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Report to Congressional Committees

December 2010

NEIGHBORHOOD STABILIZATION PROGRAM

HUD and Grantees Are Taking Actions to Ensure Program Compliance but Data on Program Outputs Could be Improved

GAO

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GAO-11-48

GAO Accountability • Integrity • Reliability

Highlights

Highlights of GAO-11-48, a report to congressional committees

Why GAO Did This Study

Congress created the Neighborhood Stabilization Program (NSP) to help reduce the number of foreclosed and abandoned properties and restore depressed local housing markets. The Housing and Economic Recovery Act of 2008 (HERA) authorized the program's first round (NSP 1), providing $3.92 billion in grant funds to states and local governments. The Department of Housing and Urban Development (HUD) administers the program. HERA mandated that GAO report on whether grantees were using NSP 1 funds in accordance with the act's criteria. For this mandate, GAO examined (1) grantees' progress and challenges in meeting NSP 1 obligation and income-targeting requirements, (2) HUD's actions to mitigate program risks and ensure grantees' compliance with key NSP 1 requirements, and (3) HUD's efforts to collect program data and assess program performance. To address these objectives, GAO analyzed HUD data and the information system used for NSP 1; interviewed HUD officials and representatives of NSP 1 grantees; analyzed HUD's internal control processes; and conducted limited tests of 8 grantees' compliance with key NSP 1 requirements.

What GAO Recommends

GAO recommends that HUD provide additional guidance to NSP grantees and HUD field staff to help ensure that information on output measures is collected in HUD's data system in a more consistent manner. HUD agreed with the report's recommendations.

View GAO-11-48 or key components.
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NEIGHBORHOOD STABILIZATION PROGRAM

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What GAO Found

According to HUD data, the vast majority of the 309 NSP 1 grantees obligated their funds within the required 18-month time frame. As a result, over 99 percent of NSP 1 funds were obligated as of early October 2010. Also, consistent with HERA criteria, most grantees obligated at least 25 percent of their funds for housing for low-income households. Some grantees with whom GAO spoke modified their NSP 1 strategies to meet obligation deadlines and overcome other challenges such as competition from private investors in acquiring foreclosed and abandoned homes. For instance, with HUD approval, some grantees expanded the geographic areas they were targeting. Grantees also participated in banks' "first look" programs, which give grantees the chance to bid on bank-owned properties before other potential buyers.

HUD provided training, guidance, and technical assistance to grantees to address new requirements and risks posed by NSP 1. Although the grantees GAO spoke with were generally satisfied with HUD's guidance and program support, some said these efforts would have been more useful if provided earlier. HUD officials said that some of the assistance grantees found useful was delivered using funds that HUD received well after the start of NSP 1. HUD also established various internal control processes for NSP 1 and hired additional staff to help oversee the program. HUD field office staff conducted remote monitoring of all grantees and on-site monitoring for 176 grantees that HUD considered to be higher risk. Although HUD is still aggregating the results of its on-site monitoring, available results from the four field offices GAO contacted generally showed compliance with key NSP 1 requirements but also found some financial management deficiencies. HUD is requiring grantees to take corrective actions, where appropriate. GAO's review of records for 32 properties at 8 grantees found no instances of significant noncompliance with key NSP 1 requirements.

To collect information on NSP 1, HUD adapted an existing financial and information system—the Disaster Recovery Grant Reporting (DRGR) system—and provided training and guidance on its use. HUD has used the system to monitor NSP 1 grantees' obligations and summarize program outputs for specific types of activities (rehabilitation and construction, demolition, and homeownership assistance). However, variation in the way grantees entered information into DRGR makes it difficult to summarize outputs for each activity (e.g., housing units acquired) without undercounting, and overall outputs (e.g., total benefiting households) without overcounting. HUD has developed a method for addressing the overcounting problem, but insufficient guidance to grantees and HUD field staff may be contributing to variation in data entry that limits the usefulness of DRGR output information. For example, HUD has not provided grantees with specific written guidance on selecting output measures, which can lead to inconsistency among grantees. HUD is planning an assessment of NSP outcomes that will focus primarily on the program's second round (NSP 2) but will also include NSP 1 in geographic areas where the two phases of the program overlap.

Contents

Abbreviations

AMI	area median income
ARRA	American Recovery and Reinvestment Act of 2009
CDBG	Community Development Block Grant
CPD	Office of Community Planning and Development
DRGR	Disaster Recovery Grant Reporting
FERA	front-end risk assessment
HERA	Housing and Economic Recovery Act of 2008
HUD	Department of Housing and Urban Development
NOFA	Notice of Funding Availability
NCST	National Community Stabilization Trust
NSP	Neighborhood Stabilization Program
OIG	Office of the Inspector General
PD&R	Office of Policy Development and Research
QPR	Quarterly Performance Report

United States Government Accountability Office
Washington, DC 20548

December 17, 2010

The Honorable Christopher J. Dodd
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Barney Frank
Chairman
The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
House of Representatives

In recent years, declining home prices and weak economic conditions have contributed to a surge in vacant and foreclosed properties that has negatively impacted many communities across the United States. Such properties can destabilize neighborhoods by lowering the value of surrounding homes and attracting crime. They also can impose costs on communities, for example by reducing property tax revenue and straining the resources of local police and code enforcement offices. To address these issues, Congress created the Neighborhood Stabilization Program (NSP), which provides grants to states and local governments to help reduce the number of foreclosed and abandoned properties and restore depressed local housing markets. The first phase of this program, NSP 1, was authorized by the Housing and Economic Recovery Act of 2008 (HERA), which provided $3.92 billion in grant funds.[1] The program is administered by the Department of Housing and Urban Development (HUD) through its existing Community Development Block Grant (CDBG) program.[2] In October 2008, HUD allocated NSP 1 funds to 309 CDBG

[1]P.L. 110-289. The American Recovery and Reinvestment Act of 2009 (P.L. 111-5) provided an additional $2 billion in NSP funds (referred to as NSP 2) and changed several aspects of the program. Later, the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) enacted in July 2010 provided an additional $1 billion in funding for the program (referred to as NSP 3). This report focuses on NSP 1.

[2]The CDBG program was first established in 1974 and is one of the federal government's largest and most flexible community and economic development programs. CDBG funds may be used to rehabilitate housing, improve infrastructure, provided job training, and fund other community-determined projects.

grantees, including all 50 states.[3] Under NSP 1, state grantees may use funds directly or reallocate them to local governments within their states.

HERA defines a variety of "eligible uses" of NSP 1 funds to allow grantees to address issues associated with foreclosed and abandoned properties. For example, grantees may choose to acquire and rehabilitate properties for rental or resale, or demolish blighted structures. HERA also imposed several key requirements governing the use of NSP 1 funds. For example, grantees must use the funds in "areas of greatest need" within 18 months of receiving them from HUD; for this requirement, HUD interpreted "use" to mean obligate. In addition, HERA required that all NSP 1 funds benefit households with incomes at or below 120 percent of area median income (AMI), and at least 25 percent of the funds benefit households with incomes at or below 50 percent of AMI; for the 25 percent requirement, HUD interpreted "use" to mean expended.

HERA mandated that GAO conduct periodic audits of whether NSP 1 funds are being used in a manner consistent with criteria set forth in HERA. This review examines (1) grantees' progress and challenges in meeting HERA obligation time frames and income-targeting criteria, (2) HUD's actions to mitigate program risks and ensure grantees' compliance with key NSP 1 requirements, and (3) HUD's efforts to collect program data and assess program performance.

To review grantees' progress and challenges in meeting HERA obligation time frames and income-targeting criteria, we analyzed HUD data on program obligations and grantees' uses of funds. We reviewed state grantees' action plans and reports on NSP 1 activities to determine the methods states used to distribute NSP 1 funds to subrecipients, and the factors they considered in making these decisions. We analyzed Disaster Recovery Grant Reporting (DRGR) data to determine the extent to which the subrecipients also received NSP 1 funds directly from HUD. We spoke with selected grantees to discuss their approaches to using NSP 1 funds and the challenges they faced in implementing the program.

To determine the actions HUD has taken to mitigate program risks and ensure grantees' compliance with key NSP 1 requirements, we reviewed

[3] Funds went to 50 states, 4 insular areas, Puerto Rico, the District of Columbia, and 253 county and city governments. The four insular areas are American Samoa, Guam, Northern Marianas, and the Virgin Islands.

NSP 1 regulations and guidance, examined HUD's efforts to oversee the use of NSP 1 funds and provide technical assistance to grantees, and interviewed HUD headquarters and field office officials and representatives of selected grantees. In addition, we reviewed HUD's guidance and procedures for monitoring grantee compliance with program requirements and obtained and summarized on-site monitoring results (as of September 15, 2010) from four HUD field offices responsible for overseeing grantees we visited. We also conducted limited tests of selected grantees' compliance with key NSP 1 requirements and relevant internal controls through reviews of property-level records of completed NSP 1 activities (see discussion of site visits below). Additionally, we spoke with staff from the HUD Office of the Inspector General (OIG) about their NSP-related audits and reviewed the results of their completed audits.

To review HUD's efforts to collect program data and to assess the reliability of the data, we reviewed HUD OIG audits of the information system HUD adapted for NSP 1 (the DRGR system) and HUD documentation and guidance for using the system. We also interviewed HUD and grantee staff responsible for entering and monitoring DRGR data. We also assessed the reliability of the DRGR information we used by conducting reasonableness checks to identify any missing or erroneous data and by interviewing knowledgeable HUD officials to ensure we interpreted the data correctly. For the purpose of this and the first objective, we concluded that the data we used were sufficiently reliable for our purposes. To review HUD's efforts to assess program performance, we interviewed HUD's Office of Policy Development and Research and Office of Community Planning and Development (CPD) staff knowledgeable of a planned NSP assessment.

To address all of our objectives, we interviewed representatives from 18 NSP 1 grantees. We interviewed a group of 11 grantees selected to represent different housing markets, grant amounts, and grantee types to discuss their approaches for using NSP 1 funds, progress they had made, and challenges they faced in implementing the program. We conducted site visits at another group of 8 grantees selected to represent a variety of completed NSP 1 activities, types of grantees, and geographic areas.[4] To avoid overburdening grantees, we focused our site visits on grantees that, on the basis of information from HUD, were not receiving extensive

[4]One grantee was included in both of these groups.

technical assistance or being monitored on-site by HUD staff. At these sites, we interviewed grantee staff to obtain information on their processes for complying with NSP 1 requirements and internal control procedures, and reviewed property-level records of completed NSP 1 activities. We also interviewed staff from four HUD field offices: Columbus, Ohio; Miami, Florida; Philadelphia, Pennsylvania; and San Francisco, California. Appendix I contains a more detailed description of our scope and methodology and a list of NSP 1 grantees we contacted.

We conducted our work in two phases. We did our initial audit work (April through December 2009) in Washington, D.C., and at 15 sites across the United States, including Florida, Indiana, Maryland, Nevada, Pennsylvania, and Virginia. This work resulted in briefings to your staff in December 2009 on the status of HUD's and grantees' initial implementation of NSP 1. The second phase of our NSP 1 work was conducted in Washington, D.C., and at 8 sites across the United States, including locations in Arizona, Florida, Ohio, Pennsylvania, and Virginia from January through December 2010. This report focuses on the results of our audit work during the second phase. We conducted all of our NSP 1 work in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions.

Background

Congress established NSP to try to reduce inventories of foreclosed homes by providing funding to state and local governments to, among other things, acquire and rehabilitate or demolish foreclosed and abandoned homes. HERA allows grantees to use NSP 1 funds to

- establish financing mechanisms for the purchase and redevelopment of foreclosed homes and residential properties;
- purchase and rehabilitate homes and residential properties that have been abandoned or are in foreclosure in order to sell, rent, or redevelop them;
- establish land banks for foreclosed homes and residential properties;

- demolish blighted structures; and
- redevelop demolished or vacant properties.[5]

Land banks are governmental or nongovernmental nonprofit entities established, at least in part, to assemble, temporarily manage, and dispose of vacant land for the purpose of stabilizing neighborhoods and encouraging reuse or redevelopment of urban property. Land banks often acquire properties through tax foreclosures, intergovernmental transfers, nonprofit transfers, and open-market purchases but can also acquire them through foreclosure.

In addition to these five eligible uses, HERA outlined the following key requirements for using NSP 1 funds, as follows:

1. All NSP 1 funds must be used within areas of greatest need as determined by grantees on the basis of the following factors:

- percentage of foreclosures,
- percentage of homes financed by subprime loans, and
- likelihood of a significant rise in the rate of foreclosures.

2. All NSP 1 funds must be used to benefit households with incomes at or below 120 percent of AMI.
3. At least 25 percent of NSP 1 funds must benefit households with incomes at or below 50 percent of AMI.
4. The sale, rental, or redevelopment of abandoned and foreclosed homes must remain affordable to the above income groups for the longest feasible term.
5. All NSP 1 funds must be used (obligated) by grantees within 18 months of their receipt.

[5]NSP 1 grantees may redevelop demolished or vacant properties for residential and nonresidential uses, commercial use, or mixed residential and commercial use. The American Recovery and Reinvestment Act limits redevelopment of such properties under NSP 2 and NSP 3 to residential purposes.

6. All properties must be acquired at a discount established by HUD.

7. If a property is sold to an individual as a primary residence, the sale price cannot be more than the total acquisition and redevelopment costs.

In October 2008, HUD issued guidance on implementing NSP 1 in a Notice in the *Federal Register*.[6] With respect to the requirement that NSP 1 funds be used within 18 months, HUD stated, “funds are used when they are obligated by a state, unit of general local government, or any subrecipient thereof for a specific NSP activity; for example the acquisition of a specific property.” According to the Notice, funds are considered to be obligated for an activity when orders are placed, contracts are awarded, and goods and services are received. HUD specified that funds are not obligated for an activity when subawards (for example, grants to subrecipients or units of local government) are made. The Notice also stated that grantees must expend their NSP 1 funds within 4 years of receipt. In accordance with HERA, HUD established a required discount rate that would apply to any property acquired through NSP 1. Initially, HUD set the discount at 15 percent for grantees’ total acquisition portfolios but subsequently reduced it to 1 percent per property acquired.[7] HUD reduced the required discount to provide grantees with more flexibility in acquiring foreclosed properties and to avoid the potentially adverse impact of discounts on neighborhood property values. Among other provisions, HUD required that each NSP-assisted homebuyer complete at least 8 hours of homebuyer counseling.

HUD also required that NSP 1 grantees submit “NSP 1 action plans” in the form of substantial amendments to their existing CPD consolidated plan.[8] HUD required grantees to identify in these plans areas of greatest need within their states or communities, approaches for implementing NSP 1 and expected program outputs, and plans for complying with key requirements. After grantees submitted these plans and HUD approved them, HUD executed grant agreements for NSP 1.

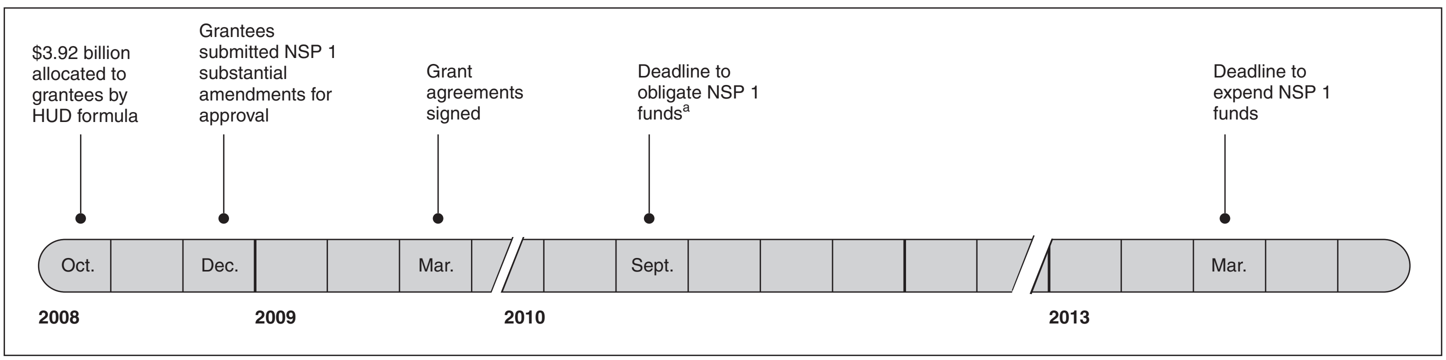
[6] 73 Fed. Reg. 58330 (Oct. 6, 2008).

[7] 74 Fed. Reg. 29225 (June 19, 2009).

[8] CPD requires grantees to submit consolidated plans covering up to four of its major grant programs: CDBG, HOME Investment Partnerships, Emergency Shelter Grants, and Housing Opportunities for Persons with AIDS.

NSP 1 implementation has a tight time frame (see fig. 1). For instance, HUD had to establish its formula for allocating funds 60 days after the enactment of HERA. As HERA linked NSP 1 to CDBG, HUD was able to take advantage of the administrative infrastructure of one of the federal government's largest and most flexible community and economic development programs. Established in 1974, CDBG provides states and local entitlement communities—eligible metropolitan cities and counties—with funding to address locally determined community and economic development priorities.[9] CDBG funds may be used to rehabilitate housing, improve infrastructure, provide job training, and fund other community-determined projects.[10]

Figure 1: NSP 1 Implementation Time Line



Source: GAO analysis of HUD information.

[a]A grantee's specific deadline depended on the date it received NSP 1 funds from HUD, so obligation deadlines varied among grantees. According to HUD, 300 NSP 1 grantees had obligation deadlines expiring in September 2010. The obligation deadlines for the remaining grantees were some time in August, October, or November 2010.

In accordance with the time frames and criteria established by HERA, in October 2008 HUD allocated NSP 1 funds using formulas based on the number and percentage of the following:

[9]Generally, entitlement communities are (1) principal cities of metropolitan areas, (2) other metropolitan cities with populations of at least 50,000, and (3) qualified urban counties with populations of at least 200,000 (excluding the population of entitled cities).

[10]Some examples include the building of community centers or firehouses, or repairing sewage treatment plants.

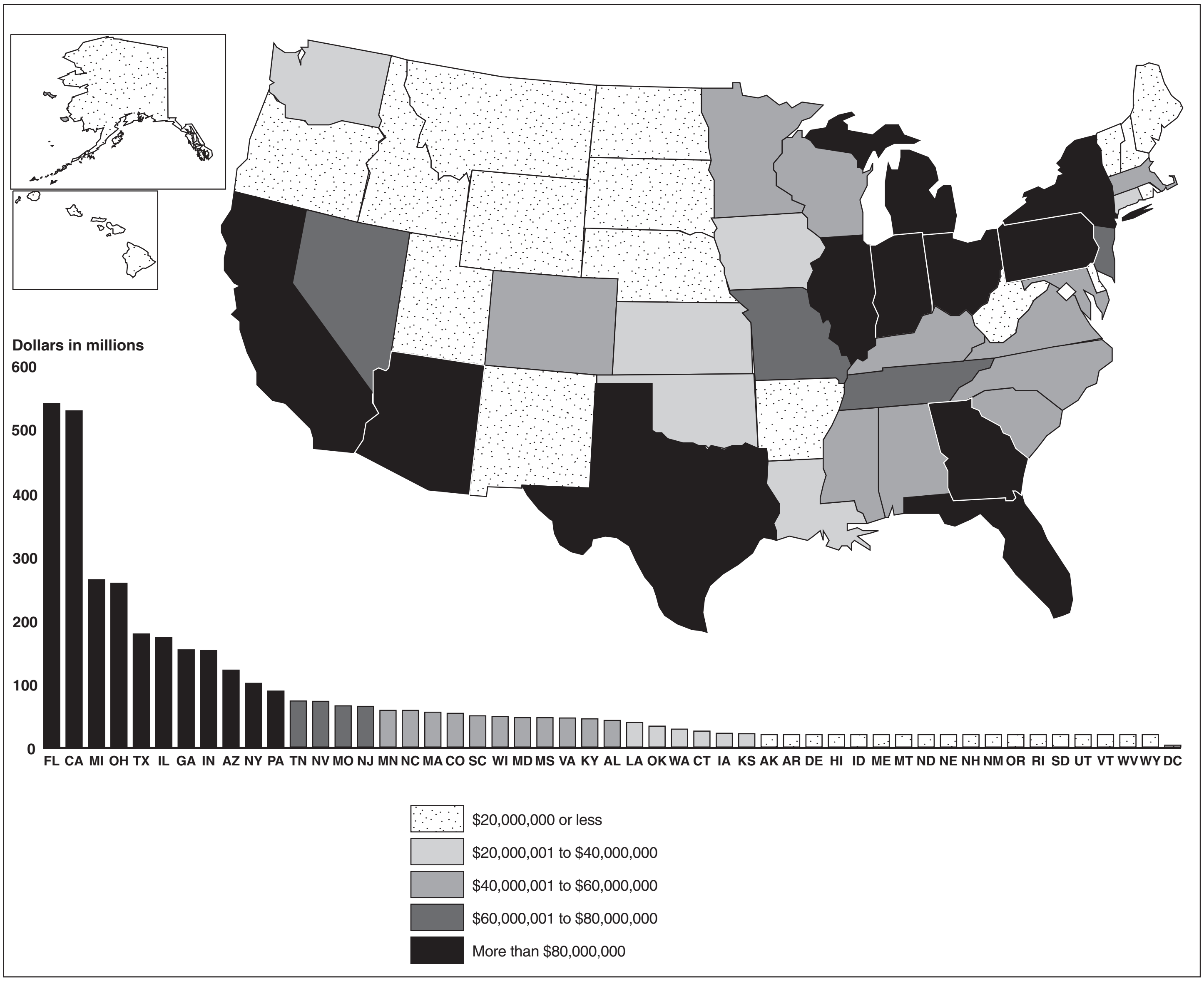
- foreclosed homes in each state or locality,
- subprime mortgages in each state or locality, and
- homes in default or delinquency in each state or locality.[11]

As required by HERA, all 50 state governments and Puerto Rico received an allocation of at least $19.6 million. HUD also allocated NSP 1 funds to local (city and county) governments.[12] Figure 2 shows the total state and local government allocations for each state.

[11]HERA required HUD to establish a formula for allocating NSP 1 funds to states and eligible local governments no later than 60 days after the law's enactment and to distribute these funds no later than 30 days after establishing the formula.

[12]For details on HUD's methodology for allocating funds to state and local governments, see 73 Fed. Reg. 58343-9 (Oct. 6, 2008).

Figure 2: Total NSP 1 State and Local Government Allocations, by State



Source: GAO analysis of HUD data.; MapInfo.

HUD CPD is implementing NSP 1. CPD administers CDBG and other formula and competitive grant programs from its offices at HUD headquarters and 43 field offices located throughout the United States. The headquarters office sets program policy, while field office staff are responsible for a wide range of grant management activities, including annual reviews and approval of grantee action plans, execution of grant agreements, and monitoring of grant recipients. CPD's monitoring of the CDBG program focuses on high-risk recipients. Each year, CPD sets a formal monitoring goal. For fiscal year 2010, the overall goal for CPD and each of its field offices was to monitor a minimum of 870 formula and competitive grant recipients. For each CPD program, field staff analyze potential risks for grantees in a number of areas, including: financial (size of grant, financial compliance), physical (physical control of assets), management (staff capacity), satisfaction (citizen complaints and grantee responsiveness), and services (meeting program objectives and progress).

HUD modified the DRGR system for the purposes of collecting and maintaining information on NSP activities. DRGR is new to NSP 1 grantees and HUD field staff unless they had prior experience with Disaster Recovery Assistance grants, another program managed by CPD.[13] In its NSP 1 Notice, HUD explained that no other reporting system was as flexible as DRGR and that statutory time frames did not allow sufficient time to develop a new system or modify an existing one to perfectly fit NSP. HUD's key modifications to DRGR included:

- adding data fields to collect information specific to NSP, such as land banking;
- removing drop-down menu selections for ineligible uses under NSP; and
- adaptations to enable grantees to designate whether properties had been resold or rented or were single- or multifamily.

DRGR was set up to monitor grantees' progress in implementing NSP 1 by tracking budgets, obligations, expenditures, and program outputs. DRGR also serves as a financial management system through which grantees obligate and draw down funds. At the beginning of NSP 1, grantees inputted their NSP 1 action plans into DRGR. In their actions plans in DRGR, grantees set up their budgets and performance measures for different DRGR activities that were linked to larger projects. The action plan serves as a template for required progress reports, or Quarterly Performance Reports (QPR), that grantees must submit to HUD field staff

[13]In response to disasters, Congress may appropriate additional funding for CDBG to provide disaster recovery grants to rebuild affected areas and provide seed money to start the recovery process.

on a quarterly basis. QPRs show updated information on NSP 1 progress for grantees' projects and activities listed in DRGR.

For each DRGR activity, NSP 1 grantees complete data fields that include (1) the projected start date, (2) the national objective (the income group the activity benefits), (3) the responsible organization (either the grantee or a subrecipient), and (4) the activity type (e.g., acquisition, rehabilitation, demolition).[14] For each DRGR activity, grantees must also include a narrative and output measures—for example, the number of housing units or properties acquired, rehabilitated, land banked, or demolished, or the numbers of households or persons benefiting from the activity. In addition, grantees must list the addresses of properties benefiting from the activity but are not required to include the amount of funds spent on each property in DRGR. In a June 2009 report, the HUD OIG concluded that DRGR was sufficient to collect the basic information that HUD needed to monitor NSP 1.[15] In a September 2009 report, the HUD OIG reviewed selected controls within DRGR in order to examine whether funds were properly safeguarded. While the OIG did not find misuse of funds in their review, they did identify several weaknesses, including access policies and testing of transactions, that CPD staff have been addressing.[16]

[14]Under the CDBG program, grantees' activities must meet one of three national objectives. They must either (1) benefit low- and moderate-income persons, (2) eliminate slums or blight, or (3) meet urgent needs. Under NSP, there is one national objective grantees' activities must meet—they must benefit low-, moderate-, and middle-income persons. Low-income is defined as 50 percent of AMI or lower, moderate-income as 51 percent to 80 percent of AMI, and middle-income as 81 percent to 120 percent of AMI. The middle-income category applies to NSP but not CDBG, which defines low- and moderate-income persons as those being at or below 80 percent of AMI.

[15]HUD Office of Inspector General (OIG), *HUD's Disaster Recovery Grant Reporting System Can Collect the Basic Information Needed to Monitor the Neighborhood Stabilization Program*, 2009-FW-0001 (Amended), June 25, 2009.

[16]HUD OIG, *Review of Selected Controls within the Disaster Recovery Grant Reporting System*, 2009-DP-0007, September 30, 2009.

NSP 1 Grantees Overcame Challenges and Used a Variety of Strategies to Meet Obligation and Income-Targeting Requirements

Most Grantees Met the Deadline for Obligating Funds

HERA required NSP 1 grantees to obligate all of their funds within 18 months, creating a September 2010 deadline for most grantees.[17] In order to obligate their funds, grantees had to satisfy certain conditions, including providing a specific property address and (where applicable) a detailed scope of work for rehabilitating, constructing, or demolishing a property. According to HUD guidance, grantees are considered to have obligated NSP 1 funds once they have placed orders, awarded contracts, received goods and services, or executed similar transactions that will require payment by the grantee. For example, funds for acquiring a property are considered obligated when the property seller accepts the grantee's purchase offer.

Data in DRGR indicate that the vast majority of the 309 NSP 1 grantees met their deadline for obligating funds.[18] As a result, more than 99 percent of NSP 1 funds were obligated as of October 1, 2010. Figure 3 shows grantees' progress toward meeting obligation deadlines as of June 24, 2010 (about 3 months prior to most grantees' deadlines), compared with their progress by their deadlines. As of the earlier date, 27 grantees had obligated an amount equal to 100 percent of their total NSP 1 grant funds. In contrast, 275 grantees had obligated 100 percent by October 1, 2010—at which point the vast majority of grantee's deadlines had passed— and 29 had obligated between 80 percent and 99.9 percent. These figures are

[17]As discussed previously, a grantee's deadline depended on the date it received NSP 1 grant funds from HUD, so obligation deadlines varied among grantees. HUD officials confirmed that the majority of obligation deadlines expired in September 2010.

[18]HUD made NSP 1 grant allocations to 309 units of state and local government. However, there are only 307 grant agreements because the State of Colorado and City of Colorado Springs (Colorado) entered into a cooperative grant agreement, as did Clark County and the City of Las Vegas (Nevada).

preliminary because HUD (1) gave grantees 30 days after their deadlines to ensure that all obligations prior to the deadline were recorded in DRGR and (2) is in the process of reviewing whether grantees' obligated their NSP 1 funds properly.[19] CPD staff told us that 1 business day after a grantee's obligation deadline passes, they are blocking the grantee's access to funds and reviewing samples of obligations to ensure they are proper. As of the end of September, HUD officials told us that field office staff had reviewed samples for 20 grantees and found no improper obligations. They plan to review all grantees for compliance with obligation guidance. Additionally, the OIG is reviewing obligations as part of its compliance audits of selected NSP 1 grantees.[20] In August 2010, HUD outlined a process for addressing a grantee's failure to meet its obligation deadline and anticipated that many such grantees would face a choice of entering into an agreement with HUD to use the remaining funds or having their funds recaptured.[21]

[19]As indicated in the NSP 1 Notice, HUD did not distinguish between obligation of grant funds and program income (e.g., income a grantee received from reselling a property) in assessing compliance with the 18-month requirement. Therefore, grantees met the requirement as long as they obligated grant funds and program income in an aggregate amount equal to their NSP 1 allocation. HUD officials said they took this approach so as not to penalize grantees that progressed faster in implementing NSP 1, potentially resulting in larger amounts of program income.

[20]In its audits of the State of Kansas and the City and County of Denver, the OIG concluded that these grantees had improperly obligated NSP 1 funds by reporting its funds as obligated without linking these funds to a specific address or household, as required. See HUD OIG, *The State of Kansas Did Not Properly Obligate Its Neighborhood Stabilization Program Funds*, 2010-KC-1006, August 20, 2010; and HUD OIG, *The City and County of Denver Did Not Properly Obligate and Report NSP 1 Funding*, 2010-DE-1006, September 17, 2010. However, several other OIG compliance audits found that the grantees generally complied with NSP 1 requirements.

[21]Depending on the grantee's NSP 1 performance and the amount of unobligated funds, HUD may enter into a memorandum of agreement with the grantee designed to enable use of the funds for the purposes intended in the NSP 1 Notice. See 75 Fed. Reg. 52772 (Aug. 27, 2010).

Figure 3: NSP 1 Grantees' Obligations as of June 24, 2010, and as of October 1, 2010

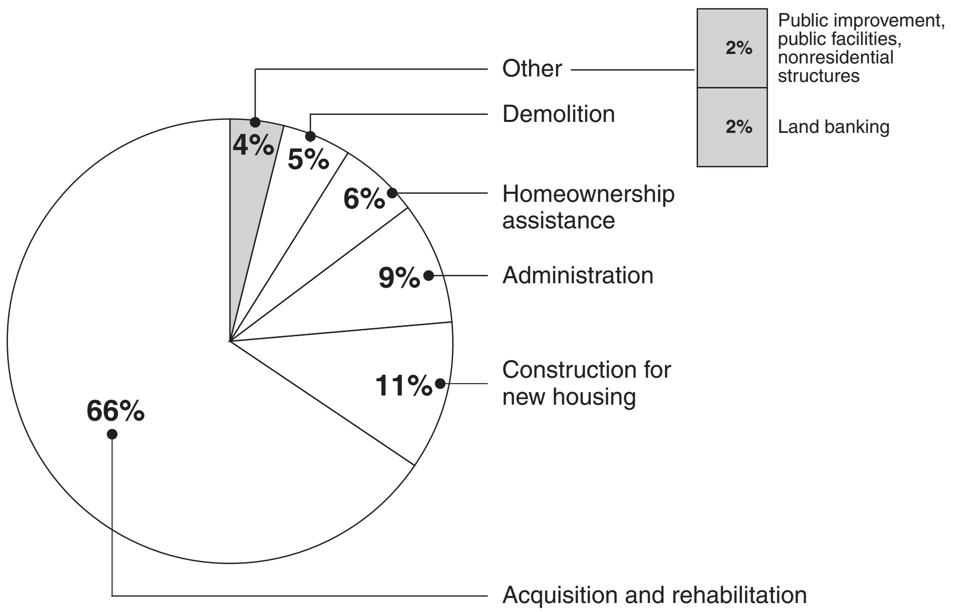
Percentage of funds obligated	Number of grantees: June	Number of grantees: Oct.
0% to 19.9%	18	0
20.0% to 39.9%	28	0
40.0% to 59.9%	70	1
60.0% to 79.9%	87	2
80.0% to 99.9%	77	29
100%	27	275
	307[a]	307[a]

Source: GAO analysis of HUD DRGR data.

[a]There are 307 entries representing 309 grantees in HUD's DRGR system because the State of Colorado reports information in DRGR for both the State and for the City of Colorado Springs, and Clark County reports information for both the County and the City of North Las Vegas (Nevada) under their cooperative grant agreements.

Figure 4 shows the percentage of grantee obligations that fell under different NSP 1 activities as of October 1, 2010. NSP 1 grantees obligated most NSP 1 funds for acquisition and rehabilitation, with smaller amounts obligated for other activities such as construction of new housing, demolition, and land banking.

Figure 4: Reported NSP 1 Grantee Obligations by Activity, as of October 1, 2010



Source: GAO analysis of HUD DRGR data.

Notes: The purpose of this graph is to show the relative magnitude of NSP 1 obligations by activity type. As discussed later in this report, some grantees may group multiple activities under a single activity type (for example, both acquisition and rehabilitation activities under rehabilitation) when entering obligation data into DRGR. Because this practice is most likely to occur when grantees enter data on acquisition and rehabilitation activities, we combined the data for these two activities. The "disposition" activity type is also likely to be included under rehabilitation, therefore we included obligations for disposition within the "acquisition and rehabilitation" grouping.

"Homeownership assistance" includes various types of homeownership assistance such as down-payment assistance and housing counseling for those applying for down-payment assistance.

Due to rounding, the percentages in the graphic add up to a total of 101 percent. Funds spent toward public services and relocation payments and assistance were not included in the graph because they each rounded to zero percent, as did the total amount of funds not yet obligated.

HUD data also show that 298 NSP 1 grantees obligated at least 25 percent of their grant funds for activities benefiting low-income households. As of October 1, 2010, the data indicate that, in total, grantees obligated 35.1 percent of funds set aside for activities that would benefit this group. This pattern is consistent with a HERA requirement that 25 percent of NSP 1 funds be used to benefit households at or below 50 percent of AMI. In the NSP 1 Notice, HUD stated that it will assess grantees' compliance with this provision prior to and at grant closeout on the basis of grantees' expenditures.

State Grantees Often Used a Combination of Methods to Distribute NSP 1 Funds within Their States

As discussed earlier, HUD made NSP 1 allocations to 309 units of government, including each of the 50 states. Collectively, the states received more than half of NSP 1 funds. States had some flexibility in how they chose to distribute NSP 1 funds but were required to target areas of greatest need. States could choose to use funds themselves through state-administered programs or could reallocate funds to local entitlement or nonentitlement communities within their areas of greatest need.[22] In their HUD-approved action plans, states had to identify areas of greatest need using factors that included the following:

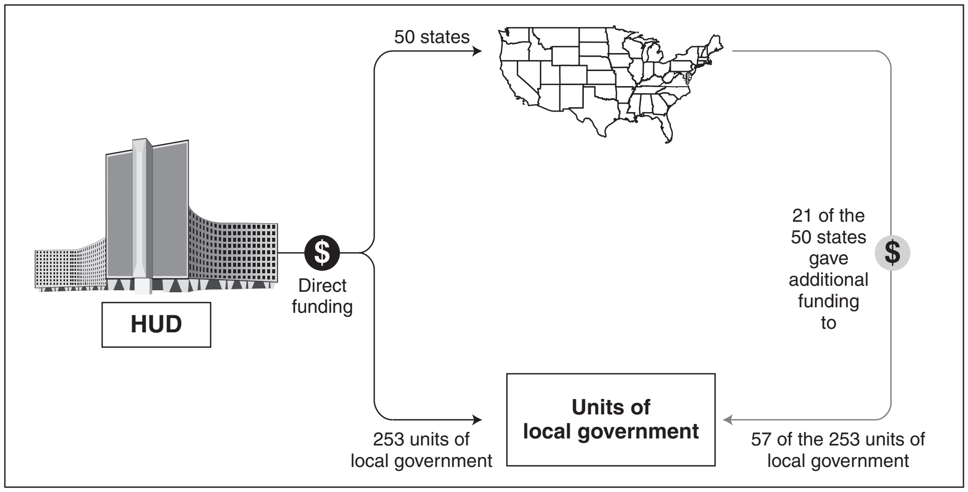
- foreclosure rates,
- percentage of homes financed by subprime loans, and
- likelihood of a significant rise in foreclosure rates.

Our review of NSP 1 action plans for all states (including the District of Columbia) found that all of the states included these factors among their criteria for determining their areas of greatest need. Some states also used factors not listed in HERA in determining their areas of greatest need, such as unemployment rates or percentages of the population at or below 50 percent of AMI. In their action plans, states had to outline their methods for reallocating NSP 1 funds or for using the funds themselves to make the most impact within the areas of greatest need within their state. HERA also allowed states to allocate their funds to local entitlement communities that may have already received NSP 1 funds directly from HUD, as well as to nonentitlement communities. According to HUD data as of June 2010, of the total NSP 1 funds that HUD allocated to the states, states reallocated approximately 9 percent, or $176 million, to 57 local

[22]Under CDBG, HUD provides funds to metropolitan cities and urban counties, known as entitlement communities, and provides funds to states for distribution to nonentitlement communities. States may not use CDBG funds directly. However, the NSP 1 Notice spells out the various ways in which states may use NSP 1 funds directly for activities, including using their own employees, procuring contractors, or providing grants through nonprofit subrecipients, among other direct uses. In prior work, we examined how the states distribute CDBG funds. See GAO, *Community Development Block Grants: Entitlement Communities' and States' Methods of Distributing Funds Reflect Program Flexibility*, GAO-10-1011 (Washington, D.C.: Sept. 15, 2010).

governments in 21 different states that had already received NSP 1 funds directly from HUD (see fig. 5).[23]

Figure 5: States' Reallocation of NSP 1 Funds to Units of Local Government That also Received Funds Directly from HUD



Source: GAO analysis of HUD DRGR data; Art Explosion.

Once states determined the areas of greatest need, many of them used competitions to award NSP funds for specific purposes. For example, one state used a competition for the acquisition and rehabilitation of multifamily properties, and another state used a competition specifically to help it meet NSP 1's 25 percent set-aside requirement to benefit households with incomes at or below 50 percent of AMI. Eligible applicants—nonprofits, for-profit developers, and local governments, among others—often varied by state and by the type of competition. While some states invited nonprofits and for-profit developers to compete for funds directly, other states allowed only local jurisdictions to apply or required nonprofits to get buy-in from their local governments in order to receive funds.

Our review of NSP 1 action plans found that states distributed funds using three main methods: (1) reallocation through competitions, (2)

[23]The percentage (9) and dollar amount ($176 million) are estimates because in two cases it was unclear exactly how much NSP 1 funds were reallocated to direct local government NSP 1 grantees. However, we included the amount in the estimates—totaling $3.6 million—as it seemed likely that the funds were used by the direct grantee.

reallocation on the basis of formulas, and (3) through state-administered programs. Many state grantees used a combination of methods to distribute funds, while a smaller number relied on a single method. More specifically, our review found that 14 states distributed all of their NSP 1 funds by reallocating them on a competitive basis, 7 states used a formula to reallocate all of their funds, and 1 state used all of the funds itself by administering the program through its housing finance agency and by contracting with other entities. In contrast, 26 states used a combination of two or more of the methods.[24] For example, a number of states with some of the largest NSP 1 grants, including California and Ohio, used a formula to allocate funds to areas of greatest need within the state and then held a competition for the 25 percent set-aside to benefit households with incomes at or below 50 percent of AMI. Six states utilized all three distribution methods—competition, formula, and use of funds—through state-administered programs. A number of states decided to administer some of their NSP 1 funds themselves through state-administered programs; for example, 1 state created a new statewide soft second loan financing program (Arizona) and another state channeled some of its NSP 1 funds into the Low Income Housing Tax Credit Program and the Permanent Supportive Housing Program (Georgia).[25]

Many states that used competitions to distribute NSP funds used similar criteria to rank applicants and award funds. For example, on the basis of our review of their action plans, many states considered applicants' capacity to carry out projects and project readiness, as well as whether applicants' proposals focused on projects that would serve the areas of greatest need within the state. Other frequently used competitive factors included applicants' experience administering NSP-related activities and ability to leverage other funding sources. A few states ranked applicants based on green building activities or gave priority to applicants that proposed projects that would help meet the 25 percent set-aside requirement.

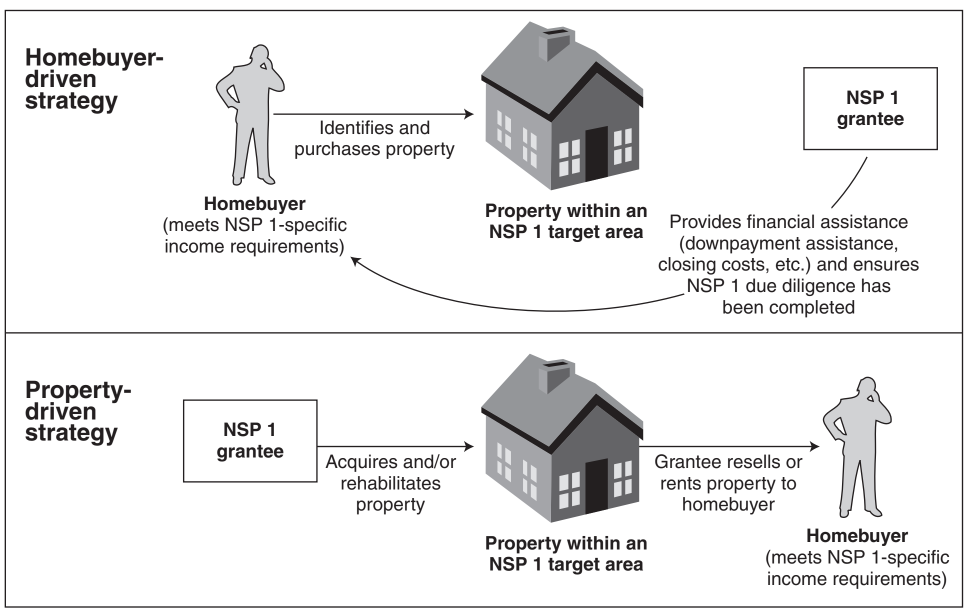
[24]For 3 states, it was unclear from their action plans which method was used to distribute funds within the state. Our review of states' NSP action plans included all 50 states and the District of Columbia but did not include Puerto Rico.

[25]A soft second loan is a second mortgage with payments that are forgiven, deferred, or subsidized in some fashion, generally until resale of the mortgaged property.

Grantees Employed Various Strategies for Using NSP 1 Funds

NSP 1 grantees with whom we spoke employed various different strategies for obligating and expending funds for NSP-eligible activities.[26] For example, as shown in figure 6, some grantees found that homebuyer-driven strategies—that is, strategies that allowed individual homebuyers to identify NSP-eligible properties and receive NSP 1 funds from grantees to assist with the acquisition or rehabilitation—were the most appropriate for the market conditions in their area. An example of a homebuyer-driven strategy would be one in which a grantee provided homebuyers with financial assistance—down-payment assistance, closing costs, rehabilitation costs, or soft second loans—to enable them to acquire a home within an NSP 1 target area. Another approach grantees used was a more property-driven strategy in which grantees or their subrecipients—such as housing authorities, nonprofits, or for-profit developers—directly acquired, rehabilitated, and resold or rented NSP properties to individuals or families meeting NSP-specific income requirements. Finally, in some cases, grantees' strategies included demolishing blighted structures and land banking the parcels on which the demolished properties stood for future use.

Figure 6: NSP Strategies for Acquiring and/or Rehabilitating Homes



Source: GAO; Art Explosion.

[26] As discussed in app. I, we spoke with 18 grantees (2 states, 6 counties, and 10 cities).

NSP 1 grantees we spoke with used different NSP strategies depending on the particular housing market conditions in their target areas. For example, one grantee we contacted used a homebuyer-driven strategy in areas where the generally good condition of the properties could attract potential purchasers. Under that strategy, qualified homebuyers looked for properties in NSP 1 target areas and chose NSP-eligible homes that did not require a lot of rehabilitation. The grantee then conducted the required due diligence on the home, including having it appraised and inspected, and completing environmental reviews. After the due diligence had been completed, the grantee assisted buyers with the acquisition of a property (at the required discount) and provided some funding for down-payment assistance and closing costs. The same grantee implemented a more property-driven strategy in target areas where homes required a higher level of rehabilitation—a potential deterrent for some homebuyers. Under this strategy, the grantee worked with nonprofit developers to acquire and rehabilitate the homes, then resold the homes to NSP-eligible buyers. Another grantee with whom we spoke used NSP 1 funds for demolition projects and the removal of blight to help stabilize its communities. Some of the land on which the demolished properties were located will be land banked for future use. This strategy made the most sense for this particular grantee as it did not have a strong housing market for sale or rental.

In order to meet the 25 percent set-aside requirement to benefit households with incomes at or below 50 percent of AMI, most of the grantees we spoke with employed similar strategies. Several of the grantees we spoke with planned to acquire, rehabilitate, and rent out multifamily properties to meet this requirement. A couple of grantees also had back-up strategies for meeting the 25 percent set-aside as well, such as acquiring and rehabilitating single-family homes and renting them out to low-income individuals or families.

Some Grantees Modified Their Strategies to Meet the Obligation Deadline and Address Implementation Challenges

Grantees we spoke with faced several challenges implementing NSP 1—including tight time frames, competition from private investors, and challenges in acquiring properties—but generally found ways to address them. While 16 of the 18 NSP 1 grantees that we contacted had obligated their full grant allocations by October 1, 2010, most said they had faced some difficulties in trying to meet this requirement.[27] For example, several grantees mentioned they had encountered competition from private investors in their efforts to acquire NSP-eligible properties. One grantee said both in-state and out-of-state investors have seized the opportunity to acquire NSP-eligible properties at low prices, and another grantee provided an example where a group of investors acquired about 90 properties at one time. One grantee official expressed concern that investors looking to rent out properties may not be responsible landlords, which could undermine efforts to stabilize neighborhoods. Finally, private investors sometimes outbid grantees for NSP-eligible properties, and because investors may pay with cash and do not have to meet the same due diligence requirements as NSP 1 grantees, they are able to act more quickly and have more success acquiring properties.

Furthermore, a few of the grantees we spoke with that planned to rent out multifamily properties said they faced challenges meeting the 25 percent set-aside obligation requirement. Officials from two grantees told us it was difficult to find foreclosed multifamily rental projects to purchase in NSP 1 target areas. Additionally, one grantee told us that they were facing neighborhood opposition to a multifamily project because neighbors feared that affordable housing units would depress home values in the area.

A broader study of NSP grantees sponsored by the Board of Governors of the Federal Reserve System and two Federal Reserve banks cited challenges similar to those that we identified. For example, the study highlights competition from private-sector investors, grantees' difficulties identifying a potential pool of foreclosed properties to acquire, and the reluctance of some property holders to work with grantees. The study also noted that local requirements and practices, such as stringent local

[27]The two grantees that did not obligate their total grant amounts by October 1 had obligated 94 percent and 97 percent, respectively.

standards for publicly financed rehabilitation, often put NSP grantees at a competitive disadvantage to investors.[28]

In order to overcome implementation challenges such as meeting deadlines or competition from investors, some grantees we spoke with modified their implementation strategies by

- moving away from homebuyer-driven models to directly acquiring properties,
- expanding target areas,
- working with banks' "first look programs," and
- working with the National Community Stabilization Trust (NCST).

To overcome implementation challenges, some grantees had to make changes to their original program strategies. For example, several grantees we contacted said it would be difficult to meet the obligation deadline using their homebuyer-driven strategies. Competition from private investors and tight obligation time frames required some grantees to move funds from their homebuyer-driven models towards supporting more property-driven strategies where they purchased and rehabilitated homes themselves. Using a more direct strategy allowed some grantees to speed up the pace of obligations. In addition, one grantee shifted its focus from homebuyers to renters in order to help it meet the deadline for obligating funds, as potential homebuyers in its housing market were finding it difficult to obtain mortgages due to job loss and poor credit.

Some NSP 1 grantees also expanded their target areas to expedite property acquisition. With HUD approval, some NSP grantees expanded their target areas to include more ZIP codes or census tracts in order to expedite acquisitions and circumvent investor competition. Several grantees also worked with banks' "first look" programs, which gave them the opportunity to bid on bank-owned foreclosed properties before other potential buyers. Grantees also worked with NCST, a national nonprofit organization to acquire foreclosed properties in their target areas. NCST

[28]Harriet Newburger, Federal Reserve Bank of Philadelphia, "Acquiring Privately Held REO Properties with Public Funds: The Case of the Neighborhood Stabilization Program." *REO & Vacant Properties: Strategies for Neighborhood Stabilization*, A Joint Publication of the Federal Reserve Banks of Boston and Cleveland and the Federal Reserve Board, 2010.

facilitates communication between NSP grantees and banks and provides grantees with listings of NSP-eligible properties from which to choose. Many grantees with whom we spoke found NCST to be very helpful in acquiring properties, and one grantee we contacted said working with NCST helped it acquire 80 percent of the homes on which it had placed bids. In an effort to standardize the acquisition process for NSP grantees, HUD recently partnered with NCST to create the "National First Look Program" in September 2010. The program gives communities participating in NSP a "first look" or right of first refusal to purchase foreclosed homes before the properties are made available to private investors.[29] According to HUD officials, the program grew out of an initiative HUD announced in July 2010, which gave NSP-eligible purchasers the opportunity to acquire foreclosed properties owned by HUD's Federal Housing Administration at 10 percent below the appraised value.[30]

HUD Has Taken Actions to Mitigate NSP 1 Program Risks through Training, Technical Assistance, and the Establishment of Internal Controls

As previously noted, HERA established specific program requirements for NSP 1 beyond those for CDBG, including an accelerated timeline for obligating funds and the requirement that grantees must use 25 percent of their NSP 1 funds to benefit households at or below 50 percent AMI. Additionally, HERA required that NSP 1 grantees ensure, among other things, that properties are acquired at a discount and properties sold to individuals as a primary residence cannot be resold for more than the total cost of acquisition and redevelopment.

At the start of NSP 1, HUD conducted a front-end risk assessment (FERA) to assess NSP 1 program risks and identify actions required to reduce control risks to an acceptable level.[31] Among other risks, HUD's review noted that the scale of the effort could overwhelm some grantees; meeting the requirement to obligate funds within an 18-month time frame could be

[29]*HUD Secretary Announces National First Look Program To Help Communities Stabilize Neighborhoods Hard-Hit By Foreclosure*, September 1, 2010.

[30]75 Fed. Reg. 41225 (July 15, 2010).

[31]The purpose of a FERA is to detect conditions that may adversely affect the achievement of program objectives and to provide reasonable assurance that program goals, including compliance with applicable laws and regulations, will be met. The FERA is mandatory for any new HUD program with a funding level totaling $10 million or more and for certain substantially revised programs. HUD uses the FERA in accordance with principles of risk assessment outlined in OMB Circular A-123, to identify and analyze risks, from both internal and external sources, which may affect the ability of the agency to meet objectives.

challenging for grantees, especially those with limited real estate experience; and HUD's personnel resources were not adequate to oversee the program. The FERA concluded that implementing NSP 1 successfully and within required time frames would require early and regular deployment of controls, including training, technical assistance, and monitoring. The FERA also recommended additional HUD staff to support NSP-related activities, because field staff were already overextended managing existing programs.

HUD Provided Training and Guidance and Made Program Modifications to Address Program Challenges, but Some Grantees Said Some of These Efforts Were Not Timely

HUD provided training and guidance on NSP 1 using a variety of methods, including

- online guidance, webinars, and answers to frequently asked questions;
- e-mail updates;
- teleconferences and increased communication with field staff; and
- classroom and one-on-one instruction (e.g., on DRGR).

HUD provided eight online video training presentations with associated printouts ("modules") that outlined NSP 1-specific requirements, policies, and procedures. For example, the first module provided overall NSP 1 guidance and rules on eligible uses, activities, and properties.[32] HUD also released webinars, hosted by HUD staff and technical assistance providers, on a weekly basis that provided guidance on topics such as obligating funds and meeting the 25 percent set-aside requirement. A majority of the grantees we spoke with said that, overall, the material covered in the modules and webinars provided good information and helped them implement their NSP 1 programs.

HUD faced significant challenges in issuing comprehensive guidance and training to grantees at NSP 1's outset because the program was relatively complex and had to be implemented quickly. Most of the grantees that we

[32] The eight modules were: (1) Eligible Uses, Activities, and Properties; (2) Pre-Acquisition Considerations; (3) Post-Acquisition Considerations; (4) Disaster Recovery Grant Reporting System; (5) Financing Issues; (6) Program Administration; (7) Land Banking and Demolition; and (8) Eligible Use Scenarios. They are available at http://www.hud.gov/offices/cpd/communitydevelopment/programs/neighborhoodspg/training/index.cfm.

interviewed said that the combination of HUD's guidance and training was helpful but some grantees had raised some concerns. Several grantees that we spoke with about 1 year after the program began said that the guidance and training they received was not always timely. For example, one grantee said that the information it received at an NSP problem-solving clinic in early 2010 would have been more useful had it been provided 6 months earlier. Additionally, two grantees said they did not always get timely answers to questions about program rules when the field office staff they asked had to obtain clarification from HUD headquarters. HUD officials said that some of the assistance grantees found useful was delivered using funds that HUD received well after the start of NSP 1.

HUD modified NSP policy in two key respects to address challenges faced by grantees in implementing the program. Grantees we spoke with said that the first of these modifications helped them overcome difficulties they were experiencing in acquiring properties. More specifically, in June 2009, HUD reduced the required discount from the appraised value at which grantees must purchase NSP-eligible properties. HUD reduced the discount from a minimum of 5 percent for individual acquisitions to a minimum of 1 percent, and eliminated the 15 percent discount for aggregate acquisitions.[33] This change was intended to mitigate the potentially adverse impact that the larger discounts could have on neighborhood property values and the inability or unwillingness of the holders of foreclosed properties to sell at prices that reflect the higher discount.

NSP 1 grantees had mixed views about the effect of the other program modification, implemented in April 2010, which expanded the definitions of foreclosed and abandoned properties.[34] As a result of the program modification, properties no longer had to have completed the foreclosure process to be purchased with NSP funds, and the standards for what constituted an abandoned property eligible for NSP were loosened—for

[33]Aggregate purchases for NSP are defined as all of the properties that an NSP grantee purchases with its NSP funds.

[34]We spoke with a number of grantees we contacted during our review about the impact of HUD's definition changes on their NSP programs. This work was done in coordination with another GAO team reviewing issues of incomplete or "abandoned" foreclosures. See GAO, *Mortgage Foreclosures: Additional Mortgage Servicer Actions Could Help Reduce the Frequency and Impact of Abandoned Foreclosures*, GAO-11-93 (Washington, D.C.: Nov. 15, 2010).

example, to include tenant-occupied properties.[35] HUD made these changes in response to suggestions from local communities to increase the reach of NSP by allowing more properties to qualify. HUD headquarters staff said this change also enabled some NSP 1 grantees to increase the pace of their acquisitions and meet their obligation deadlines. They added that, on the basis of comments from grantees, the expanded definitions had helped grantees acquire multifamily properties but had not yet been used to acquire single-family homes. Similarly, some CPD field staff said the expanded definitions helped grantees that were facing challenges in meeting the obligation deadline by increasing the number of eligible properties they could acquire. Specifically, field staff reported that it helped some of their grantees to fulfill the 25 percent set-aside requirement by easing restrictions on acquiring multifamily properties, which many grantees we spoke with intend to rent to low-income households. Several grantees we spoke with expressed similar views, noting that the new definitions helped them acquire multifamily properties. However, others indicated that the broader definitions would not make a significant impact at this stage in their NSP 1 efforts because they had made many of their acquisitions prior to the definition changes or had a large inventory of fully foreclosed homes available. The expanded definitions may have a greater effect on acquisitions of properties for the more recent rounds of funding (NSP 2 and NSP 3), since they are in earlier stages of planning and implementation.

HUD Provided Technical Assistance to Support Grantees in Implementing NSP 1

In August 2009, HUD awarded $50 million in ARRA funds through a competition to provide technical assistance for NSP grantees (under both NSP 1 and NSP 2). According to HUD, as of October 2010, $28.6 million had been budgeted for NSP technical assistance and $11 million of that amount had been drawn down. Nine national technical assistance providers were awarded 89 percent of the funds to operate at the national

[35]The term “abandoned” was originally defined as a property that had been foreclosed upon and was vacant for at least 90 days. However, HUD explained that this definition limited opportunities for acquiring properties in a strategic and timely manner. For example, the requirement that the property had to be vacant for at least 90 days left out properties abandoned by owners, but where tenants were still in place. Therefore, HUD expanded the definition of abandoned to include vacant and nonvacant properties (a) for which no mortgage or tax payments have been made by the property owner for at least 90 days, (b) for which a code enforcement inspection determined that the property is not habitable and the owner has taken no corrective actions within 90 days of the notification of the deficiencies, or (c) subject to a court-ordered receivership or nuisance abatement related to abandonment.

level, and three local technical assistance providers received 11 percent of the funds to operate at the local level.[36] Among other areas, NSP technical assistance providers were tasked with

- helping NSP grantees implement sound underwriting, management, and fiscal controls;
- building the capacity of public-private partnerships;
- developing strategies to serve low-income households;
- providing training on the operation and management of land banks; and
- training grantees and their subgrantees on HUD program rules and financial management requirements.

The providers delivered support to grantees through various methods, including "direct assistance" (assistance provided in person), "on-call remote assistance" (assistance provided via phone or e-mail), and "Web-based" assistance, which provides answers to questions submitted via HUD's NSP resource exchange Web site.

- *Direct.* HUD headquarters and field staff identified grantees that demonstrated a need for support in specific NSP program areas or exhibited capacity concerns in meeting the obligation deadline. Technical assistance providers conducted needs assessments for direct assistance for 98 grantees during late 2009 and early 2010. As of August 2010, 59 grantees had requested direct assistance, 58 of which received it.
- *On-call remote.* As of August 2010, technical assistance providers had received 93 requests for on-call remote technical assistance and responded to 84 of those requests (with 27 completed and 57 in progress). HUD officials said they received approximately 3 to 4 on-call remote technical assistance requests weekly. Technical assistance providers also facilitated NSP problem-solving clinics that were open to all grantees and field staff.
- *Web-based.* HUD officials said that technical assistance providers had established the NSP resource exchange Web site as a place for grantees to submit technical assistance requests and share knowledge. The Web site

[36] Local technical assistance providers serviced the following locations: Northern and Southern California, Northern and Southern Florida, Illinois, Indiana, Ohio, Georgia, New England, and Michigan. HUD news release: HUD No. 09-159 on August 26, 2009.

also has a “frequently asked questions” link that is regularly updated with answers to questions from grantees that can be searched by topic. According to HUD, technical assistance providers answered 2,389 out of 2,544 NSP questions submitted between April and August 2010.

HUD officials said that NSP 1 grantees mostly requested technical assistance in two major areas: (1) program design and (2) financial underwriting skills. In terms of program design, HUD staff said that some grantees had selected unsuitable NSP 1 approaches for their local housing markets. For example, some grantees had planned to implement strategies for selling homes or increasing home ownership in what were primarily rental markets. In another example, one grantee was initially not planning to use NSP 1 funds for demolition, even though, according to HUD staff, demolition was an appropriate use of NSP 1 funds given the grantee’s local housing market conditions. Grantees also requested technical assistance to enhance their knowledge of property financing.

HUD set up accounts in DRGR for each technical assistance provider to track the use of technical assistance funds and the performance of grantees receiving the assistance. HUD staff told us they plan to use this information to assess whether the technical assistance improved grantees’ performance. HUD staff also said they will conduct post-technical assistance monitoring to assess grantees’ compliance with NSP 1 requirements and determine if additional assistance is necessary. Additionally, HUD officials said that the agency is collecting feedback on the quality of technical assistance at training events and through the NSP resource exchange Web site, among other means. HUD officials said they would use this feedback to determine potential needs for NSP 2 and 3, and to help determine whether current technical assistance providers should continue to participate in HUD programs. Given the critical role that HUD assigned to technical assistance for mitigating program risks, it will be important for HUD to follow through with these planned assessments to ensure that the assistance had the intended effect.

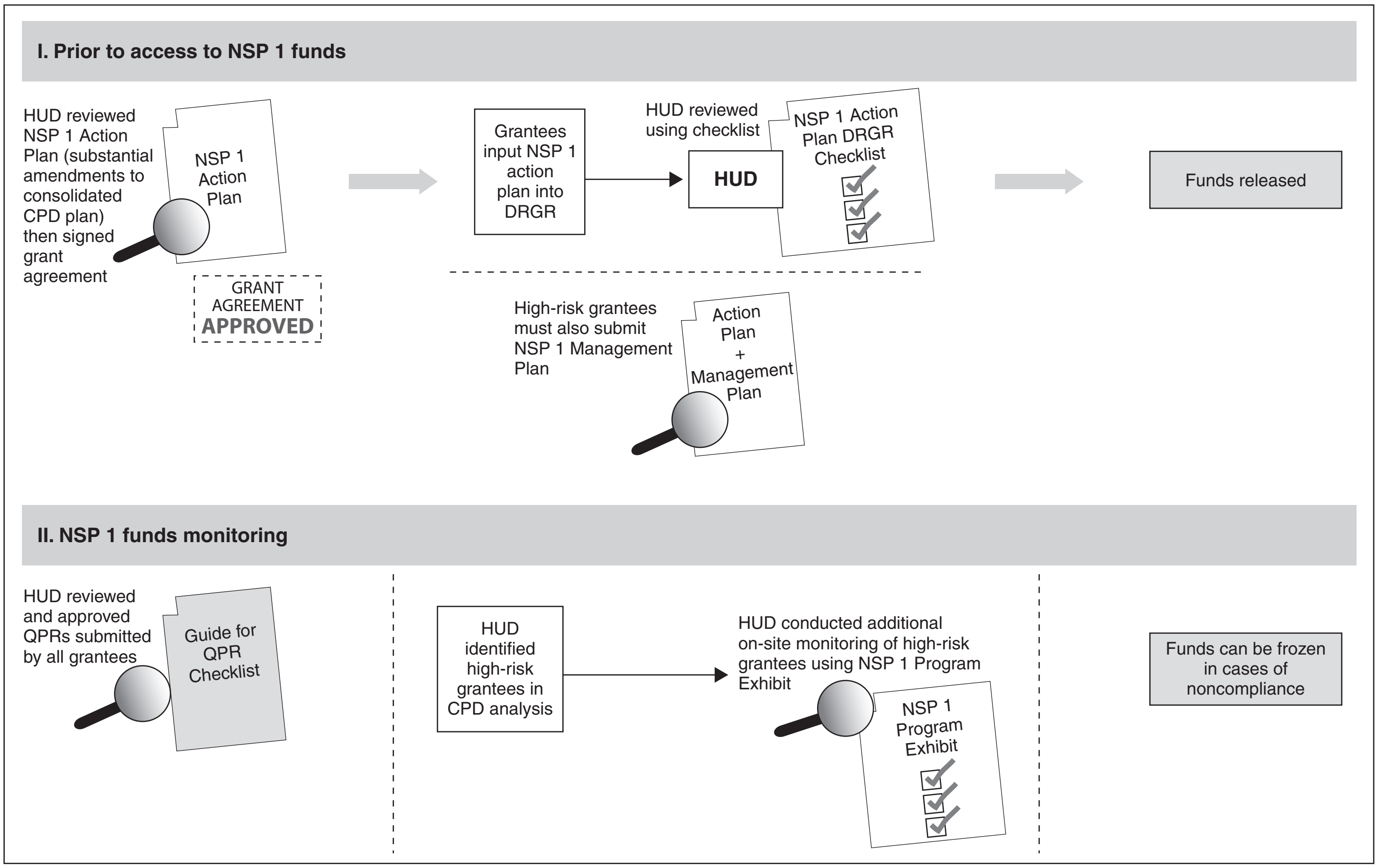
HUD Hired Staff and Implemented Internal Control Processes for NSP 1

The FERA conducted for NSP 1 cited the lack of HUD staff capacity to absorb the additional workload and recommended the addition of 20 to 25 staff to support NSP 1. With funding from the fiscal year 2009 continuing resolution, as of November 2010, HUD had hired 10 term staff as NSP specialists—whose duties include monitoring and oversight of grantees—placing 7 in field offices that generally had more than 20 NSP 1 grantees and 3 in headquarters.[37] Also as of November 2010, the agency had hired an additional 32 field staff with funding provided by the American Recovery and Reinvestment Act of 2009 (ARRA) to work on implementing NSP 2 but also to contribute to NSP 1 efforts, such as monitoring grantee compliance with program requirements.

The FERA also noted the importance of implementing controls to mitigate program risks. HUD adapted a range of internal control processes already in place for the CDBG program to ensure compliance with program requirements and mitigate the risks posed by NSP 1 (see fig. 7). Before releasing grantees' NSP 1 funds, HUD required all grantees to submit a substantial amendment (or "NSP 1 action plan") to their CPD consolidated and annual action plans by December 2008 to describe how they would use NSP 1 funds. As noted earlier, NSP 1 action plans identify areas of greatest need, establish expected program outputs, set forth plans for complying with key requirements, and define relevant NSP 1 terms (such as blighted structures, housing rehabilitation standards, and affordable rents). HUD reviewed NSP 1 action plans to determine if grantees' planned uses of funds were in accordance with key HERA requirements. After approving the action plans, HUD signed the grant agreements (most were signed in March 2009, according to HUD officials, resulting in 18-month obligation periods ending in September 2010).

[37]The field offices are in Jacksonville and Miami, Florida; Columbus, Ohio; Detroit, Michigan; San Francisco and Los Angeles, California; and Las Vegas, Nevada. The Las Vegas field office reports to the San Francisco regional office.

Figure 7: Selected HUD Internal Controls for NSP 1



Source: GAO analysis of HUD information.

Also prior to releasing NSP 1 funds, HUD implemented additional controls for grantees at higher risk of noncompliance with program requirements. For example, in the initial stage of the program, HUD designated 104 grantees as high risk because their NSP 1 grants were at least three times greater than their annual CDBG allocations or they had audit findings or other performance problems in similar HUD grant programs. HUD added a “special condition” to the NSP 1 agreements of these high-risk grantees that required them to submit management plans along with their NSP 1 action plans. The management plans detail the number, types, and responsibilities of staff positions supporting the grantee's NSP 1 program.[38]

Furthermore, after grantees inputted their action plans into DRGR, CPD field office staff used a checklist to confirm that the action plans were entered in a manner that would allow HUD to track NSP 1 funds and monitor whether some key reporting requirements were met (see fig. 7). Field staff used an action plan checklist to verify that grantees had identified eligible NSP 1 uses, responsible organizations, and income-based national objectives associated with activities in DRGR.[39] Once field office staff reviewed and approved a grantee's action plan in DRGR, HUD headquarters released the grantee's NSP 1 funds.

After releasing grantees' funds, HUD has used remote and on-site monitoring of grantees' ongoing performance to assess compliance with program requirements. HUD field staff used a QPR checklist to review areas covered by the action plan checklist and to monitor grantees' progress in meeting their obligation deadlines.

Additionally, CPD field office staff conducted on-site monitoring of 176 grantees (57 percent of NSP 1 grantees). The field offices selected these grantees on the basis of risk scores calculated using five risk factors: (1) financial soundness, (2) overall management capacity, (3) client satisfaction with services, (4) extent to which services benefit targeted areas and clientele, and (5) NSP 1 program progress.[40] The factor for management, which constituted the largest part of the score, considered grantees' capacity to implement NSP 1 based on HUD monitoring information and grantees' use of subrecipients. The factor for NSP 1 program progress—the second-largest scoring component—considered other aspects of grantee capacity, including how much NSP 1 funding the grantee received relative to its regular CDBG allotment, the type of activities undertaken, and the grantee's capacity to manage its NSP 1

[38]The HUD OIG identified some inconsistency in the way HUD field offices applied the special conditions. While some field offices considered past performance only in the CDBG program, others also considered grantees' performance in other HUD programs—for example, HOME Investment Partnerships and the Supportive Housing Program. See HUD Office of the Inspector General Audit Report 2010-CH-0001, March 29, 2010.

[39]HUD officials told us that HUD headquarters staff reverified compliance with the checklist for the vast majority of grantees.

[40]HUD Notice CPD-09-04: *Implementing Risk Analyses for Monitoring Community Planning and Development Grant Programs in FY 2010 and 2011*, Issued 8-24-2009.

program. Although CPD field offices primarily used the risk analysis scores to select grantees for monitoring and identifying specific compliance areas to review, they also considered HUD OIG audit findings, where applicable.[41]

To prepare for on-site monitoring, CPD issued a revision to HUD's *Community Planning and Development Monitoring Handbook* in April 2010 that provided HUD staff with guidance for monitoring grantees' compliance with NSP 1 requirements. The guidance includes "exhibits," or checklists that cover key NSP 1 requirements, including the income qualifications of program beneficiaries, rules on continued affordability, obligation deadlines, and the 25 percent set-aside for low-income families.

HUD field offices conducted the majority of on-site monitoring from April through September 2010. As of September 2010, HUD officials told us they were still in the process of aggregating on-site monitoring results. As a result, program-wide data on the extent to which grantees are complying with NSP 1 requirements are not readily available. In the absence of centralized data, we reviewed the monitoring results for 40 NSP 1 grantees overseen by the four CPD field offices that we contacted during the course of our work (the field offices are in Philadelphia, Pennsylvania; Columbus, Ohio; Miami, Florida; and San Francisco, California).[42] The on-site monitoring found that 32 of the 40 grantees were in full compliance with the requirements reviewed. However, CPD field staff identified a total of 13 findings (potential deficiencies requiring corrective action) for the other 8 grantees.[43] Most of the findings were related to financial management and accounting issues—for example, deficiencies in accounting systems for personnel and other administrative costs—and

[41]As of the end of September 2010, the OIG had issued capacity audits of 22 NSP 1 grantees and found that 12 grantees generally had sufficient capacity, while 8 grantees needed to improve their capacity to administer the program. Further, 2 grantees did not have the capacity to effectively and efficiently administer NSP funding. Examples of lack of capacity included inadequate staffing levels and policies, procedures, and internal controls.

[42]In total, the four field offices are responsible for overseeing 86 NSP 1 grantees, 50 of which they monitored on-site. We reviewed the monitoring results for the 40 grantees for which the field offices had completed "monitoring letters" as of September 15, 2010. Sixty days after completing an on-site visit, HUD field staff send a monitoring letter to the grantee discussing, among other things, the field staff's conclusions, any monitoring findings, and any corrective actions required.

[43]Monitoring letters containing findings specify corrective actions the grantee should take and the time frame in which the grantee should respond.

others related to oversight of subrecipients. Additionally, 1 grantee did not clearly document that two homebuyers received homebuyer counseling prior to obtaining their mortgages loans. The same grantee did not take adequate steps to ensure that a multifamily rental property would remain affordable to income-eligible households. HUD required the 8 grantees to take corrective actions on the findings and has an established process for following up on the status of corrective actions. Because many grantees are still completing their NSP 1 activities, following through on this process will be key to ensuring grantees' compliance with program requirements.

In cases where HUD identifies major compliance problems, it may freeze a grantee's access to NSP 1 funds. HUD officials said they had not needed to take this action as of September 2010.

Selected Grantees Complied with Key NSP 1 Requirements for Properties We Reviewed

We reviewed selected grantee's compliance with key NSP 1 requirements for a nonstatistical sample of 32 NSP 1 properties. We selected eight grantees in five states covering different geographic regions and housing market conditions and reviewed records for four properties at each grantee.[44] Our review focused on requirements relevant to activities (e.g., acquisition, rehabilitation, etc.) that had been completed when we conducted our selection process.[45] We did not conduct a financial audit of the grantee or the funds expended on the properties.

As shown in figure 8, we reviewed grantee compliance with key NSP 1 requirements and relevant internal controls concerning the use of grant funds. Some of the requirements and controls were relevant to all types of NSP 1 activities. Other requirements and controls applied only to specific activity types.

[44] See app. I for a detailed description of our methodology.

[45] By focusing on grantees with completed activities, our sample intentionally overrepresented those grantees that had made the most progress in implementing NSP 1 at the time of our review. Also, while our methodology for selecting properties at each grantee focused on properties with the most completed activities, some planned activities for some of the properties in our sample had yet to be completed. We did not include those planned activities in our compliance review.

Figure 8: Program Requirements and Controls We Reviewed

		NSP 1 statutory or regulatory requirement	Other requirement or control[a]
All activities	Property was located within a defined area of greatest need	✓	
	Property was eligible for all relevant NSP 1 activities	✓	
	Property address was included in grantee's Quarterly Performance Report in DRGR, where applicable		✓
	Grantee had relevant procedures and checklists		✓
Acquisition	Acquisition price was at least 1 percent below the appraised value	✓	
	Appraisal was conducted no more than 60 days prior to purchase offer	✓	
	Proof of purchase and title transfer		✓
	Documentation of title insurance		✓
	Documentation that the required environmental review process was completed prior to acquisition and had been certified by the responsible official		✓
Rehabilitation	Documentation of work write-ups and appropriate approvals		✓
	Documentation of estimated and final rehabilitation costs		✓
	Final inspection reports documented that all rehabilitation work was completed in a satisfactory manner		✓
Demolition	Documentation indicating the structure met the grantee's definition of blighted	✓	
	Evidence of the structure prior to demolition		✓
	Documentation of estimated and final demolition costs		✓
Resale	Provisions for primary residence and continued affordability were in place[b]	✓	
	Property was resold at a price lower than the sum of the acquisition and rehabilitation costs	✓	
	Proof of purchase and title transfer		✓
	Income eligibility of homebuyers was determined and documented	✓	
	Evidence that homebuyers attended at least 8 hours of homebuyer counseling	✓	
	Homebuyers obtained a traditional mortgage product	✓[c]	
Financing (assistance provided to homebuyers for purchase or rehabilitation)	Provisions for primary residence and continued affordability were in place	✓	
	In cases where down payment assistance was provided, the assistance was less than 50 percent of the home's sale price	✓	
	Income eligibility of homebuyers was determined and documented	✓	
	Evidence that the homebuyers attended at least 8 hours of homebuyer counseling	✓	
	Homebuyers obtained a traditional mortgage product	✓[c]	

Source: GAO.

[a]Other requirements and controls are based on those from other relevant HUD programs (e.g., the CDBG and HOME Investment Partnerships programs) or are practices consistent with federal internal control standards.

[b]Some grantees addressed the primary residence requirement and continued affordability restrictions by inserting clauses in purchase and loan contracts. Under the continued affordability requirement for NSP 1, grantees must ensure, to the maximum extent practicable and for the longest feasible term, that the sale, rental, or redevelopment of abandoned and foreclosed-upon homes and residential properties remain affordable to individuals or families whose incomes do not exceed 120 percent (or 50 percent if property qualifies as low income) of area median income.

[c]NSP 1 grantees are required to ensure that homebuyers obtain mortgage loans from lenders that agree to comply with federal banking regulator guidance for nontraditional mortgages. (Nontraditional mortgages include loan products that allow borrowers to defer payment of principal and, in some cases, interest. These features create the potential for “payment shock” when the monthly payments adjust to a fully amortized amount.) We did not review compliance with this requirement directly because of potential variation in what would constitute such assurance. However, we did determine whether homebuyers obtained traditional mortgage products (e.g., 30-year fixed-rate loans). For the 10 properties in our sample that had been purchased by a homebuyer (either directly or from the grantee), the homebuyer obtained a 30-year fixed-rate mortgage.

We found no instances of significant noncompliance with the key NSP 1 requirements we reviewed for the 32 properties in our nonstatistical sample.[46] The results of our review cannot be generalized to the total population of NSP 1 activities or grantees.

Table 1 shows the types of activities that had been completed at the properties we reviewed. Seventeen of the 32 properties we reviewed had been acquired and undergone rehabilitation. Six of those 17 properties were resold by the grantees, and a seventh property was directly acquired and rehabilitated by the homebuyer with NSP 1 assistance.

Table 1: Activities Reviewed for 32 NSP 1 Properties

Activities reviewed	Number of properties	Number of properties with homebuyer assistance
Acquisition by grantee	7	n/a[a]
Acquisition and rehabilitation by grantee	10	n/a[a]
Acquisition, rehabilitation, and resale by grantee	6	6
Demolition by grantee[b]	5	n/a[a]
Acquisition by homebuyer	3	3
Acquisition and rehabilitation by homebuyer	1	1
Total	**32**	**10**

Source: GAO.

[46]For one property, however, the grantee did not receive final supervisory approval of an otherwise complete environmental review until after the property had been acquired.

[a]The properties in these categories were not yet at the resale stage (or in the case of demolitions not intended for resale) when homebuyer assistance is provided.

[b]Of the five demolished properties, only one was acquired using NSP 1 funds. The others were donated or blighted structures.

HUD Adapted an Information System for NSP 1, but Data on Program Outputs Have Limitations

HUD Modified DRGR and Provided Training and Guidance

HUD made several modifications to DRGR—a system that was designed to assist in managing Disaster Recovery grants—in order to collect information for NSP 1 and subsequent rounds of the program. For example, HUD modified system menus to include items unique to NSP, such as land banks; removed inapplicable items; and enabled grantees to designate whether properties had been sold or rented or were single- or multifamily. HUD also provided training and technical assistance to HUD field staff and NSP grantees that were unfamiliar with DRGR. These efforts included one-on-one troubleshooting workshops, online information, and a help desk. In addition, HUD technical assistance providers held 10 joint sessions for HUD field staff and grantees on DRGR.

As we have seen, grantees established action plans in DRGR, creating projects and linking activities to them. For activities, HUD required detailed information, including

- a national objective (e.g., targeting low-, moderate-, and middle-income persons),[47]
- an activity type (e.g., acquisition, rehabilitation, demolition, homeownership assistance, land banking, administration),[48]

[47]As previously noted, under the CDBG program, grantees' activities must meet one of three national objectives, but under NSP grantees' must meet one national objective—they must benefit low-, moderate-, and middle-income persons.

[48]The activity type menu in DRGR includes a number of variations of acquisition, rehabilitation, and other major activity types. For ease of presentation, we generally refer only to the major activity type (e.g., "acquisition" or "rehabilitation").

- a responsible organization (grantee or subrecipient carrying out the activity), and
- performance measures (e.g., output measures such as the number of properties, housing units, or households or persons benefiting).[49]

In addition, HUD instructed grantees to enter projected and actual output measures for each activity in DRGR and provided a predetermined list of outputs for each activity type. HUD officials said they considered the number of households benefiting to be the primary output measure for NSP 1. Under each activity, HUD also required grantees to enter a property address at the point they obligated funds for a property.

HUD headquarters developed training and checklists for CPD field office staff to use in reviewing the information grantees entered in DRGR, including action plans and QPRs.[50] The action plan checklist required field offices to ensure that (1) grantees established an activity for each responsible organization, (2) activities met income-based national objectives, (3) every activity type had a corresponding NSP eligible use, and (4) each multifamily project had its own activity. The QPR checklist covers these areas and requires field staff to monitor grantees' progress in meeting their obligation deadlines and projected outputs.

HUD uses DRGR for a number of monitoring and reporting purposes. As discussed earlier, HUD uses information grantees enter into DRGR to monitor grantees' progress in meeting obligation deadlines and set-aside requirements for low-income households. HUD also has put program-wide and grantee-specific "snapshot" reports on its NSP Resource Exchange Web site to provide financial and other information about NSP 1 to the public. In addition, the Administration has included DRGR-generated information on NSP 1 in its monthly housing scorecard.[51] Thus far, the scorecard has reported three output measures: (1) number of housing units constructed or rehabilitated, (2) number of housing units demolished

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[49]Outputs are the products and services delivered by a program.

[50]HUD headquarters staff set policy for managing and monitoring NSP 1 activities, and CPD field staff conduct the actual oversight of individual grantees under their purview.

[51]The scorecard contains data on key housing market indicators and includes performance metrics for the Administration's housing recovery efforts. Data are presented by HUD and the Department of the Treasury in "The Obama Administration's Efforts to Stabilize the Housing Market and Help American Homeowners" brochure, October 2010.

or cleared, and (3) number of housing units for which direct homeownership assistance was provided. In the October housing scorecard, HUD reported that by March 2013, about 36,000 units would be rehabilitated or constructed; 8,000 units would be demolished; and direct homeownership assistance would be provided for about 18,000 units.[52] For reasons described in the next section, it is difficult to know the number of unique housing units or benefiting households these data represent, and the data may tend to understate activity-specific outputs.

Reporting Flexibilities and Shortcomings in HUD Guidance Have Limited the Usefulness of Output Data in DRGR

Although DRGR has been a useful tool for monitoring grantees' obligations, variation in the way grantees were allowed to classify certain activities and select output measures in DRGR complicates the analysis of program outputs. As under the CDBG program—-which was designed to give grantees substantial flexibility—-HUD officials said they permit NSP 1 grantees to group activities in different ways. For example, HUD officials told us they instructed grantees to enter information for property acquisitions under a rehabilitation activity if the acquisition and rehabilitation are to be carried out by the same responsible organization and are to be rehabilitated within a short time frame. Accordingly, our review of DRGR information for 18 grantees identified a number of variations, including: (1) one activity (classified as "rehabilitation") covering both the acquisition and rehabilitation of housing units; (2) two activities (one classified as "acquisition" and the other as "rehabilitation") for acquiring and rehabilitating units; and (3) one activity (classified as "acquisition for land banking") for acquiring, demolishing, and land-banking housing units.[53] Due to these variations, totaling outputs for individual activity types can result in undercounting program outputs (because grantees that combine two or more activities report the associated outputs under a single activity type) and totaling outputs across multiple activity types can result in double counting program outputs

[52]HUD data indicate that the number of rehabilitated units is greater than the number of newly constructed units.

[53]We reviewed action plans and QPRs for the second quarter of calendar year 2010 for the 18 grantees we interviewed or visited on-site. (See app. I for a list of these grantees and our selection criteria.)

(because grantees that do not combine activities may report the same outputs under multiple activity types).[54]

HUD officials said that the variation did not affect their ability to monitor grantees' compliance with program requirements but acknowledged that it complicated analysis of program outputs. HUD officials said they were in the process of identifying duplicate property addresses in DRGR, which will allow them to report total numbers of NSP 1 housing units and benefiting households without double counting these outputs. Undercounting is likely primarily an issue with the acquisition activity type, because, as previously noted, HUD allows grantees to combine acquisition and rehabilitation under a rehabilitation activity in some circumstances. Additionally, HUD officials said they were more focused on reporting outputs for "end uses" of NSP 1 funds, such as the number of housing units rehabilitated and demolished and the number of benefiting households.

However, we found that grantees did not always group acquisition and rehabilitation under a rehabilitation activity. For instance, contrary to HUD's instructions, we identified several instances in which grantees combined acquisition and rehabilitation under an acquisition activity. HUD officials indicated they had found similar cases in their reviews of DRGR information. As a result, totaling output data for rehabilitation activities may understate actual outputs. HUD training and its QPR review checklist developed for CPD field staff responsible for reviewing activity data in DRGR do not adequately address this issue. In particular, the checklist that field staff use to review grantees' QPRs does not require field staff to determine whether grantees grouped activities in accordance with HUD guidance. As a result, HUD staff may not be detecting errors in how grantees are classifying activities, which can negatively affect the accuracy and reliability of NSP 1 output data and therefore the usefulness of these data for monitoring program progress and results.

We also found variation in how grantees selected output measures for different activity types. For example, one grantee selected "number of

[54]To illustrate, for a grantee that used a "rehabilitation" activity to report outputs for the acquisition and rehabilitation of five housing units, DRGR would show no properties under "acquisition" (understating the actual number of acquisitions by five). For a grantee that set up both "acquisition" and "rehabilitation" activities for acquiring and rehabilitating five units, DRGR would show five units under each activity. Consequently, totaling across these activities would result in double counting.

properties" as its sole output measure for the majority of its activities (including acquisition and rehabilitation) and did not select numbers of households benefiting, which HUD told us it considers the program's primary output measure. For the same activities, another grantee selected multiple output measures—number of properties, housing units, households benefiting, and persons benefiting. HUD officials said they explained the output measures grantees should input into DRGR as part of DRGR training and strongly encouraged grantees to select all applicable output measures. However, the documentation HUD staff cited as guidance for grantees, including the NSP 1 Notice, did not provide specific instructions on which output measures should be linked to each activity type. Additionally, while HUD's QPR checklist requires field staff to determine whether grantees used the "right" output measures for each activity, it does not specify which output measures should be entered for each activity type. As a result, HUD may not be collecting consistent output data for each activity, which impairs the agency's ability to summarize and report on program outputs in an accurate and consistent manner.

GAO's *Standards for Internal Control* emphasizes the need for federal agencies to collect reliable information with which to manage their programs and to review the integrity of performance measures.[55] Due to limitations in HUD guidance to grantees and field office staff, HUD lacks assurance that these standards are being met.

A Planned Assessment of NSP Outcomes Will Focus on NSP 2 but Will Also Include NSP 1-assisted Areas

HUD is in the process of contracting for an assessment of NSP that will evaluate the impact of the program by tracking outcomes in the neighborhoods where NSP-assisted activities took place.[56] HUD's Office of Policy Development and Research (PD&R) is overseeing the assessment in collaboration with CPD. The assessment will focus primarily on the impacts of NSP 2—which funds the same types of activities as NSP 1—but will also incorporate the results of NSP 1 where the two rounds of the program overlap. According to PD&R staff, many neighborhoods receiving NSP 2 funds also received NSP 1 funds. HUD does not plan to conduct a separate assessment of NSP 1 outcomes, in part because HERA did not

[55]See GAO, *Standards for Internal Control in the Federal Government,* GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

[56]Outcomes describe the intended result of carrying out a program or activity.

provide funding for an evaluation. However, ARRA, which authorized NSP 2, did provide funds for program evaluation.

HUD has established outcome measures for NSP. In its May 2009 Notice of Funding Availability (NOFA) for NSP 2, HUD established short- and long-term outcome measures as guidance for grantees in their application process. CPD staff said they would also apply these measures to NSP 1. The outcome measures are

- short-term: (1) arrest decline in home values and (2) reduce or eliminate vacant and abandoned properties; and
- long-term: (1) increase sales in target areas and (2) increase median property values.

PD&R staff said they have been working closely with CPD to develop the objectives and scope of the assessment. They said the assessment will track conditions and trends in NSP-assisted neighborhoods in relation to the short- and long-term outcome measures. They also will attempt to identify suitable comparison areas (e.g., similar areas that did not receive assistance) to demonstrate the impact of NSP, but expect this to be more challenging. Additionally, PD&R staff noted that DRGR was structured to track spending by DRGR activity rather than by property, making it difficult to determine the amount of NSP 1 funds that were spent in a particular geographic area. PD&R staff plan to obtain and review additional records from NSP 2 grantees to determine the amount of funds spent on NSP 2 properties and may collect similar information for NSP 1 properties in areas served by both rounds of the program. HUD is anticipating that the assessment will be completed no earlier than January 2014. Given that NSP 1 and NSP 2 share a common set of eligible activities, the results of the assessment should be useful for understanding the impact of both rounds of the program on assisted neighborhoods.

Conclusions

NSP 1 provided a mechanism for state and local governments to mitigate the destabilizing effects of mortgage foreclosures, but HUD and grantees faced a number of implementation challenges, including the program's tight time frames and the limited capacity of some grantees to undertake real estate activities. HUD took actions to help grantees meet these challenges though guidance, training, and technical assistance. Additionally, HUD established internal control procedures to mitigate risks and promote compliance with program requirements. Our work suggests that these efforts helped grantees obligate funds in a timely manner, adopt strategies appropriate to their communities, and follow program rules. Nevertheless, because many NSP 1 activities have not been completed, continued HUD oversight will be required to ensure that any implementation and compliance problems are identified and addressed in an effective manner. In particular, HUD will need to follow through on its efforts to ensure that grantees are taking corrective actions on findings from on-site monitoring visits.

As NSP 1 and other rounds of NSP progress, assessing program outputs and outcomes will become increasingly important. HUD took a number of important steps to collect key program data in DRGR, including information on grantees' activities and performance measures. However, variation in how grantees entered this information make it difficult to accurately summarize program outputs without undercounting (in the case of activity-specific outputs) or overcounting (in the case of program-wide outputs). While HUD has developed a method to resolve the overcounting issue, limitations in HUD's written guidance to grantees and field staff may be contributing to variation in data entry and impairing HUD's ability to accurately summarize program outputs. Existing guidance does not require field staff to review whether grantees properly grouped activities and does not specify which output measures grantees should select for each type of activity. Similarly, HUD has not provided grantees with written guidance specifying the output measures they should select for different activity types. In the absence of such guidance, HUD lacks assurance that it is collecting consistent information from NSP 1 grantees and that it is summarizing and reporting program outputs in an accurate manner. Because grantees involved in NSP 2 and 3 also are using DRGR, addressing limitations in written guidance would benefit HUD's analysis of output data for all rounds of NSP.

Recommendations for Executive Action

To ensure the consistency of data collection in DRGR and enhance the reporting of program outputs for all rounds of NSP, we recommend that the Secretary of HUD take the following two actions:

- Update the QPR review checklist to include reviews of whether grantees are (1) grouping activities in accordance with HUD instructions and (2) selecting the appropriate output measures for different activities.
- Issue written guidance to NSP grantees on the output measures they should select for different activities.

Agency Comments and Our Evaluation

We provided a draft of this report to HUD for its review and comment. We received written comments from the Deputy Assistant Secretary for Grant Programs, CPD, that are reprinted in appendix II. We also received technical comments from HUD that we incorporated into the final report as appropriate. In its written comments, HUD stated that, in general, the draft report accurately represented its efforts to implement NSP 1. HUD also agreed to implement both of the report's recommendations in the first half of 2011.

We are sending copies of this report to the appropriate congressional committees, the Secretary of Housing and Urban Development, and other interested parties. In addition, the report will be available at no charge on GAO's Web site at http://www.gao.gov.

If you or your staffs have questions about this report, please contact me at (202) 512-8678 or sciremj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix III.

Mathew J. Scirè
Director, Financial Markets
and Community Investment

Appendix I: Objectives, Scope, and Methodology

Congress created the Neighborhood Stabilization Program (NSP), which is administered by the Department of Housing and Urban Development (HUD), to help reduce the number of foreclosed and abandoned properties and restore depressed local housing markets. The Housing and Economic Recovery Act of 2008 (HERA) authorized the first phase of this program (NSP 1), providing $3.92 billion in grant funds to states and local governments.[1] HERA mandated that GAO report on whether NSP 1 funds were being used in a manner consistent with criteria set forth in the act. To respond to this mandate we examined (1) grantees' progress and challenges in meeting NSP 1 obligation time frames and income-targeting criteria, (2) HUD's actions to mitigate program risks and ensure grantees' compliance with key NSP 1 requirements, and (3) HUD's efforts to collect program data and assess program performance.

Grantee Progress and Challenges

To examine NSP 1 grantees' progress and challenges in meeting HERA obligation time frames and income-targeting criteria, we reviewed data from HUD's Disaster Recovery Grant Reporting (DRGR) system on grantee obligations, analyzed states' methods for distributing funds to other entities for obligation, and interviewed representatives from selected NSP 1 grantees (see selection criteria below). We also reviewed relevant HERA provisions and program guidance from the Department of Housing and Urban Development (HUD), including the NSP 1 Notice.

We analyzed DRGR data as of June 24, 2010, and October 1, 2010, to calculate the percentage of their grant allocation each grantee had obligated at both points in time. Using the October data, we also calculated the overall percentage of NSP 1 funds obligated by grantees and the proportion of funds obligated for different activities. To do these calculations, we used the approach set forth in the NSP 1 Notice, which does not differentiate between obligation of grant funds and program income in assessing progress toward obligation deadlines.[2] For the

[1]P.L. 110-289. The American Recovery and Reinvestment Act of 2009 (P.L. 111-5) provided an additional $2 billion in NSP funds (referred to as NSP 2) and changed several aspects of the program. The Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203), enacted in July 2010, provided an additional $1 billion for the program (referred to as NSP 3). This report focuses on NSP 1.

[2]That is, we considered grantees to have met the obligation requirement as long as they obligated grant funds and program income in an aggregate amount equal to their NSP 1 allocation. HUD officials said they took this approach so as not to penalize grantees that progressed faster in implementing NSP 1, potentially resulting in larger amounts of program income.

analysis of obligations by activity type, we combined the data for acquisition, rehabilitation, and disposition because—as described in the body of this report—grantees sometimes group two or more of these activities together under a single activity in DRGR.

Because state grantees could reallocate their funds to other entities (e.g., local governments) for obligation as long as the funds targeted areas of greatest need, we examined the methods states used to distribute their NSP 1 funds. We did this by analyzing information in DRGR on states' HUD-approved NSP 1 action plans to determine whether the states used required criteria for determining areas of greatest need and the types of distribution methods they used, including reallocation by competition, reallocation by formula, and through state-administered programs. Additionally, by analyzing DRGR data as of June 24, 2010, we also determined the number of states that reallocated funds to local governments that had also received NSP 1 funds directly from HUD. We also determined the number of local governments that received NSP 1 funds both directly from HUD and from state reallocations, as well as the amount and percentage of program funds this represented. The funding amounts and percentages are approximate because in two states it was unclear from HUD data how reallocations were divided between two recipients, only one of which was a direct grantee. We included the entire reallocations for these two cases ($3.6 million in total) in our nationwide total of $175.8 million as it seemed likely that the funds were used by the direct grantee.

We also assessed the reliability of the DRGR information (discussed later in this section). We concluded that the data we used were sufficiently reliable for our purposes.

We interviewed 11 grantees to discuss their approaches to implementing NSP 1, the progress they had made, and challenges they faced in meeting obligation time frames and income-targeting criteria. We selected these grantees to cover areas with substantial foreclosure problems and provide some variation in geographic location, housing market conditions, and grantee types. We also focused on grantees that had made some progress in implementing their NSP 1 programs. The grantees were: State of Indiana, City of Fort Wayne, and City of Indianapolis (Indiana); Lee County, Orange County, and City of Tampa (Florida); and State of Nevada, Clark County, City of Henderson, City of Las Vegas, and City of North Las Vegas (Nevada). We had previously spoken with these grantees during the first phase of our work, which we conducted in April through December 2009.

We also interviewed officials from four HUD field offices about grantees' progress and challenges in implementing NSP 1. We selected these field offices to provide some geographic variation and because they were responsible for overseeing some of the grantees that we visited on-site. The field offices were located in Columbus, Ohio; Miami, Florida; Philadelphia, Pennsylvania; and San Francisco, California.

We also spoke with staff from NeighborWorks® America and the National Community Stabilization Trust to obtain their perspectives on grantees' progress and challenges.

HUD's Actions to Mitigate Risks and Ensure Compliance

To examine the steps HUD has taken to ensure grantees' compliance with key NSP 1 requirements and mitigate program risks, we reviewed NSP 1 statutes and regulations and HUD's front-end risk assessment (FERA) for the program. We reviewed relevant documentation and interviewed HUD officials about the agency's efforts to hire additional staff to address gaps in capacity to oversee NSP 1 grantees (a program risk identified in the FERA) and to provide training and technical assistance to grantees. Additionally, we interviewed staff from the 11 grantees described above about HUD's training, technical assistance, and oversight processes for NSP 1 to obtain their perspectives on these efforts.

We reviewed HUD's internal controls for NSP 1, including HUD's guidance and procedures for monitoring grantee compliance with key program requirements. In addition, we reviewed results of on-site monitoring of NSP 1 grantees conducted by the four field offices we contacted. More specifically, we reviewed the results for the 40 grantees for which the field offices had completed monitoring letters as of September 15, 2010.[3] In addition, we interviewed HUD headquarters and field office officials on the status and results of their on-site monitoring.

Additionally, we visited 8 grantees to conduct limited tests of compliance with key program requirements. We purposefully selected the grantees to cover different eligible NSP 1 activities, types of grantees, and geographic areas where characteristics of housing markets may vary. The grantees we selected were: Collier County and Lee County (Florida); City of Columbus

[3]In total, the four field offices are responsible for overseeing 86 NSP 1 grantees, 50 of which they monitored on-site. Sixty days after completing an on-site visit, HUD field staff send a monitoring letter to the grantee discussing, among other things, the field staff's conclusions, any monitoring findings, and any corrective actions required.

and City of Dayton (Ohio); Maricopa County and City of Phoenix (Arizona); Philadelphia, Pennsylvania; and Prince William County, Virginia. We primarily focused on grantees with completed activities, which intentionally overrepresented grantees that had made the most progress in implementing NSP 1 at the time of our review and ensured we would review a variety of activities for compliance with NSP 1 key requirements. Further, to avoid overburdening grantees, we focused our site visits on grantees that, on the basis of information from HUD, were not receiving extensive technical assistance or being monitoring on-site by HUD staff.

At each grantee, we reviewed records for four properties, for a total of 32 properties in our sample. To select the four properties to be reviewed at each grantee, we obtained a list of NSP 1 properties with completed activities and applied the following steps: (1) We identified the group of properties with the largest number of completed activities (e.g., acquisition, rehabilitation, resale, etc.). We grouped the remaining properties by type of activity. (2) We allocated the number of properties to be selected from the different groupings to intentionally capture properties with the most completed activities, while also covering the grantee's full range of activities. (3) We randomly selected properties from each group up to the predetermined allocation.

We developed a checklist to review compliance with program requirements and internal controls for the following types of activities for each property: acquisition, rehabilitation, demolition, financing, and resale. We selected the checklist components by reviewing federal internal control standards and analyzing NSP 1 requirements in statutes, regulations, and relevant HUD program guidance. Figure 8 in the body of this report includes the requirements and controls we reviewed.

We are not able to generalize the results of our compliance testing to all NSP 1 grantees or activities. We did not conduct financial audits of the 8 grantees or the 32 properties.

HUD Data Collection and Performance Assessment

To examine HUD's efforts to collect program data and assess the reliability of NSP data, we reviewed HUD Office of Inspector General (OIG) audits of the DRGR system. We interviewed OIG staff about these audits and reviewed documentation on HUD's actions to address the OIG's recommendations. We also reviewed documentation on HUD's modifications to DRGR and efforts to train system users. This information included HUD training materials and guidance to grantees and field staff on entering and reviewing data on program activities and output measures. We also interviewed HUD headquarters, HUD field office, and grantee staff with responsibilities for inputting or monitoring DRGR data. We also conducted reasonableness checks of DRGR data to identify any missing or erroneous data and by interviewing knowledgeable HUD officials to ensure we interpreted the data correctly. For the purpose of this and the first objective, we concluded that the data we used were sufficiently reliable for our purposes.

Additionally, we reviewed the NSP output data that HUD posted on its NSP Web site and included in the Administration's monthly housing scorecard. Furthermore, we examined DRGR action plans and Quarterly Performance Reports (for the second quarter of calendar year 2010) for 18 grantees—the 11 cited previously plus others we visited on-site (described in the previous section of this appendix). Our examination focused on the consistency with which grantees set up activities and selected program output measures in DRGR when entering their action plans and performance reports, and the extent to which they followed applicable HUD guidance. Finally, we reviewed federal internal control standards relevant to data quality and controls.

To obtain information on HUD's plans to assess NSP 1, we reviewed the scope of work for a planned HUD study of NSP program outcomes. In addition, we interviewed HUD staff knowledgeable of the study, including officials from HUD's Office of Policy Development and Research and Office of Community Planning and Development.

We conducted this performance audit from January to December 2010, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Department of Housing and Urban Development

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-7000

OFFICE OF COMMUNITY PLANNING
AND DEVELOPMENT

DEC - 6 2010

Mr. Matthew J. Sciré
Director, Financial Markets and
Community Investment
US Government Accountability Office
441 G St., NW
Washington, DC 20548

Dear Mr. Sciré:

Thank you for the opportunity to comment on the draft report entitled "Neighborhood Stabilization Program – HUD and Grantees Are Taking Actions to Ensure Program Compliance but Data on Program Outputs Could be Improved."

In general, the Department finds that the draft report accurately represents the Department's efforts to implement the Neighborhood Stabilization Program (NSP1) since its enactment as part of the Housing and Economic Recovery Act of 2008 (HERA). Editorial comments on the draft report have been informally conveyed to your staff via a conference call on December 2, 2010. This letter provides a response to the Recommendations for Executive Action identified in the draft report.

The first recommendation calls for HUD to "[U]pdate the QPR review checklist to include reviews of whether grantees are (1) grouping activities in accordance with HUD instructions and (2) selecting the appropriate output measures for different activities." The Department will revise the QPR checklist in draft format and issue it to Community Planning and Development (CPD) field staff for testing by March 31, 2011. Based on comments received from the field testing effort, HUD intends to issue a final revised QPR checklist not later than June 30, 2011.

The second recommendation call for HUD to "issue written guidance to NSP grantees on the output measures they should select for different activities." The Department concurs with the recommendation and will issue guidance on this point not later than March 31, 2011.

The Department appreciates the willingness of your staff to accommodate CPD staff schedules and workload considerations over the duration of this engagement as we have worked to implement not only NSP1 but also NSP2 and NSP3. Please contact me at (202) 708-2111 if you have any questions regarding this matter.

Sincerely,

Yolanda Chávez

Yolanda Chávez
Deputy Assistant Secretary
for Grant Programs

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Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Mathew J. Scirè, (202) 512-8678 or sciremj@gao.gov

Staff Acknowledgments

In addition to the individual named above, Steven Westley, Assistant Director; Allison Abrams; Emily Chalmers; Mya Dinh; Ying Long; John McGrail; Meredith Moore; Jasminee Persaud; and Carl Ramirez made key contributions to this report.

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