal year 1985. Problems, however, have been encountered in implementing cost containment largely because of HUD's use of fair market rents to control costs.

Additional opportunities exist to further reduce program costs. We estimate that program costs could be reduced an additional $19 million annually if more efficiency units were built to house the single elderly. Our estimate is based on HUD projections of the cost savings between building an efficiency and one-bedroom unit ($2,800 average) times the additional efficiency units (6,800) needed to bring the number of efficiencies in line with the single elderly population served by the program. Additional savings are also possible if HUD were to give greater consideration to project costs when selecting projects for funding.

Most of the beneficiaries in the projects sampled had very low incomes--equal or less than 50 percent of the median income for the area--and received substantial rent subsidies under HUD's section 8 rental assistance program. Most of the projects sampled, however, had few if any minorities.

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We discussed the information obtained during our review with agency program officials and have included their comments where appropriate. As requested by your office, we did not solicit official agency comments on a draft of this document.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time we will send copies to the Secretary of Housing and Urban Development. Copies will also be made available to other interested parties upon request.

Also as arranged with your office, we will provide you with a more complete report later. If I can be of further assistance, please call me on 275-6111.

Sincerely yours,

John Luke

John Luke
Associate Director

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ABBREVIATIONS

GAO General Accounting Office

HUD Department of Housing and Urban Development

FMR fair market rent

BRIEFING ON SECTION 202 HOUSING

Section 202 program and HUD's cost containment requirements.

--Under the section 202 program, HUD makes reduced-interest rate loans to not-for-profit entities to construct elderly housing. Since 1974 the program has been used with HUD's section 8 rental assistance program. This program provides a subsidy to cover the difference between the 30 percent of income the tenant pays for rent and the actual project rent.

--Project rents cannot exceed 120 percent of the fair market rents (FMR) HUD establishes for an area on the basis of the rents tenants are willing to pay for housing that is modest in design. The income from project rents is used to pay for a project's operating and maintenance expenses and to amortize project financing costs (principal and interest). Consequently, by controlling rental income, fair market rents serve to limit the mortgage financing (section 202 loans) and in turn the project's construction costs.

--In 1981 HUD issued cost containment and modest design requirements to further control project costs. These requirements (see app. II) imposed limits on the type and size of units, amenities, and commercial space that could be included in projects. HUD also issued supplemental guidelines (see app. III) in May 1983 to aid its field offices and project sponsors in eliminating other costly features from projects.

Is cost containment working?

--HUD data showed that projects built under cost containment requirements had on average 11 percent less space; more efficiencies; and fewer amenities, most notably no balconies, than projects built before cost containment (see app. IV).

--Our analysis of construction cost data, adjusted for inflation, for 802 section 202 projects in HUD's Computer Underwriting and Processing System showed that units in cost containment projects had construction costs that averaged 16 percent less than the average for units in projects built before cost containment.

--At the 10 HUD offices we visited, the average section 202 loan for cost containment projects we reviewed ranged from 9 to 25 percent less per unit than those for pre-cost-containment projects. We estimate these reductions lowered project rents an average of 10 percent. (See app. V.)

--On the basis of these cost/loan reductions, we estimate that if HUD had not implemented cost containment, section 202/8 program costs would have been about $100 million more to fund the 12,400 units HUD approved for funding in fiscal year 1985.

Problems in implementing cost containment.

--According to some HUD officials and program sponsors, FMRs precluded the same project built in one area from being built in another area where FMRs are lower. For example, the cost containment projects reviewed in HUD's San Francisco office, where FMRs are high in comparison to Pittsburgh's, included more or better amenities than did the Pittsburgh projects. Moreover, projects at the San Francisco office were able to provide more or better amenities while keeping rents within 110 percent of FMRs whereas projects at the Pittsburgh office required rents of 120 percent of FMRs.

--At the projects we reviewed in HUD's Chicago and Pittsburgh offices, the FMRs for efficiency units required project sponsors to reduce construction costs by amounts greater than the savings that could be realized by building an efficiency. For example, at 120 percent of FMRs, efficiencies provided $105 less in monthly rents on projects in Chicago than did the FMRs for one-bedroom units. With this loss in rent revenues, we estimate that project financing (costs) had to be reduced by about $12,200 for each efficiency included in the project. However, according to HUD officials in Chicago, an efficiency unit cost only $2,600 less to construct than a one-bedroom unit.

--In our report Section 8 Subsidized Housing: Some Observations on Its High Rents, Costs, and Inequities (GAO/CED-80-59, June 6, 1980), we reported that too few comparables were available to establish FMRs for newly constructed units. This lack of comparables can result in large errors in establishing FMRs. We also reported on the lack of documentation, arithmetic errors, and improper adjustments in establishing FMRs. According to HUD's Chief of the Architectural and Engineering Branch, the nonavailability of comparables, especially nonluxury rental units, was still a problem. Although rents for luxury units can be adjusted (reduced) to reflect the rents for modest housing, this official stated that these adjustments were subjective and therefore prone to error and abuse.

--FMRs also gave section 202 projects exempted fully or partially from real estate taxes--such as those in Florida, North Carolina, Illinois, and Massachusetts--an advantage over projects not having such an exemption. For example, the projects reviewed in HUD's Pittsburgh office paid an average of $27,800 annual real estate taxes. We estimate that these taxes reduced project construction costs by an average of $280,000 because more of the project's rents had to be used for taxes leaving less available to finance construction. Exempted projects, however, were not similarly affected.

--HUD requires projects with rents in excess of 100 percent of FMRs to comply fully with HUD's supplemental cost containment guidelines. Projects in some areas such as Boston and San Francisco were able to develop projects with rents within 100 percent of FMRs. According to HUD officials in San Francisco, one project there had features that were inconsistent with HUD's supplemental guidelines but no changes were made because rents did not exceed 100 percent of FMRs. HUD officials in Boston stated that no attempt was made there to determine whether project features were excessive for projects with rents within 100 percent of FMRs.

--HUD required projects with rents in excess of 110 percent of FMRs to be reviewed by HUD headquarters for compliance with cost containment. The projects reviewed in HUD's Chicago and Pittsburgh offices all had rents over this limit and therefore were subject to a headquarters review. Projects subject to a headquarters review, which generally took 5-6 weeks, were sometimes required to reduce project costs and in some instances to undergo a redesign to achieve economies in construction. In contrast, the 27 projects reviewed in HUD's Boston, Jacksonville, and San Francisco offices, where FMRs were high relative to construction costs, all had rents within the 110 percent limit and therefore were not subject to a headquarters review.

--Under cost containment HUD required 25 percent of a project's units to be efficiencies. However, HUD field offices could waive this requirement when these units were not considered marketable. Fifteen (18 percent) of the 85 cost containment projects we reviewed had no efficiency units. Projects with waivers, however, were not required by HUD to meet the same space requirements as those with efficiencies. Projects meeting HUD's 25-percent efficiency requirement had an average unit size that was limited to 509 square feet (75% one-bedroom units x 540 sq. ft. plus 25% efficiency units x 415 sq. ft.). The projects with waivers that we reviewed averaged 527 square feet per unit.

--HUD's Denver, Fort Worth, and San Francisco offices imposed a 110-percent FMR limit on rents for projects within their jurisdiction. Sponsors for 8 of the 23 projects we reviewed within these 3 offices paid for some of the projects' costs to keep rents within the 110-percent FMR limit. This occurred without evidence that the projects' costs were excessive on the basis of cost containment requirements. By imposing this limit, these field offices were not required to submit these 8 projects to a headquarters review for compliance with cost containment.

<u>Opportunities for reducing program costs</u>.

--HUD's 25-percent efficiency requirement creates inequities in housing the single elderly. Eighty-seven percent of tenants at the 142 projects sampled were single and over 80 percent were single when they moved in. Thus, on the basis of HUD's 25-percent efficiency requirement, about 30 percent of the single elderly would receive an efficiency unit and the remainder (70%), larger one-bedroom units. Tenants, however, pay the same rent (30% of income) regardless of the type unit they occupy.

--HUD is precluded by law from requiring more than 25 percent of units to be efficiencies. Moreover, sponsors have little incentive to include more than the maximum number of efficiencies that HUD can require in view of the effect the lower FMRs for efficiencies can have on project construction cost and financing. Overall, 24 percent of the units at the 85 cost containment projects reviewed were efficiencies. Only 10 of the projects had 30 percent or more of their units as efficiencies.

--According to HUD officials and project sponsors, some sponsors were also reluctant to build efficiencies because either they were small and lacked privacy in comparison to one-bedroom units or increased administrative costs. Other sponsors, however, had found ways to resolve these problems. One sponsor had designed an efficiency unit that incorporated a separator between the living and sleeping areas. Other sponsors prohibited tenants from moving from their efficiency units when a one-bedroom unit became vacant to avoid unnecessary administrative costs.

--According to HUD estimates obtained at five of the offices we visited, an efficiency unit cost $1,500-$5,100, or an average of $2,800, less to construct than a one-bedroom unit. If these savings in construction costs were adequately reflected in the FMRs and if sufficient efficiencies were built to house the single elderly expected to live in future projects, we estimate HUD could save about $19 million annually, based on present funding levels.

--Project costs differ widely within HUD field offices for both the same and different structural types. For example, in HUD's Los Angeles office, high-rise elevator projects cost an average of $63,500 per unit while 2-4 story low-rise elevator projects cost an average of $48,300 per unit--a difference of about 31 percent. Moreover, high-rise elevator projects in the Los Angeles office cost from $58,700 to $69,500 per unit--an 18-percent difference--and low-rise projects cost from $43,700 to $52,300--a 20-percent difference.

--According to HUD instructions, HUD field offices were not to consider a project's cost in project selection. Instead HUD field offices were to rate projects on the bases of their modest design. Field office officials, however, stated that projects with characteristics known to reduce costs--such as smaller units, more efficiencies, or low-rise construction--would not receive any more points when rating a project's modest design than projects not having these characteristics. In addition, the importance of modest design is diminished by other project selection factors and the weights assigned to them (see app. VI).

Elderly housing needs and program beneficiaries.

--On the basis of our statistical sample of 142 of the 1,274 section 202/8 projects constructed between February 1975 and January 1985, 87 percent of the program beneficiaries were single. Beneficiaries on average were 73 years old, were white, had lived in their unit/project for about 2.5 years, and had an annual income of about $6,600. Most (82%) had very low incomes--below 50 percent of the median income (adjusted for household size) for the areas in which they lived.

--Most beneficiaries lived in a one-bedroom unit that rented on average for $480 a month and contributed about $146 toward this rent. The balance of $334 was paid by the government through section 8 rental assistance payments.

--Most projects had few if any minorities. At the 142 projects sampled, (1) 42 percent of the projects, which accounted for about 33 percent of program beneficiaries, had no minority tenants and (2) 70 percent of the projects, with 68 percent of the tenants, had 5 percent or less minority tenants. (See app. VII.)

--For the most part, minorities were concentrated in a few projects. Sixty percent of the minorities in the sample were housed in 13, or 9 percent, of the projects sampled. At each of the 13 projects, more than 50 percent of the tenants were minorities.

APPENDIX II

HUD's COST CONTAINMENT PROVISIONS FOR THE SECTION 202 ELDERLY HOUSING PROGRAM

Unit square footage	Limited to 415 square feet for efficiencies, 540 square feet for one-bedroom units, and 800 square feet for two-bedroom units.
Efficiency units	Twenty-five percent of the units in each elderly project must be efficiencies, unless efficiencies are not "readily marketable."
Cost not attributable	The total cost of nondwelling space normally should not exceed 10 percent of total project cost, and common rooms must be designed to serve multipurpose functions.
Two-bedroom units	Prohibited for the nonhandicapped elderly.
Commercial space	Limited to 5 percent of total project square footage, and proposed commercial activities must be self-supporting and of direct service to tenants.
Amenities and design	Amenities and design features are to be controlled to reduce development costs.

HUD's SECTION 202 COST CONTAINMENT SUPPLEMENTAL LIST (MAY 1983)

1. Eliminate parapets and other unnecessary projections or breaks at roofs. Flashing and counterflashings are expensive to build and to maintain during occupancy. Investigate the use of membrane (rubber) roofing in lieu of built-up.

2. Single-width masonry wall construction is acceptable if properly flashed to prevent the penetration of moisture. Nonbearing veneers should be aluminum/vinyl siding or plywood.

3. Limit the number of elevators to a minimum. Check elevator design for costly features such as excess speed and unnecessary control. Cab and door design should be baked enamel.

4. Lightweight concrete floor topping is excessively costly. Carpet is an effective sound control.

5. Eliminate decorative door sidelights and transoms.

6. Do not provide air conditioning in cool climates (northern zones particularly) especially for the elderly.

7. Parking lots should be efficiently designed as close as possible to buildings with no excess parking spaces or roadways. Both parking lots and sidewalks should be paved with bituminous concrete in lieu of portland cement concrete. Use precast concrete at islands and protrusions. Curbs and bumpers should be bituminous, or railroad ties.

8. Ceiling heights should be a maximum of 8'0" floor to ceiling.

9. Bathroom lights and outlets should be integral to medicine cabinets or ceiling fans, eliminating a separate fixture.

10. Closet doors should be full height--where possible, full width--and metal bifold in lieu of bypassing wood, thus eliminating dry-wall headers and stub partitions.

11. Hose bibs should be used in place of yard hydrants.

12. Site lighting can be accomplished by building mounted fixtures rather than freestanding poles and fixtures.

13. Sheetrock may be fastened directly to wood joists instead of to furring channels or strapping. At metal joists, sheetrock may be attached to metal strapping without suspension.

14. Ceramic tile should be used only in the tub and shower enclosures and the remaining areas, painted. Epoxy paint may be used in lieu of ceramic tile.

15. Ductless hoods may be used instead of ducted hoods unless there is a requirement for mechanical ventilation.

16. Where possible, use one or two large windows in place of two or three smaller ones.

17. Eliminate finish in stairwells (except in primary stairwell), mechanical rooms, and other utility areas.

18. Specify 5/8" sheetrock only to meet code requirements.

19. Specify residential hardware except in common areas.

20. Avoid costly items such as elaborate signs and directories, stainless steel brackets, and railings.

21. Minimize landscaping.

22. Electrical fixtures and plumbing trim should be minimum and not extravagant.

23. In smaller buildings, a gable roof should be used in lieu of a flat roof.

24. One- or two-story protrusions to high rise buildings are costly and should be avoided.

25. Underground or covered parking should be avoided except in extreme cases where no alternative exists to meet local requirements. Excessive local requirements should be appealed.

26. Large, elaborate, and extensive entrances and elevator lobbies should be avoided.

27. Excessive common areas must be avoided. Common areas exceeding 5 percent of net rentable space must be investigated completely by the area office staff with an eye to eliminating them. The 5-percent calculation will include the lobby, common kitchen and dining areas, meeting and recreational areas, tenant workshops, etc. This calculation will not include mechanical rooms, managers' units, and small offices or halls.

28. Commercial areas must support market rates that service the pro rata share of cost and expenses. Otherwise, these areas must be included in the common area calculation.

29. If the sponsor includes design features and amenities that exceed the intent of cost containment and proposes to pay for excess costs, the payment must take into consideration any excess maintenance costs associated with the excess design. Payments by the sponsor that originate from HUD by way of Block Grant or Urban Development Action Grants funds cannot be accepted as justification for exceeding the modest design criteria.

COMPARISON OF PROJECT CHARACTERISTICS BETWEEN PRE- AND POST-COST-CONTAINMENT PROJECTS

Characteristic	Nationwide[a] Pre	Nationwide[a] Post	Nationwide[a] Percent change	Projects included in GAO review Pre	Projects included in GAO review Post	Projects included in GAO review Percent change
Gross square foot per unit[b]	814	720	-11.5	818	732	-10.5
Average square foot per unit	563	507	-9.9	555	502	-9.5
One-bedroom size (square foot)	563	529	-6.0	555	528	-4.9
Percent of projects without efficiencies	88.3	34.2	-61.3	92.6	17.6	-81.0
Percent of units that were efficiencies	3.0	19.7	+556.7	1.8	23.6	+1211.1
Cost not attributable to dwelling space (percent)	8.0	6.0	-25.0	9.6	6.7	-30.2
Percent of projects exceeding 5 percent for commercial space	1.9	0	c	4.3	0	c
Percent of units that were two-bedroom units	2.5	.2	-92.0	1.7	.1	-94.1

[a]Projects included in HUD's Computerized Underwriting Processing System.

[b]Includes a pro rata share of common space.

[c]Not computable.

SECTION 202 LOAN REDUCTIONS CAUSED BY COST CONTAINMENT AND GAO's ESTIMATE OF THE REDUCTIONS' IMPACT ON PROJECT RENTS

HUD field office	Reduction in loan amount[a]	Estimated reduction in project rents[b]
	----------(percent)----------	
Pittsburgh	24.8	17.9
Boston	17.1	12.0
San Francisco	16.1	12.2
Los Angeles	15.6	12.3
Jacksonville	12.9	9.2
Fort Worth	12.7	8.0
Denver	11.8	8.5
Philadelphia	9.7	6.7
Greensboro	8.5	6.5
Chicago	8.5	5.7
Average	13.8	9.9

[a]Based on comparisons of the average per-unit loan amount (after adjustments for inflation) for the pre- and post-cost containment projects reviewed at the HUD offices visited.

[b]Based on the percentage of rents used to amortize project debt. For the projects reviewed at the 10 HUD offices, this averaged 72 percent, resulting in an average rent reduction of 9.9 percent (13.8% x 72%). These percentages varied from office to office because of differences in operating and maintenance expenses.

THE RANKING FACTORS AND CORRESPONDING POINT VALUES OF HUD's SECTION 202 PROJECT SELECTION

	Factor	Maximum points
1.	The borrower's financial capacity	30
2.	The borrower's capacity to carry through to long-term operation a project for housing and related facilities	20
3.	Location (site/neighborhood)	15
4.	Modest design/cost containment	25
5.	Special needs (to be rated by the regional office)	10
	Total	100

DISTRIBUTION OF PROJECTS BY PERCENTAGE OF MINORITY TENANTS

Minority tenant percentages	Projects Number	Projects Percent		Percent of tenants served by projects	
0	59	42	70	33	68
Over 0 - 2	20	14		18	
Over 2 - 5	20	14		17	
Over 5 - 10	9	6		6	
Over 10 - 15	4	3		3	
Over 15 - 25	8	6		5	
Over 25	22	15		18	
Total	142	100		100	

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