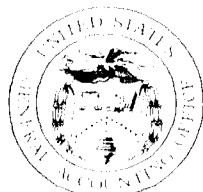


May 1989

COMMUNITY DEVELOPMENT

Distribution of Small Cities Funds by Pennsylvania



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RELEASED

**Resources, Community, and
Economic Development Division****B-225235****May 3, 1989****The Honorable Paul E. Kanjorski
The Honorable Joseph M. McDade
The Honorable Thomas J. Ridge
House of Representatives****The Honorable John Heinz
United States Senate**

This letter responds to your April 14, 1988, request that we review the methodology Pennsylvania used to distribute the Community Development Block Grant, Small Cities Program funds. Under this program, funds are allocated to the states on a formula basis for the development of viable communities by providing decent housing and a suitable living environment, and expanding economic opportunities, principally for low- and moderate-income persons. Persons of low- and moderate-income are families and individuals whose incomes do not exceed 80 percent of the median area income. Examples of activities funded with Small Cities Program funds are the purchases of fire-fighting equipment and street and sewer improvements.

Specifically, you requested that we examine the methodology Pennsylvania used to develop low- and moderate-income population estimates and determine whether it, or a method suggested by the Department of Housing and Urban Development (HUD), more closely meets the requirements of existing statutes. You also asked us to determine whether HUD's suggested method of arriving at an estimated percentage of low- and moderate-income persons excludes single persons over the age of 62, relies upon inappropriate income data from the Census Bureau to update its income criteria, and includes college and university students living in group quarters in its computations, which erroneously skews the estimated number of low- and moderate-income persons.

Results in Brief

Our examination of the methodology used by Pennsylvania and HUD showed that:

- The state's methodology for estimating the percentage of low- and moderate-income persons is not consistent with the Housing and Community Development Act of 1974. The result is that the number of communities that are predominately of low and moderate income is higher than if

HUD's estimates were used. HUD's methodology, on the other hand, is consistent with the statute.

- HUD's methodology includes single persons over 62 years of age in its estimate of the percentage of low- and moderate-income persons.
- The census data HUD used to update its income criteria are appropriate and consistent with the requirements of the Housing Act of 1937 and the Housing and Community Development Act of 1974.
- HUD used census data that include college and university students living in group quarters. Including these students may have increased the estimated number of low- and moderate-income persons in certain communities and made these communities appear more distressed than they were.

Disagreement Over Methodology

HUD believes that the methodology the state used overestimates the low- and moderate-income population in certain areas and has required the state to use HUD's estimates or some other appropriate alternative to distribute Small Cities funds.

Officials of Pennsylvania's Department of Community Affairs said they distributed 1987 and 1988 funds on the basis of their methodology, which was permitted by HUD's 1989 Appropriation Act. They are, however, using HUD's low- and moderate-income population estimates to distribute 1989 Small Cities funds even though they do not necessarily agree with them. Their disagreement is primarily based on the results of recent income surveys of the residents of selected areas by 26 communities that were applying for 1987 Small Cities funds. These surveys showed a higher percentage of low- and moderate-income persons in selected areas than the estimates based on HUD's methodology in all but one instance. HUD questioned the survey results on the basis of its preliminary examination of nine surveys and on March 3, 1989, recommended that Pennsylvania reexamine the results of all surveys. Regardless of whether Pennsylvania's or HUD's methodology is used to allocate funds to individual communities, the amount of federal funds allocated to Pennsylvania for the Small Cities Program will not change.

Scope and Methodology

In performing our work, we interviewed HUD officials in the Office of Block Grant Assistance, the Office of Economic Affairs, and the Office of General Counsel in Washington, D.C.; state officials in Pennsylvania's Department of Community Affairs; and representatives of the Pennsylvania State Data Center, the contractor who helped the state prepare the state's estimates of the low- and moderate-income population. We

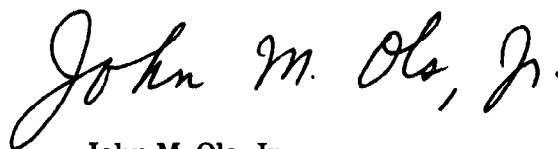
obtained documentation and information from HUD, the state, and the state's contractor on the methodologies used. We also obtained and included information from HUD's Office of General Counsel and our Office of the General Counsel on the legal issues raised in your request letter.

As requested, we briefed representatives of your offices on the results and agreed to summarize the results of our review and describe the methodology HUD and Pennsylvania used in arriving at low- and moderate-income population estimates. Our response to the questions in your letter are included in appendixes I and II.

We obtained informal comments on a draft of this report from HUD and state officials, and changes have been made where appropriate. However, as requested, we did not obtain official agency comments. Our work was performed between May and October 1988, in accordance with generally accepted government auditing standards.

Unless your offices publicly release its contents earlier, we will make this report available to other interested parties 30 days after the date of this letter. We trust that this information will satisfy your interest in this matter. Major contributors to this report are listed in appendix III.

Sincerely yours,



John M. Ols, Jr.
Director, Housing and
Community Development Issues

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Abbreviations

| | |
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| GAO | General Accounting Office |
| HUD | Department of Housing and Urban Development |

The Small Cities Program

Background

The Department of Housing and Urban Development's (HUD) Small Cities Program was authorized by the Housing and Community Development Act of 1974. The program is primarily intended to foster viable urban communities by providing decent housing and a suitable living environment and expanding economic opportunities principally for persons of low and moderate income. The federal funds are allocated to the states on a formula basis that considers factors such as the population below the poverty level and housing-crowding statistics. Program funds are then allocated, by the states, primarily to nonurban counties, small cities, and other communities located outside of metropolitan areas; and large urban counties that do not automatically receive funds under HUD's Community Development Block Grant Entitlement Program.¹

The term "low- and moderate-income persons" means families and individuals whose incomes do not exceed 80 percent of the median area income as determined by the Secretary of HUD, with adjustments for smaller and larger families. Fifty-one percent or more of the residents of the designated area which the activity is intended to serve must be of low and moderate income. In fiscal years 1987 and 1988, about \$38.5 million and \$37.1 million, respectively, were allocated to Pennsylvania under the program. The state, which assumed responsibility for administering the program in July 1982, is required by state law to distribute 85 percent of the funds to local communities on a formula basis. Communities use these funds for a broad range of activities which can benefit all or part of a county, town, or neighborhood. Examples of activities funded include streets, storm and sanitary sewers, recreational purposes, fire equipment, community centers, libraries, and street lighting. These activities are classified as "indirect benefit activities," since they benefit a majority of the residents in an area. The remaining 15 percent of the Small Cities funds may be used by the Pennsylvania Department of Community Affairs for program administration and discretionary projects such as projects in communities that are not automatically entitled to funds.

Dispute Over Pennsylvania's Methodology

States have the option of developing procedures for distributing funds as dictated by state and local priorities. In 1982, Pennsylvania contracted with the Pennsylvania State Data Center to develop a methodology to estimate the number of low- and moderate-income persons. Using income data from the Bureau of Census' 1980 Decennial Census and

¹Under this entitlement program large urban jurisdictions (city and county governments) are entitled to funds, based on a formula.

HUD's low- and moderate-income criteria (income limits) for 1982,² the data center developed estimates of the percentage of the population composed of low- and moderate-income persons. The state used these estimates in its evaluation of fiscal year 1982 Small Cities grant applications from the communities. Subsequently, the methodology for estimating the number of low- and moderate-income persons was revised by the data center to use 1983 income criteria. Pennsylvania then used the revised estimates to evaluate grant applications from the communities for funds beginning with fiscal year 1983 through fiscal year 1988.

In a memorandum to the state in June 1986, HUD questioned the use of the 1983 income criteria and advised the state that the data center's estimates should not be used. The memorandum noted that the estimates may not be accurate since the state's methodology may have used income criteria other than those for 1979. HUD's methodology for developing estimates of low- and moderate-income persons was basically to compare 1979 income criteria with 1979 income data. In December 1987—after numerous meetings with state officials and an exchange of correspondence—HUD told Pennsylvania officials that because the state's methodology compared 1979 income levels with 1983 income criteria, a significantly larger number of communities were classified as predominately lower income communities than would have been if HUD's methodology were used. HUD told the state to use the low- and moderate-income estimates it provided to the state for the 1988 program allocations and to freeze any 1987 indirect-benefit activities not yet under contract until it can be determined whether each activity meets the legislatively mandated low- and moderate-income benefit criteria. Subsequently, HUD's 1989 Appropriation Act included a provision that allowed Pennsylvania to use its methodology for the distribution of 1987 and 1988 Small Cities funds.

²Income information collected in the 1980 Census is income earned for calendar year 1979.

Explanation of the Differences Between HUD and State Estimates of the Percentage of Low- And Moderate-Income Persons

HUD's estimates of the percentages of low- and moderate-income persons are lower than Pennsylvania's estimates for a large number of communities. In some cases, the difference was 30 percent or more. The estimates are important because the law requires that assistance provided under the Small Cities Program must be used to support activities that principally benefit low- and moderate-income persons. HUD and the state use similar approaches and generally the same data sources to develop estimates of the low- and moderate-income persons. Essentially, both use income data from the 1980 Decennial Census, and both use income criteria developed by HUD. The basic differences between HUD's and the state's methodology are the income criteria, or "cut point" for program eligibility, and the income distribution of the persons to be served under the Small Cities Program, which are discussed below.

Income Criteria for Receiving Funding

Both HUD and Pennsylvania use the HUD Section 8 Rental Housing Assistance Program definition of low- and moderate-income persons as the income criteria for determining program eligibility. The Section 8 Program (42 U.S.C. 1437f) aids low-income families in obtaining decent, safe, and sanitary housing in private accommodations through the use of rental subsidies. The term "low- and moderate-income" means families and individuals whose incomes do not exceed 80 percent of the median area income as determined by the Secretary of HUD, with adjustments for smaller and larger families.

HUD obtains the median family income from the decennial census. In arriving at the median family income, HUD uses the census' definition of "family," which is two or more persons related by birth, marriage, or adoption who are living in the same house (this excludes one-person households as well as households consisting of unrelated individuals). HUD defines family median income from the decennial census as representing a four-person family. HUD makes adjustments to the family median income for other-size families and also for individuals.

For example, the 1980 Census showed a median family income to be \$20,923 for Butler County, Pennsylvania. Therefore, a family with an income of \$16,738 or less (80 percent of \$20,923) is considered as a low- and moderate-income family.

HUD and Pennsylvania Use Different Income Distributions

HUD and Pennsylvania use income data obtained from the 1980 Decennial Census, but they use different income distributions. (An income distribution shows the number of families, individuals, or households by income range or level for specific areas, such as a county.) HUD uses the income data from two income distributions—one was for families and the other for unrelated individuals. Pennsylvania, however, uses a different census distribution, which is termed “households” and is defined by the Census Bureau as a person or persons occupying a specific housing unit and includes family members as well as unrelated individuals.

On the basis of our analysis, the primary difference, or the net result of the two approaches, is that the census data on unrelated individuals used by HUD include persons living in group quarters, such as college or university students living in dormitories. The census data on households—the distribution that the state used—do not include persons residing in group quarters. Residents of institutions, such as prisons or mental hospitals, are not included in census tables used by HUD and the state.

HUD Includes College Students Living in Group Quarters

Pennsylvania charged that HUD’s use of a census income distribution that includes college or university students living in dormitories “skewed” or erroneously increased the percentage of lower income persons in areas where large numbers of students are located. For example, state officials said HUD’s estimates show that the county with the second highest percentage of lower income persons in the state contained a large student population. In the state officials’ opinion, this county was not the second most distressed county in the state.

Regarding the inclusion of persons in group quarters, HUD officials said that to adjust the census data to eliminate students living in group quarters would be expensive and time-consuming and would affect a small number of communities. They added that HUD’s low- and moderate-income population estimates are just that—“estimates”—and if a community believes that these estimates do not accurately reflect conditions in the community, they may use appropriate alternative approaches to estimate the number of low- and moderate-income persons.

In December 1987, HUD’s Director, Office of Community Planning and Development, Philadelphia Regional Office, offered the state an alternative to using HUD’s estimates by advising the state it could use the household income distribution figures from the 1980 Census, but it would

**Appendix II
Explanation of the Differences Between HUD
and State Estimates of the Percentage of
Low- And Moderate-Income Persons**

have to use the 1979 income criteria as the cut point rather than the 1983 income criteria as the state was doing. The director's proposal was to use this approach for the 1988 Small Cities Program and for the 1987 program funds that had not been obligated by the date of the proposal.

Subsequently, HUD's 1989 Appropriation Act included a provision that allowed the state to use its methodology for distributing 1987 and 1988 Small Cities funds. However, whether the state's or HUD's methodology is used, the amount of funds the state receives from HUD under the Small Cities Program remains the same.

**HUD Includes Single
Persons Over 62 Years of
Age in Its Estimates**

Your letter stated that HUD data may not include single persons over the age of 62 in its estimates of the percentage of low- and moderate-income persons and that this resulted in a lower and inaccurate estimate of the percentage of lower income persons in Pennsylvania. Our analysis of the census data HUD used showed that it did, in fact, include single persons over the age of 62. One of the census income distributions that HUD used was "unrelated individuals," which includes single persons, including those over the age of 62.

During our examination, state officials said they did not fully understand HUD's basis or methods for estimating the percentage of low- and moderate-income persons. HUD, at our request, provided the state with this information in July 1988. HUD officials also agreed to provide any additional assistance that may be required to help the state understand HUD's method of estimating the low- and moderate-income population.

**HUD's Methodology
for Updating Income
Limits Is Consistent
With the Law**

HUD's methodology for updating section 8 income limits uses census data based on a geographic division that groups Pennsylvania in a three-state cluster with New York and New Jersey. Your letter stated that this practice may be invalid and inconsistent with the legislative intent of section 567 of the Housing and Community Development Act of 1987.

Family income data are not available for counties between decennial censuses. HUD, therefore, uses other census information on family income which is based on geographic divisions and county business pattern data as a means of establishing county income limits. According to HUD, this methodology is a valid and reliable indicator for estimating income. In our opinion, HUD's use of this method is defensible statistically and satisfies the statutory requirements to use the median income of the county.

Pennsylvania's Estimates of the Percentage of Persons of Low- And Moderate-Income Were Higher Than HUD's

The primary differences between HUD's and Pennsylvania's estimates of the percentages of persons classified as being in the low- and moderate-income category are due to the establishment of the income criteria and the use of different income distributions. HUD and the state both used section 8 income criteria as the cut point; however, HUD used 1979 income criteria while Pennsylvania used 1983 income criteria. Because the state used a 1983 income criteria, which on the average was about 27.5 percent higher than the 1979 income criteria, and applied this to a 1979 income distribution, a greater percentage of persons was designated in the low- and moderate-income category as compared with the HUD method, which used the 1979 income criteria and the 1979 income distribution.

HUD data showed that the median income for nonmetropolitan counties in Pennsylvania increased by an average of about 27.5 percent from 1979 to 1983. Table II.1 shows the increase in median income for these counties from 1979 and 1983. Because the section 8 income limit for a family of four is 80 percent of the median family income of the county, the use of the higher income limit resulted in increasing the state's estimate of the percentage of persons classified as being in the low- and moderate-income category. For example, in one county where the median family income increased from \$18,020 in 1979 to \$22,800 in 1983, the income criteria for a family to qualify as being in the lower income category increased from \$14,416 to \$18,240. As a result, by using the state's approach, families with incomes of less than \$18,240 would be classified as being in the low- and moderate-income category whereas under HUD's approach, the income criteria was \$14,416. The state's use of a higher income criteria has the net effect of "qualifying" many more persons in the county or subcounty area. Table II.2 shows the difference in the estimated percentage of low- and moderate-income persons for Pennsylvania's nonmetropolitan counties as computed by HUD and the state.

Appendix II
Explanation of the Differences Between HUD
and State Estimates of the Percentage of
Low- And Moderate-Income Persons

Table II.1: Median Family Income Using
1979 And 1983 Census Data

| Nonmetropolitan county ^a | Median family income | | Difference | Percentage of increase in median family income (1979 to 1983) |
|----------------------------------------|----------------------|----------|------------|---------------------------------------------------------------------------|
| | 1979 | 1983 | | |
| Armstrong | \$18,020 | \$22,800 | \$4,780 | 26.53 |
| Bedford | 15,372 | 19,600 | 4,228 | 27.50 |
| Bradford | 16,402 | 20,900 | 4,498 | 27.42 |
| Butler | 20,923 | 26,400 | 5,477 | 26.18 |
| Cameron | 16,832 | 21,600 | 4,768 | 28.33 |
| Clarion | 18,915 | 23,900 | 4,985 | 26.35 |
| Clearfield | 17,368 | 22,300 | 4,932 | 28.40 |
| Clinton | 17,036 | 21,900 | 4,864 | 28.55 |
| Columbia | 16,455 | 21,000 | 4,645 | 28.23 |
| Crawford | 17,934 | 23,000 | 5,066 | 28.25 |
| Elk | 19,404 | 24,900 | 5,496 | 28.32 |
| Fayette | 17,282 | 22,100 | 4,818 | 27.88 |
| Forest | 15,492 | 19,800 | 4,308 | 27.81 |
| Franklin | 19,253 | 24,600 | 5,347 | 27.77 |
| Fulton | 15,372 | 19,600 | 4,228 | 27.50 |
| Greene | 17,866 | 22,900 | 5,034 | 28.18 |
| Huntingdon | 15,744 | 20,100 | 4,356 | 27.67 |
| Indiana | 18,933 | 23,900 | 4,967 | 26.23 |
| Jefferson | 17,644 | 22,700 | 5,056 | 28.66 |
| Juniata | 15,659 | 19,800 | 4,141 | 26.44 |
| Lawrence | 19,199 | 24,600 | 5,401 | 28.13 |
| Lebanon | 19,961 | 25,200 | 5,239 | 26.25 |
| Mc Kean | 17,580 | 22,200 | 4,620 | 26.28 |
| Mifflin | 17,012 | 21,500 | 4,488 | 26.38 |
| Montour | 18,654 | 23,600 | 4,946 | 26.51 |
| Northumberland | 15,862 | 20,100 | 4,238 | 26.72 |
| Pike | 17,055 | 21,900 | 4,845 | 28.41 |
| Potter | 15,384 | 19,500 | 4,116 | 26.76 |
| Schuykill | 16,214 | 20,600 | 4,386 | 27.05 |
| Snyder | 17,218 | 21,800 | 4,582 | 26.61 |
| Sullivan | 14,559 | 18,700 | 4,141 | 28.44 |
| Tioga | 16,007 | 20,400 | 4,393 | 27.44 |
| Union | 18,083 | 22,900 | 4,817 | 26.64 |
| Venango | 19,531 | 25,000 | 5,469 | 28.00 |
| Warren | 19,160 | 24,500 | 5,340 | 27.87 |
| Wayne | 15,494 | 19,900 | 4,406 | 28.44 |
| Wyoming | 17,068 | 21,900 | 4,832 | 28.31 |

^aCounties located outside a metropolitan area as defined by the Office of Management and Budget. Other jurisdictions such as a borough or an incorporated town also receive Small City funds.
Source: HUD, Office of Economic Affairs, Economic Market Analysis Division.

Appendix II
Explanation of the Differences Between HUD
and State Estimates of the Percentage of
Low- And Moderate-Income Persons

Table II.2: HUD and State Estimates of the Percentage of Persons With Low- And Moderate-Incomes for Nonmetropolitan Counties

| Nonmetropolitan county | Estimates of percentage of low/moderate income persons by | |
|------------------------|-----------------------------------------------------------|-------|
| | Pennsylvania | HUD |
| Armstrong | 51.37 | 39.99 |
| Bedford | 52.46 | 40.41 |
| Bradford | 52.11 | 39.62 |
| Butler | 49.32 | 39.55 |
| Cameron | 59.33 | 45.72 |
| Clarion | 50.02 | 45.95 |
| Clearfield | 52.54 | 39.54 |
| Clinton | 49.31 | 40.95 |
| Columbia | 51.72 | 44.68 |
| Crawford | 51.39 | 41.62 |
| Elk | 53.15 | 38.33 |
| Fayette | 63.97 | 51.47 |
| Forest | 56.03 | 41.13 |
| Franklin | 50.42 | 38.64 |
| Fulton | 50.93 | 40.08 |
| Greene | 52.50 | 42.23 |
| Huntingdon | 50.82 | 42.71 |
| Indiana | 49.62 | 45.10 |
| Jefferson | 52.53 | 39.36 |
| Juniata | 51.19 | 40.40 |
| Lawrence | 50.94 | 40.64 |
| Lebanon | 52.05 | 40.54 |
| Mc Kean | 51.43 | 39.51 |
| Mifflin | 53.39 | 41.82 |
| Montour | 47.31 | 39.68 |
| Northumberland | 52.56 | 40.87 |
| Pike | 50.24 | 40.06 |
| Potter | 52.10 | 40.41 |
| Schuylkill | 52.91 | 40.32 |
| Snyder | 46.12 | 40.01 |
| Sullivan | 49.49 | 42.29 |
| Tioga | 50.08 | 42.53 |
| Union | 43.64 | 44.10 |
| Venango | 50.89 | 39.36 |
| Warren | 50.82 | 38.59 |
| Wayne | 52.35 | 40.15 |
| Wyoming | 50.95 | 38.79 |

Source: HUD, Office of Economic Affairs, Economic Market Analysis Division.

Pennsylvania's Methodology for Estimating the Percentage of Lower Income Persons Is Not Consistent With the Statute

On the basis of our review of the methodology used by HUD and the state, we believe that HUD's approach is appropriate. The state's approach, however, is not consistent with the statute. Our primary objection to Pennsylvania's approach is that it calculated the percentage of lower income persons by comparing a 1979 income distribution with a 1983 income limit. It is not consistent with the statute to compare incomes for one year with an income limit for some other year. The use of the higher 1983 income limit had the effect of increasing the number of communities that had at least 51 percent of the population classified in the low- or moderate-income category.

Pennsylvania Department of Community Affairs officials said they used their methodology because in 1979, the state was at an economic peak, so they wanted to develop estimates of the number of low- and moderate-income persons that more accurately reflected current conditions. They said that by using 1983 income limits and 1979 income distributions, they offset the high point that the state's economy was at in 1979. They said they did not continue to update the income limits after 1983 because they realized that at some point, it would produce unreasonable results.

State officials said local community surveys of residents' incomes indicated that HUD estimates did not reflect the actual percentage of lower income persons in Pennsylvania's communities. The results of 26 surveys performed by local communities in support of their applications for fiscal year 1987 funds showed that in all but one case, the percentage of lower income persons in the area was higher than HUD's estimate.

Using updated income limits each year while at the same time continuing to use the 1979 census data as a base puts an increasing portion of the population in the lower income category. If this continued, every county would be classified in the lower income category in about 10 years on the basis of an increase of 8 percent each year in the section 8 income limits.

In our view, the communities' local survey results may not indicate that the state's methodology results in a more accurate count than HUD's. State officials advised us that surveys were conducted only in areas where HUD's estimates of the low- and moderate-income population were less than 51 percent. Accordingly, this may not accurately represent a true picture of HUD's estimates throughout Pennsylvania. In addition, HUD officials questioned the survey results and indicated that they needed to examine the survey methodology in more detail before an

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explanation of the inconsistency between HUD's and Pennsylvania's estimates could be fully developed. The results of HUD's preliminary examination of the survey methodology identified errors in seven of the nine surveys examined. HUD advised Pennsylvania of the results of its preliminary examination on March 3, 1989, and told the state that it should reexamine all of the survey results and respond to HUD as quickly as possible, so that this matter can be resolved.

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