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**HOUSING AND URBAN
DEVELOPMENT**

**Major Management and
Budget Issues**

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Mr. Chairman and Members of the Subcommittee:

We are pleased to discuss the budget and management problems facing the U.S. Department of Housing and Urban Development (HUD) and to help set the stage for addressing those problems. Current housing policy--if continued--drives huge loan commitments and discretionary spending. Therefore, controlling HUD spending means reexamining federal housing policies and HUD's mission to carry out those policies. Finally, in the wake of the HUD scandals and HUD's multi-year efforts to overcome serious managerial problems, the Congress must be able to assure itself that the Department has the ability and the resources to effectively carry out its current or future mission.

My statement today is based on our ongoing work as well as reports that we have issued and testimony that we have given over the past 3 years. It will focus on (1) long-standing management deficiencies at HUD that hamper its effectiveness, (2) problems that HUD and the Congress face in assisted and public housing programs--which account for the bulk of HUD outlays, (3) progress HUD is making in addressing the problems it faces, and (4) some thoughts on the future of HUD.

In summary,

- Four longstanding departmentwide deficiencies hamper HUD's ability to effectively carry out its mission. These deficiencies are weak internal controls, an ineffective organizational structure, an insufficient mix of staff with the proper skills, and inadequate information and financial management systems. Because of HUD's slow progress in correcting these management weaknesses, in January 1994, we determined that the Department warranted the focused attention that comes with being designated as a GAO "high-risk area".¹
- The four departmentwide management deficiencies, along with a variety of other problems, have created particularly vexing problems for both HUD and the Congress in the area of public and assisted housing. These problems include how to (1) minimize mortgage loan defaults and address the physical inadequacies of insured multifamily properties--an area that is of critical importance given that HUD expects to lose about \$10 billion as a result of defaults on multifamily loans over the next 6 years, (2) deal with billions of dollars of backlogged housing rehabilitation needs, increased vacancy levels, and declining tenant incomes that exist in public housing, and (3) address the spiraling costs of providing housing subsidies to lower-income families.

¹GAO High Risk Program (GAO/AIMD-94-72R, Jan. 27, 1994).

- HUD has taken steps that begin to address its department-wide deficiencies as well as the problems that exist in assisted and public housing. But many of these efforts are in their early stages. HUD's top management team has focused much attention and energy on overhauling the way the Department is operated. It has formulated an entirely new management approach and philosophy that is intended to balance risks with results, has begun to implement a substantial field reorganization, and has initiated a number of other actions that begin to address the four fundamental management deficiencies. But HUD still has a long way to go.
- Solving the problems that exist at HUD will not be easy and will require a full reexamination of housing policy and HUD's mission. Budget needs for HUD's programs are growing and, given current housing policy, will remain at high levels for the foreseeable future, in part because of HUD's long-term financial commitments. Also, correcting management deficiencies at HUD will take years and will require an infrastructure that provides information on which to base policy decisions. Reforms--be they mild or drastic--could have serious budget and social implications because HUD currently serves millions of Americans by providing rental subsidies, making home ownership more accessible, addressing housing discrimination, and helping revitalize communities.

HUD'S PROGRAMS AND BUDGET

Established in 1965, HUD is the principal federal agency responsible for programs dealing with housing and community development and fair housing opportunities. Among other things, HUD's programs provide (1) mortgage insurance to help families become home owners and to help provide affordable multifamily rental housing for low- and moderate-income families, (2) rental subsidies for lower-income families, and (3) grants and loans to states and communities for community development and neighborhood revitalization activities.

HUD is responsible for the expenditure of significant amounts of tax dollars. Discretionary budget outlays for HUD programs were estimated to be close to \$28 billion in fiscal year 1994. Over three quarters of this amount is for public and assisted housing programs. HUD also has management responsibility for more than \$400 billion of mortgage insurance and another \$400 billion in outstanding securities.

HUD'S MANAGEMENT DEFICIENCIES

Scandals that occurred during the late 1980s focused public attention on management problems at HUD. In the most infamous of these, known as the "Robin HUD" incident, the Federal Housing Administration (FHA) did not have accounting data and internal

controls in place to reconcile funds from the sales of government-owned properties with deposits to the U.S. Treasury. As a result, private real estate agents were able to steal millions of dollars by simply keeping the proceeds from the sale of FHA-owned properties rather than transferring the funds to the Treasury.

Internal control weaknesses, such as a lack of necessary data and management processes, were a major factor leading to the HUD scandals. Organizational problems included overlapping and ill-defined responsibilities and authorities between HUD headquarters and field organizations and a fundamental lack of management accountability and responsibility. An insufficient mix of staff with the proper skills has hampered the effective monitoring and oversight of HUD programs and the timely updating of procedures. Poorly integrated, ineffective, and generally unreliable information and financial management systems have failed to meet program managers' needs and have not provided adequate oversight over housing and community development programs.

HUD's slow progress in correcting fundamental management weaknesses that allowed such incidents to occur and a concern that HUD needed congressional attention led us to decide in January 1994 that the Department warranted the focused attention that comes with being designated as a GAO "high-risk area."²

Similar HUD management deficiencies have been reported by HUD's Office of Inspector General (OIG) and by the National Academy of Public Administration (NAPA). The OIG's most recent Semiannual Report to the Congress (for the period ending Sept. 30, 1994), states that management controls, resource management, and data systems continue to be systemic management problems requiring significant improvement before HUD can substantially improve its programs' abilities to delivery services and results. In addition to pointing out problems with HUD's organization, staff capacity, and information management and systems integration, NAPA noted that an overload of programs saps HUD's resources, muddles priorities, fragments the Department's work force, creates unmeetable expectations, and confuses communities. NAPA concluded that the process of rationalizing HUD's programs would provide the badly needed opportunity for the Congress and the administration to decide what HUD is supposed to do.

EXAMPLES OF MAJOR BUDGET AND MANAGEMENT PROBLEMS

The following three areas illustrate some of the budget and management challenges that face HUD. These areas are multifamily

²We identified areas throughout the government that are especially vulnerable to waste, fraud, abuse, and mismanagement and termed these "high risk areas."

assisted housing, public housing, and the high cost of public and assisted housing programs.

HUD's Multifamily Housing Portfolio: Status and Problems

HUD directly subsidizes and/or insures over 20,000 multifamily properties with about 2 million units. While much of this inventory reportedly is in decent condition, it has been estimated that at least 15 percent have severe physical problems that threaten tenants' health and safety. Also, for a large proportion of this housing, the government is paying more to house low-income families than it would if these families received tenant-based assistance³ in the form of certificates and vouchers to locate alternative privately-owned housing. Finally, these properties expose the federal government to substantial current and future financial liabilities.

A large portion of HUD's assisted housing liabilities derive from the use of FHA mortgage insurance, which protects lenders from financial losses stemming from borrowers' defaults. FHA insures about \$43 billion worth of mortgage loans that support about 14,700 properties.⁴ About \$32 billion of the insurance supports about 13,300 multifamily apartment properties. The other \$11 billion provides insurance on mortgage loans for more than 1,400 other projects such as nursing homes, hospitals, housing cooperatives, student housing, and condominiums. In addition to mortgage insurance, about three-fourths of all FHA-insured properties receive some form of direct assistance or subsidy such as below-market interest rates or section 8 project-based rental assistance from HUD.⁵

While demographic information on residents of FHA-insured multifamily properties is not generally available, a 1992 study conducted by a HUD contractor--Abt Associates--provides estimates on a subset of properties. According to the Abt study, very-low income households represented about 68 percent of the units. Elderly persons occupied about 33 percent of the units.

HUD also provides section 8 project-based assistance to properties that are not FHA-insured. According to HUD's data, HUD

³Tenant-based assistance is designed to allow lower-income families to live in private rental housing of their choice provided that units meet HUD's requirements for rent levels and housing quality standards.

⁴See also Multifamily Housing: Status of HUD's Multifamily Loan Portfolio (GAO/RCED-94-173FS, Apr. 12, 1994).

⁵Unlike tenant-based rental subsidies, project-based subsidies are attached to specific property units.

has 5,350 section 8 contracts with non-FHA-insured projects containing about 300,000 project-based assisted units.

HUD faces three fundamental and interrelated problems in overseeing the multifamily housing portfolio:

- First, a large number of defaults on FHA-insured loans have occurred in the past and are expected to continue into the future, partly because FHA has not effectively managed its insured loan portfolio. FHA paid out over \$700 million in multifamily insurance claims in 1993 and established a reserve of \$10.3 billion to cover additional losses on loans in the insured multifamily portfolio as of September 30, 1993. This reserve would have been even higher without the prospect of continuing section 8 project-based and other types of assistance used to prevent or delay loan defaults. While some loan defaults are inevitable, early identification of troubled loans and prompt actions to address underlying problems are essential if defaults and resulting losses are to be minimized.

Numerous studies over the last two decades by Price Waterhouse, and HUD's Office of Inspector General, and us have identified weaknesses in HUD's default prevention activities. Many of the weaknesses identified were the same fundamental departmentwide deficiencies that we noted earlier in this statement. For example, HUD's automated data systems cannot be relied on to provide relevant, timely, accurate, or complete information and do not adequately support the early detection of problem loans. Also, not having enough loan servicers with the proper skills has hampered the performance of fundamental FHA activities, such as monitoring the insured loan portfolio and servicing loans on properties whose owners have defaulted on their mortgages. Furthermore, field office physical property inspections, financial statement reviews, and on-site management reviews have not been performed in a way that consistently identifies and resolves problems.⁶

- Second, in many cases, the cost to the federal government of providing section 8 project-based subsidies is excessive. Specifically, about three-fourths of the almost 10,000 section 8 New Construction and Substantial Rehabilitation properties receive rents exceeding those in the marketplace.⁷ Furthermore, owner neglect is making matters worse. A 1992 study estimated

⁶We are currently reviewing FHA default prevention activities as part of a legislatively-mandated study.

⁷The section 8 New Construction and Substantial Rehabilitation programs provided assistance to private developers to construct new units or to substantially rehabilitate existing units for rental to low- and moderate-income families.

that about 3,200 HUD-assisted and/or insured properties were in such severe physical and financial condition that they needed almost \$1 billion in new capital to correct those problems. Some of these properties were the subject of hearings held last year at which both the HUD Inspector General and we testified.⁸ We pointed out that while the condition of properties we visited ranged from very good to very poor, some families were housed in units with leaking toilets and sinks, exposed electrical wiring, holes in walls and ceilings, inoperative air conditioners and smoke detectors, missing and broken kitchen cabinets, and evidence of roach and rodent infestation. Again, because of the management deficiencies previously cited, HUD does not know either the full extent of these conditions or all the properties with such conditions.

Furthermore, while HUD has various enforcement tools to ensure that owners maintain HUD-assisted properties in compliance with housing quality standards and other requirements, HUD has used these tools sparingly and inconsistently. Also, current legislation and regulations limit HUD's discretion in dealing with certain properties in its multifamily portfolio. For instance, current property disposition legislation generally requires that HUD preserve the housing so that it remains available to and affordable for low-income persons.

- Third, as discussed later, subsidy costs associated with project-based section 8 assistance are already high and rising.

Public Housing: Budget and Management Issues

Under current law, HUD provides subsidies to public housing agencies to modernize and pay a portion of the costs to operate their public housing projects. In recent years funding in both of these areas has increased significantly. However, problems still remain because of billions of dollars in backlogged modernization needs, increased public housing vacancy levels, and declining tenant incomes.

HUD's public housing program provides homes for about 1.4 million very-low-income individuals and families, more than a third of whom are elderly or have disabilities. The replacement value of this housing stock is estimated at about \$90 billion. Although about 60 percent of all public housing is more than 25 years old, much of the stock is still in good condition. Nonetheless, HUD

⁸Federally Assisted Housing: Conditions of Some Properties Receiving Section 8 Project-Based Assistance Is Below Housing Quality Standards (GAO/T-RCED-94-273, July 26, 1994) and Federally Assisted Housing: Expanding HUD's Options for Dealing with Physically Distressed Properties (GAO/T-RCED-95-38, Oct. 6, 1994).

currently spends nearly \$8 billion annually to operate and modernize this housing.

The poverty in public housing (median income of around \$7,500) is due in large part to housing laws that require housing agencies to give higher priority (called preferences⁹) to anyone who is homeless, is paying more than half of his/her income for rent and utilities, is living in substandard housing, and/or has been involuntarily displaced. Furthermore, these laws restrict housing agencies from admitting more than a set proportion of tenants whose incomes exceed 50 percent of the area's median income.

The financial impact that the poverty of public housing residents has on managing public housing increases the need for an operating subsidy from HUD. Operating subsidies are intended to make up the difference between reasonable public housing expenses and rental income, but housing agencies are generally limited by federal law to charging residents 30 percent of their income for rent. However, tenants' income has not grown nearly as fast as operating expenses so operating subsidies have increased steadily. In addition, since priority for admission to public housing is given to the poorest of the poor, operating subsidies grow even more. In the last 5 years operating subsidy costs have increased by \$1 billion, from \$1.9 billion in 1990 to \$2.9 billion in 1995 (both amounts in nominal dollars).

Public housing expenses are also growing because of increasing and poorly managed vacant units. Vacant public housing is costly and inefficient. It provides no rent revenue to housing agencies to offset their operating costs, and a lack of revenue leads to housing agencies' needs for higher operating subsidy payments from HUD. Generally, a unit of vacant housing means that an income-eligible family on the waiting list is not receiving it.

Since 1984, the average vacancy rate in public housing has increased from 5.8 percent to 8 percent. This 8 percent average, however, masks the conditions at some large housing agencies in which uninhabitable buildings caused the vacancy rate to range from 15 to 41 percent. In our ongoing survey, we contacted 41 housing agencies that had developments that were 70-percent-or-more vacant. Of these, we identified 1,177 totally vacant buildings. In addition to the estimated \$200 million subsidy cost of the 100,000 vacant units nationwide, vacant buildings exact a high toll in drug-related crime and vandalism. We plan to issue a report discussing housing agencies' need for more flexibility in replacing deteriorated housing and will provide a copy to you.

With demand in most cities exceeding supply, why are vacancy rates in public housing so high? Aside from legitimate reasons for

⁹Similar preferences also apply to section 8 housing.

vacancies, such as major rehabilitation work, we found that the primary reason was the lack of an effective maintenance program. This clearly has local management implications and spans several problems frequently associated with public housing maintenance, including a lack of preventive maintenance, an inability to spend modernization funds in a timely manner, and little accountability for maintenance at the development level. However, it also indicates that improvements in the quality of HUD's oversight function are necessary, and we will address this issue shortly.

Our final example of public housing cost increases is in the area of modernization funding for major rehabilitation projects.¹⁰ Despite almost \$15 billion in funding for modernization since 1981, a backlog estimated to be at least \$20 billion still exists. Some estimates put the backlog as high as \$28 billion. And needs continue to accrue.

Over the years, the Congress has provided HUD with significant authority for overseeing and, if necessary, intervening into the management of a housing agency. However, many of the same housing developments and agencies continue to be plagued with poor conditions and poor management. HUD calls these agencies "troubled housing agencies." According to HUD officials, from 1979 through 1994, seven large housing agencies have consistently failed HUD's management performance evaluations. However, in recent months, two housing agencies were removed from this "troubled" list. These agencies account for almost 9 percent of the total public housing stock. Although HUD can intervene in the management of such housing agencies, it has seldom used this authority.

HUD's oversight methods have been criticized for focusing too much on the administration of public housing programs and not enough on the condition of the units or management of the housing agencies. Critics of HUD's oversight strategy have stated that it does not ensure that housing agencies use federal funds to improve the condition and management of the housing units. As a result, long-standing, unacceptable conditions continue, and the public perceptions of the program have grown increasingly negative. We are currently conducting work related to HUD's oversight of troubled public housing and will keep you informed of our progress.

¹⁰Public Housing: Information on Backlogged Modernization Funds (GAO/RCED-94-217FS, July 15, 1994).

High Cost of Public and Assisted Housing Programs

Since 1977, the number of families assisted by HUD's rental subsidy programs have increased by over 2 million.¹¹ However, the cumulative effect of this action and the high cost of providing subsidies creates severe budget pressures on the Congress as it tries to meet deficit reduction goals.

According to the Congressional Budget Office¹² (CBO), both the number of families that receive rental assistance and the federal outlays for those subsidies have increased almost every year since 1977. According to CBO, the number of assisted families almost doubled from 1977 through 1994, rising from about 2.4 million to about 4.7 million. Growth has generally slowed in later years because the Congress has provided funds for fewer additional units. Outlays for rental assistance have also increased steadily since 1977. According to CBO, real outlays (adjusted for inflation) more than tripled from 1977 through 1994, rising from about \$6.6 billion to about \$22 billion (in 1994 dollars). Outlays are expected to remain at the same current high level, if not grow somewhat. The relatively rapid growth in outlays is primarily due to (1) increases in the number of assisted households and (2) rents that increased faster than assisted families' incomes.

What does the high cost of public and assisted housing programs mean for HUD? For one thing, absent a major change in federal housing policy, many of the housing programs have now reached the point where they need additional budget authority to preserve the number and quality of the rental units that current programs assist.¹³ Budget authority needs are directly related to certain assumptions, such as the length of the term of the section 8 contracts being renewed. Assuming a 5-year renewal period, CBO has estimated that the cost of preserving existing units will be about \$22 billion in budget authority per year. As the Congress faces increasing pressure to reduce the deficit, these large

¹¹These programs include public housing, section 8 tenant-based and project based assistance, and section 236 assistance (generally subsidized interest payments to help produce rental housing).

¹²Congressional Budget Office, The Challenges Facing Federal Rental Assistance Programs (Dec. 1994).

¹³Budget authority would be needed for several purposes, including (1) extending the life of assistance contracts that have started to expire, (2) providing incentives to owners of certain assisted housing projects to prevent them from dropping out of federal housing programs, (3) disposing of projects whose owners have defaulted on their federally insured mortgages, (4) continuing operating subsidies for public housing, and (5) reducing the accumulated backlog of repairs to the assisted housing stock.

figures present difficult choices for policymakers when considering competing needs.

HUD'S PROGRESS IN IMPLEMENTING MANAGEMENT REFORMS

Even after years of reform, HUD continues to face the severe organizational, staff capacity, internal controls, and information and financial management problems that were discussed earlier in our statement. HUD has started to correct these long-standing deficiencies and will need congressional action to implement some reforms. HUD's top management team has focused much attention and energy on overhauling the way the Department is operated. HUD has formulated a new management approach and philosophy, intended to balance risks with results; has begun to implement a substantial field reorganization; and has initiated a number of other actions that begin to address its four fundamental management deficiencies.

HUD has also proposed or taken actions to address the problems affecting its multifamily and public housing programs that I discussed earlier in this statement. For example, the Department has

- initiated actions to improve its multifamily default prevention capabilities, such as contracting out for property physical inspections and financial statement reviews and taking steps to develop an early warning system that should better identify financially-troubled properties and
- proposed that housing agencies be permitted to borrow against future years' modernization grants, use their modernization funds to replace demolished housing, and participate in a more performance-based oversight activity that focuses on community partnerships to solve housing problems.

However, HUD now faces the formidable challenges of completing its plans, translating its plans into effective actions, and implementing its new management approach into the fabric of the Department's day-to-day operations. Sustained focus, commitment, and diligence by all HUD managers and employees will be needed-- something that has not accompanied past attempts at reform, and that was recently reported as a concern by HUD's Inspector General. Also, within the last month, we have seen the "HUD Reinvention Blueprint," which would radically restructure and consolidate the Department's programs. Laying the massive changes envisioned under the blueprint on top of the mission-driven/customer-oriented changes currently underway creates a daunting set of challenges. It will take years to accomplish. HUD will be required to manage existing programs as well as design and transition to its reinvented form. Major reforms will likely place additional strains on the Department as HUD attempts to move from where it is to where it and the Congress want HUD to be.

THE FUTURE OF HUD

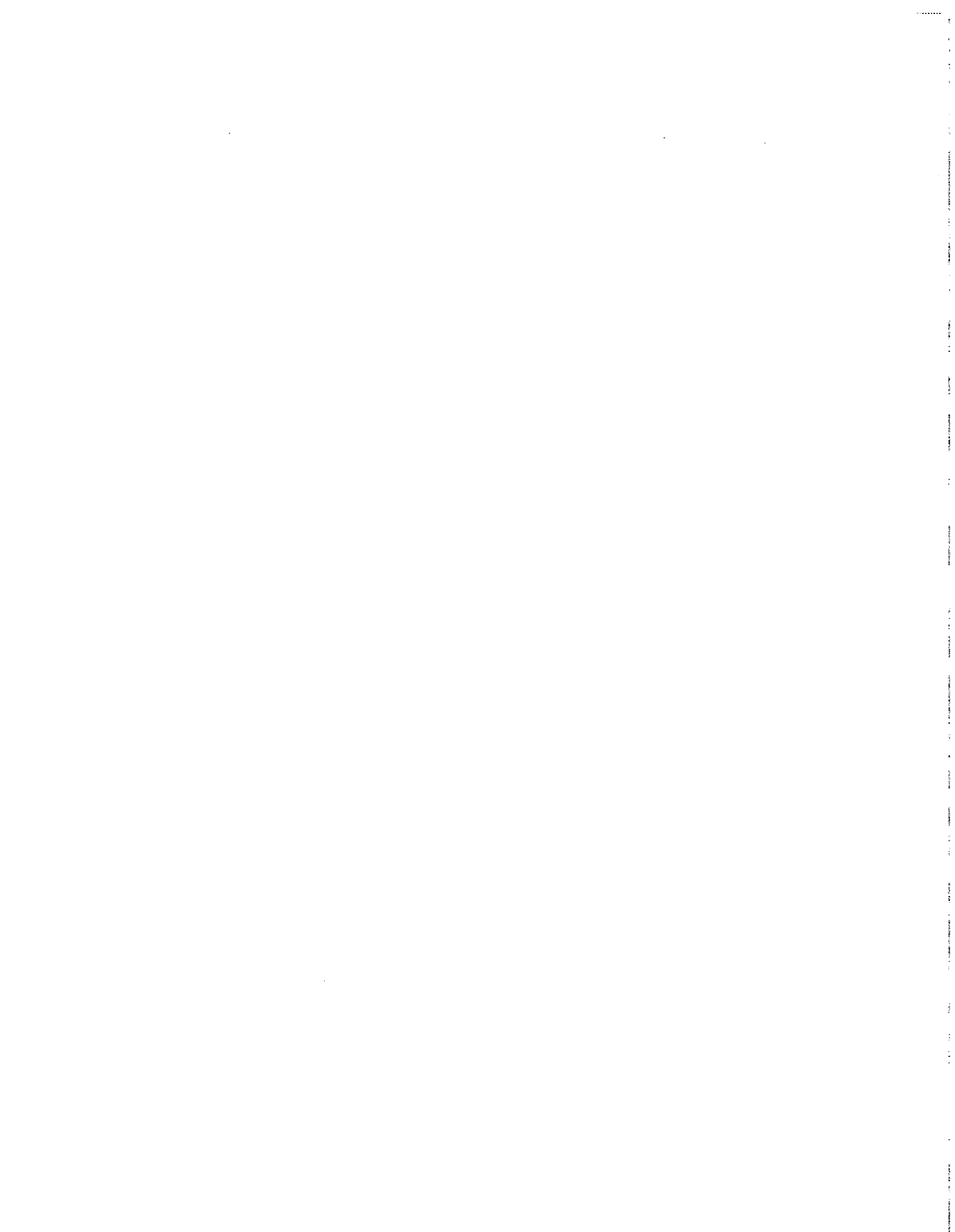
Just as the problems that we have discussed today did not arise overnight, they certainly will not be resolved overnight. Because of the magnitude of the commitments that HUD has made in assisting lower-income families, home buyers, distressed communities, and others, any "fixes" will neither be quick nor easy no matter which path to reform is taken. Recently discussions and proposals have pointed to the need to fundamentally redesign HUD and rethink housing policies. Any redesign must recognize that HUD has massive financial responsibilities, insuring or guaranteeing loans and providing housing assistance totaling about one trillion dollars.

In developing and implementing any redesign effort, it will be a formidable task to balance business, budget, and social goals. The first step in this effort should be an agreement on HUD's mission. The next steps should include clear performance expectations and agreed-upon milestones from which to judge progress in meeting those expectations. Furthermore, those expectations should include the building of HUD's infrastructure, designed to provide the Congress and the Department with quality information on which to base sound public policy. Without good baseline and ongoing program data, neither the Congress nor HUD will have the information essential to assess the implications of any redesign or the ability to accurately judge progress.

* * * * *

Mr. Chairman, this concludes our prepared remarks. We will be pleased to answer any questions that you and other members of the subcommittee might have. We would also be pleased to provide the Subcommittee with additional information and analyses to assist in its deliberations.

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