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REPORT TO THE CONGRESS ~~7/10/77~~

093662



BY THE COMPTROLLER GENERAL OF THE UNITED STATES

Major Changes Are Needed In The New Leased-Housing Program

The section 8 leasing program--the principal Federal program for housing lower income persons since August 1974--has not provided housing to the number of lower income persons and stimulated the number of new housing starts originally anticipated. Problems hindering the program include

- reluctance of owners, public housing agencies, and developers to participate,
- fair market rents allowed owners may be too low for program success,
- the inability of developers and State agencies to obtain suitable financing for construction or rehabilitation of housing units,
- program requirements may be too complex for low-income participants and/or developers, and
- administrative problems relating to staffing and allocation of funds.

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

B-171630

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

This report identifies problems that developers, owners, housing authorities or agencies, and lower income participants encountered or foresaw with the Department of Housing and Urban Development's section 8 leased-housing program and suggests improvements to the program.

We reviewed the program because it is a new and untried program which the Department is relying on almost exclusively to house the Nation's lower income families, and because of its potential significant cost.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

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

A handwritten signature in black ink, appearing to read "James A. Strickland".

Comptroller General
of the United States

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ABBREVIATIONS

| | |
|------|---|
| ACC | annual contribution contract |
| FMR | fair market rent |
| FNMA | Federal National Mortgage Association |
| GAO | General Accounting Office |
| GNMA | Government National Mortgage Association |
| HAP | housing assistance plan |
| HCD | Housing and Community Development |
| HUD | Department of Housing and Urban Development |
| PHA | public housing agency |
| SMSA | standard metropolitan statistical area |

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

MAJOR CHANGES ARE NEEDED IN
THE NEW LEASED-HOUSING PROGRAM
Department of Housing and
Urban Development

D I G E S T

B

[The Department of Housing and Urban Development's section 8 leasing program--the principal Federal program for housing lower income persons since August 1974--has had limited success in providing occupancy for lower income persons and stimulating new housing starts.]

As of September 30, 1976 (over 2 years after the program was established), 88,880 lower income families were receiving program assistance--84,513 in the program for existing housing and 4,367 in the new construction and substantial rehabilitation programs.

The Department did not specify the number of occupied units that it had expected to have to date. The Department has cited quick occupancy as an advantage of the existing housing program and made an early estimate that 140,000 units would be committed for occupancy by September 30, 1976. Only about 85,000 units were occupied by that date.

Also, [the Department had advised the Senate Committee on Appropriations that there would be 90,000 to 140,000 new section 8 housing starts by June 30, 1976. According to September 30, 1976, Department statistics there have been only about 20,800 housing starts.]

fc

[Major changes are needed to improve administration and increase activity under the four separate section 8 programs--existing, newly constructed, substantially rehabilitated, and State agency housing.]

The Department has received about \$1.9 billion of contract authority to provide about 695,000 units through fiscal year 1977. It estimates that the \$1.9 billion could cost up to \$41 billion--depending on the leases, some of which could be for 40 years.

Under the law that established the section 8 program--the Housing and Community Development

Act of 1974--the Department funds public housing agencies or private owners to encourage them to rent private housing to lower income persons. Families whose incomes do not exceed 80 percent of the median income of the area they live in generally are eligible for housing assistance. Persons in the program pay rents equal to between 15 and 25 percent of their gross incomes. The Department subsidizes the difference between the total rent, which is based on the fair market rent set by the Department, and the amount paid by the family.

ADMINISTRATIVE PROBLEMS LIMITING PROGRAM EFFECTIVENESS

[Because program regulations and guidelines had not been developed, Department field offices could not accept and process applications for participating in the program or advertise for proposals to build or rehabilitate housing units until about 8 months after the program was established.] (See p. 6.)

[Even after regulations and guidelines were developed, the field offices lacked sufficient, experienced staff to implement the program promptly.] (See p. 8.)

[Two field offices allocated program funds to communities in a way not in accord with congressional intent--they did not consider communities' required housing assistance plans. Also, one field office adjusted the amount of funds some communities were to receive.] As a result, one community received about \$4.4 million less than the Department's central office formula for allocating funds would have given it. (See pp. 9 and 13.)

SECTION 8 FAIR MARKET RENTS MAY BE TOO LOW FOR PROGRAM SUCCESS

[Weaknesses in Department methods to establish program rents resulted in rents which appear too low to encourage sufficient participation by private housing owners in the program.] Public housing agency officials generally believe the low rents may adversely affect the program because

--landlords will not participate unless they are encountering vacancy problems,

--acceptable, standard units are not available within program rent ceilings except in "impacted areas" (areas of minority and lower income group concentrations), and

--officials will be under pressure to approve marginal or substandard units for leasing.

{ Public housing agency officials also believe that owners' unwillingness to assume the management risks associated with housing lower income families with children will result in disproportionate assistance to lower income elderly persons to the detriment of large and very-low-income families. } (See p. 17.)

{ Various housing officials believed that the program would not be successful unless "premium" rents (rather than the prevailing market rents) were paid. } (See p. 17.)

DIFFICULTIES IN IMPLEMENTING THE
SECTION 8 PROGRAM FOR EXISTING
HOUSING

Several problems, in addition to those previously discussed, appear to be limiting existing housing program activity.

{ Some owners are reluctant to participate in the program because they believe the Department-established fair market rents will not compensate them for complying with the section 8 requirements and for accepting the heavier management burden which they believe comes with renting to lower income persons. } (See p. 33.)

{ Some smaller communities and public housing agencies also have refused or were unable to participate due to small section 8 allocations and/or low administrative fees which, they asserted, would not support the cost of an effective program. } (See p. 38.)

{ Program activity has also been limited by program regulations which assign lower income participants numerous complex responsibilities and by public housing agency-imposed residency requirements which restrict participant mobility. } (See pp. 41 to 44.)

LIMITED ACTIVITY BY PRIVATE DEVELOPERS
IN NEW CONSTRUCTION AND SUBSTANTIAL
REHABILITATION PROGRAMS

As of September 30, 1976, (private developers) were constructing and rehabilitating only about 10,000 units, and only about 1,306 units were occupied.

*how limited financing
activities
housing
of*

Developers, mortgage banking officials, and Department officials identified the following major reasons for this limited activity:

- { Lack of financing. (See pp. 60 to 62.)
- Owners' numerous program responsibilities compared with the low financial rewards. (See p. 63.)
- Low Department-established fair market rents.]
(See p. 22.)

These same people told GAO that getting conventional financing for constructing section 8 projects for other than the elderly was almost impossible. Developers said also that Department mortgage insurance programs were not economically feasible alternatives for financing. Thirteen of 14 section 8 proposals submitted for mortgage insurance in the Department's Jacksonville, Florida, office were disapproved for not meeting certain mortgage insurance program criteria. (See p. 62.)

LIMITED STATE
AGENCY ACTIVITY

{ State agencies have been unable to sell bonds to finance section 8 projects. } Investors apparently do not want to invest in State bonds despite their tax-exempt status and record-high interest rates because the bonds lack the security and higher return available in the corporate bond market.]
The Department had believed that the 40 State agencies would provide the early construction success in the section 8 program because of their prior housing and financing experience. But, as of December 31, 1975, the Wisconsin Housing Finance Agency was the only State agency able to sell bonds exclusively to finance section 8 housing projects. (See pp. 72 and 73.)

As of September 30, 1976, State agencies had only 10,792 units under construction and only 3,061 units completed. The Department reduced its fiscal year 1976 production goal for State agencies from 100,000 units to 20,000.

RECOMMENDATIONS

NA [The Secretary of Housing and Urban Development should make major changes to improve the administration and increase activity under the section 8 program. The Secretary could improve program administration by, among other things, insuring that Department field offices

--have an appropriate number of adequately trained staff (see p. 14) and

--allocate section 8 funding (contract authority) to communities in accordance with statutory criteria. (See p. 14.)

The Secretary should make several program changes concerning the Department-established fair market rents. (See p. 29.)

The Secretary should also consider a number of alternatives which may enhance owners' participation in the program and developers' ability to obtain financing. (See pp. 55 and 68.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Department said GAO's recommendations appeared reasonable and of high quality and many of them were being implemented. Although the Department disagreed with some of GAO's recommendations, GAO believes the Department's reasons for disagreeing can be overcome and the recommendations should be adopted.

MATTERS FOR CONSIDERATION BY THE CONGRESS

RC [In enacting various laws the Congress has discouraged the Department from housing lower income families with children in high-rise elevator buildings. But because the section 8 program primarily involves eligible families shopping for housing of their

choice, the Department has permitted families with children to occupy such high-rises. The Congress should review this Department practice. }
(See p. 58.)

CHAPTER 1

INTRODUCTION

The Housing and Community Development Act (HCD) of 1974 (Public Law 93-383, Aug. 22, 1974) amended the United States Housing Act of 1937 (42 U.S.C. 1401) and added, under section 8, a new lower income housing assistance program. Section 8 provides financial assistance to lower income families enabling them to lease existing, newly constructed, or substantially rehabilitated housing.

Under section 8, the Department of Housing and Urban Development (HUD) makes payments pursuant to annual contribution contracts 1/ to public housing agencies (PHAs) 2/ authorized to engage or assist in developing or operating housing for lower income families; HUD also may contract directly with owners who agree to lease housing units to eligible families. Owners are responsible for operating and maintaining these units.

Program eligibility depends on family size and income, compared with the median income in the community. Lower income families are required to pay not less than 15 nor more than 25 percent of their gross incomes for rent. At least 30 percent of the assisted units are to be initially occupied by very-low-income families and, to the extent possible, this level is required to be maintained in subsequent leasing. A Federal subsidy is paid equal to the difference between contract rent 3/ (including utilities)--based on HUD-established

1/Written agreements between HUD and public housing agencies in which HUD agrees, pursuant to the housing act, to pay the agencies annual contributions to cover housing assistance payments and other expenses.

2/State, county, municipality, or other governmental entities or public bodies authorized to engage or assist in developing or operating housing for lower income families.

3/Rent payable to the owner under his contract, including the portion of the rent payable by the tenant.

fair market rent (FMR) 1/--and the amount payable by an eligible family.

DIFFERENCES BETWEEN SECTION 8
AND PREVIOUS SUBSIDY PROGRAMS

In January 1973 HUD suspended the low-rent public housing program, along with other HUD-assisted housing programs, such as sections 235 and 236, until a study could determine whether the programs should be continued, revised, or terminated. After this study was completed, the President announced in September 1973 that only the section 23 low-rent public housing leasing program, under which local housing authorities lease privately owned accommodations to provide low-income housing, would be resumed. The conventional (PHA-owned) public housing program to provide housing for Indians and commitments which HUD entered into before January 1973 for constructing public housing units were exempt from the suspension.

Principal reasons HUD cited for terminating conventional public housing and sections 235 and 236 programs included:

- The programs led to a concentration of low-income families with many social problems and needs.
- The programs benefited only a small percentage of eligible households.
- Sections 235 and 236 failed to serve families with incomes below the poverty levels.

Since August 1974, when the HCD Act replaced the section 23 program with section 8, HUD has viewed the section 8 program as its principal program for assisting lower income persons to find decent, safe, and sanitary housing. HUD officials have cited the following as advantages of the section 8 program, compared with the previous subsidy programs:

- Section 8 subsidies are linked to HUD-established fair market rents to emphasize use and conservation

1/Rent--including utilities (except telephone), ranges and refrigerators, and all maintenance, management, and other services--which, as determined at least annually by HUD, would be required to be paid to obtain modest (nonluxury), privately owned, standard rental housing with suitable amenities.

of privately owned existing housing rather than to construction costs which emphasize new construction.

--Section 8 is intended to avoid concentration of lower income persons by permitting them a freedom of choice within a community for location of housing.

--Section 8 is designed to encourage mixing of socioeconomic groups by placing a processing priority on newly constructed projects that are to be only partially subsidized.

--Section 8 is structured to insure that the very-low-income persons are provided an opportunity for assistance.

--Section 8's eligibility criteria are designed to serve a broader income range.

SECTION 8 ASSISTANCE GOALS

HUD has revised the total number of units to be supported and the program mix among existing, new construction, and substantially rehabilitated housing several times since the inception of section 8. HUD initially estimated that 200,000 section 8 units would be assisted during fiscal year 1975; in April 1975 it reduced that number of units to 40,000. HUD estimated that 400,000 section 8 units would be assisted during the 15-month period ending September 30, 1976. HUD initially planned to assist an additional 400,000 units during fiscal year 1977 but by September 30, 1976, this had been reduced to an estimated 200,000 units.

As shown on the next page, HUD has revised the program mix for the 15-month period ending September 30, 1976, and is placing greater emphasis on the existing program and less on the new construction and substantial rehabilitation programs. During this period HUD planned to use section 8 to assist 100,000 units in loan management. These are housing units in projects with HUD-insured mortgages that have defaulted and whose mortgages have been either assigned to HUD or are in imminent danger of assignment to HUD but have not been foreclosed. In addition, section 8 was to assist 10,000 units in property disposition. (These are HUD-owned or -acquired units that have been foreclosed.) The program mix for achieving the September 30, 1976, goal of 400,000 assisted units is shown on the next page.

Units to be assisted during 15-month
period ending September 30, 1976

| <u>Program</u> | <u>Original 1976 budget estimate</u> | <u>Revised 1976 budget estimate</u> | <u>Difference (decrease)</u> |
|---|--|---|----------------------------------|
| Existing: | | | |
| Regular | 100,000 | 165,000 | 65,000 |
| Loan management | - | 100,000 | 100,000 |
| Property dis- position | <u>-</u> | <u>10,000</u> | <u>10,000</u> |
| Total | <u>100,000</u> | <u>275,000</u> | <u>175,000</u> |
| New construction and substantial rehabilitation: | | | |
| Private developers | 200,000 | 105,000 | (95,000) |
| State agencies | <u>100,000</u> | <u>20,000</u> | <u>(80,000)</u> |
| Total | <u>300,000</u> | <u>125,000</u> | <u>(175,000)</u> |
| Total units | <u>400,000</u> | <u>400,000</u> | - |

HUD has available \$1,369 million of contract authority ^{1/} (\$761 million carried forward from fiscal year 1975 and \$608 million authorized for 1976) to provide assistance for 400,000 units. In addition, HUD received about \$520 million of contract authority which, when added to about \$269 million of authority carried forward from prior years, will provide assistance for an estimated 200,000 additional units during fiscal year 1977. The \$1.9 billion of section 8 contract authority provided by the Congress could have a total future cost of up to about \$41 billion (depending on the leases, some of which could be for 40 years).

^{1/}Authority granted to HUD by the Congress to enter into contracts to make annual subsidy payments over a number of years to support the construction and/or operation of low-income housing.

CHAPTER 2

ADMINISTRATIVE PROBLEMS LIMITING

PROGRAM EFFECTIVENESS

As of May 1, 1976, some 20 months after the section 8 program was enacted, only 18,382 units were occupied and only 5,914 additional units were under construction. As of September 30, 1976, HUD statistics showed some improvement--88,880 units were occupied and about 20,800 units were under construction. A HUD central office official said this increase was primarily existing housing units and was due principally to an improved field office reporting system. The program's slow start was due to a multitude of problems. This chapter discusses the following administrative problems which have adversely affected implementation of the section 8 program.

- Acceptance and processing of applications for participation in the program and advertising for new construction and substantial rehabilitation proposals were delayed 8 months while HUD developed program regulations and guidelines.
- Field offices 1/ lacked sufficient, experienced staff to quickly implement the program.
- The allocations of section 8 funds by two of the six HUD field offices we reviewed were not in accordance with congressional intent in that the allocations of program mix--number of existing housing units versus units of new construction to be assisted--were made without considering the proposed housing programs set forth in the communities' housing assistance plans (HAPs). 2/ Also, one field office excluded two of five indicators of need identified in the act as suggested guidance for determining allocations for financial assistance and included an adjustment factor which, in effect, reduced some communities' allocations because they had participated in previous HUD-subsidized programs.

1/Throughout this report, "field office" refers to area and/or regional offices. A regional office may include one or more area offices.

2/Plans required by the HCD Act which, among other things, assess housing needs in the communities and specify realistic annual goals for the number of units to be assisted, including the relative proportion of new, rehabilitated, and existing dwelling units.

DELAYS IN DEVELOPING PROGRAM
REGULATIONS AND GUIDELINES

The HCD Act of 1974 authorizing section 8 was enacted in August 1974. Although the act set January 1, 1975, as the date the program was to become effective, final regulations for the different program elements were not issued until 3-1/2 to 4 months later. As shown in the following schedule, 8 months elapsed from the date section 8 was authorized before program regulations and guidelines were issued. During this period, PHAs could not be invited to apply for the existing housing program, and HUD field offices could not begin advertising for proposals from builders for the new construction and substantial rehabilitation programs.

| <u>Key steps in program implementation</u> | <u>Date</u> |
|---|-------------------------|
| 1. HCD Act of 1974 authorized section 8 program | Aug. 22, 1974 |
| 2. Central office allocated funds to regional offices | Jan. 20 and 30, 1975 |
| 3. Final FMRs published | |
| New construction/substantial rehabilitation | Mar. 31, 1975 |
| Existing housing | Apr. 7, 1975 |
| 4. Final regulations published | |
| State housing finance agencies | Apr. 15, 1975 |
| New construction | Apr. 29, 1975 |
| Substantial rehabilitation | Apr. 30, 1975 |
| Existing housing | May 5, 1975 |
| 5. Handbooks issued | |
| State housing finance agencies | Apr. 28, 1975 |
| Existing housing | Apr. 29, 1975 |
| Substantial rehabilitation | May 1, 1975 |
| New construction | May 14, 1975 |

The Secretary of HUD testified before the Congress in April 1975 that section 8 was actually four new programs--new construction, substantial rehabilitation, existing housing, and State agencies. She said the delay in issuing final regulations occurred primarily because section 8 was a major and comprehensive new program that required great care in formulating regulations. The Secretary explained that the complex statutory provisions and the novelty of the concept, as well as a concern that the regulations avoid the abuses and inequities of the old housing subsidy programs, had made implementation particularly difficult and lengthy. She also pointed out that countless hours had been spent consulting with private, public, and governmental groups in preparing the rules.

We noted two instances of additional delays in implementing the new construction and existing housing elements of the program after the regulations were final. In the first instance, two of the six HUD field offices included in our review--San Francisco and Los Angeles--did not advertise for proposals for construction of section 8 units until September 1975, about 4 months after final regulations were issued. Los Angeles area office officials said they concentrated first on implementing the existing housing element of the program before addressing the new construction element. The San Francisco area office delayed its advertising until the HUD central office considered and disapproved regulation changes proposed by the San Francisco office.

Under the new construction program, HUD estimates it takes 22 to 28 months from the time proposals are requested for construction of housing units until the units are ready for occupancy. Delays in advertising for proposals add to the time needed to make units available to house lower income families.

The second instance also involved the San Francisco area office. The processing of PHAs' existing housing applications was delayed several months because that office failed to initially request PHAs to submit with their applications certain information required by State law and HUD regulations. (The area office should have known about the State law, as it had existed for several years and other HUD offices in California were aware of it.)

For example, HUD regulations require that a PHA, in applying for the section 8 program, demonstrate that it qualifies as a PHA and is legally authorized to participate in the program for the area where the program is to be carried out. The San Francisco area office did not initially require PHAs to submit documentation showing that they had authority to

provide section 8 housing in communities within their jurisdictions. Because the documentation was needed before HUD could approve applications, several months elapsed while the area office returned the applications to PHAs for the needed information. In one case, the area office noted that a PHA had not submitted the necessary documents but failed to tell the PHA to submit the information until 4 months later, when a PHA official asked for the status of his application.

HUD's central office stated that, although a delay of some months before issuing a single invitation is a questionable practice, there is merit in issuing invitations over time since many simultaneous invitations (through advertisements) could overload the office's processing capability and cause processing delays at some cost to the developers who submitted proposals. The delays we noted, however, related primarily to delays in initially advertising for any units.

LACK OF SUFFICIENT AND EXPERIENCED STAFF

HUD field office staff and PHA officials stated that staffing shortages and inexperienced staff within HUD delayed implementation of the section 8 program. In the San Francisco area office, three of the four key staff members assigned to the program transferred to the regional office between July and December 1975. According to a field office official, only one experienced staff member remained in the area office. As of March 1, 1976, two of the three remaining positions were vacant and the other was filled temporarily.

The area office's section 8 workload appeared to warrant additional staff. HUD statistics as of December 26, 1975, showed that the San Francisco area office had received 27 preliminary proposals to build new units or rehabilitate existing ones, and 37 applications for existing projects containing over 10,000 units. However, these statistics also showed that none of the preliminary proposals for new or rehabilitated units and only 20 of the applications for existing housing projects had been approved. Also, only four annual contribution contracts had been executed for section 8 assistance for existing housing.

In the Los Angeles area office, the Housing Production and Mortgage Credit Division operated for a year without a director which, according to area office officials, hindered section 8's implementation. According to officials in the Jacksonville area office, advertising for new construction was suspended from August to December 1975 because the program was cumbersome and difficult to administer and because of staffing shortages. Jacksonville area office officials

said they needed at least two new staff members to promptly process new construction proposals.

A Chicago area office official said his staff was too small to promptly administer the actual and projected section 8 workload. Another Chicago official said he did not have the staff to perform rent surveys throughout the State and instead relied on PHA data for increasing rents. These officials said that, although they had three section 8 multifamily representatives, they needed two more. A Chicago regional office official also stated that the Milwaukee area office had no staff experienced in public housing production and that the two section 8 multifamily housing representatives Chicago had were inexperienced. According to HUD section 8 handbooks, the multifamily housing representative is the primary contact in a HUD field office for PHAs needing guidance concerning the section 8 program. A Chicago area office official said the three multifamily housing representatives must deal with more than 90 PHAs in the low-rent public housing program.

Some State agency officials also mentioned inexperienced HUD field office staff as hindering section 8 activity. For example, Illinois Housing and Development Agency officials said HUD staff were slow in deciding on environmental clearances and equal opportunity plans.

Officials in HUD's Chicago and San Francisco regional offices said their section 8 staffs had been inadequately trained. Chicago officials said the central office had held a few training sessions but all were before HUD had published its final guidelines and therefore were of limited value. San Francisco field office staff described their training as merely reading published regulations.

QUESTIONABLE ALLOCATIONS OF SECTION 8 CONTRACT AUTHORITY

Of the six HUD field offices reviewed, San Francisco and Milwaukee allocated section 8 contract authority to communities without considering the program mix that communities proposed in their housing assistance plans, which did not meet congressional intent.

Improper allocations of program mix

Section 104(a)(4) of the HCD Act, which covers community development block grants, provides that applicants must submit HAPs which, among other things,

- accurately survey the condition of the community's housing and assess the housing assistance needs of lower income persons (including elderly and handicapped persons, large families, and persons displaced or to be displaced) residing in or expected to reside in the community and
- specify a realistic annual goal for the number of dwelling units or persons to be assisted, including (1) the proportion of new, rehabilitated, and existing dwelling units and (2) the sizes and types of housing projects and assistance best suited to lower income persons in the community.

Through its HAP, a community is to annually relate development activities to an overall plan for providing housing for low- and moderate-income households. Under the statute, HAP's provisions govern HUD's approval of any subsidized housing in the community. HUD may not fund specific housing proposals from local, public, and private sponsors unless they are consistent with HAPs.

Section 8 regulations require that the area offices use HAPs to determine an area's program mix--distribution of funding to new construction, substantial rehabilitation, existing, and elderly/nonelderly housing. An August 1975 HUD memorandum to field offices explained that the legislative history of the HCD Act of 1974 made it clear that the proportion of funds for new construction, substantial rehabilitation, and existing housing was to be determined by local governments through their HAPs. The memorandum quoted a House Banking and Currency Committee report which said the opportunity for communities to make such judgment was "an extremely important innovation in Federal housing policy."

The Secretary of HUD stated in a 1975 letter to a Congressman that HUD concurred in this policy and specifically required field offices to follow it in allocating section 8 assistance. The Secretary's letter also pointed out that the HCD Act of 1974 was based on the philosophy that Federal assistance under section 8 should respond to communities' HAPs. The letter further noted that HUD approved HAPs according to statutory standards, but the basic judgment rested with the localities. The HAPs, therefore, are the main link between title I of the HCD Act (community development) and title II (assisted housing).

The San Francisco and Milwaukee area offices, however, ignored the program mix identified in the communities' HAPs. The San Francisco area office allocated 60 percent of each

community's section 8 funds to the existing program and 40 percent to new construction, while the Milwaukee office allocated 33 and 67 percent, respectively.

The following illustrates the impact of San Francisco's allocation on Tulare County, California. Tulare County's HAP proposed 940 units for assistance--100 existing units, 200 substantially rehabilitated units, and 640 units of new construction. Although the existing housing goal only represented about 11 percent of the county's overall goal, HUD allocated 485 units, or 60 percent of the county's section 8 contract authority, to existing housing. The percentage that should have been allocated, based on the county's HAP, would have been even less than 11 percent--existing units are much less expensive than new or substantially rehabilitated units based on section 8 FMRs and, therefore, more existing units than new or substantially rehabilitated units can be obtained with the same amount of contract authority.

We noted other instances in which allocations of section 8 assistance were made without regard to the communities' HAPs. For example, a Los Angeles area office official said he did not follow HUD-approved HAPs in determining section 8 program mix. Instead, he used area office data on the housing market areas in computing the number of new and existing units to be allocated to local communities because he said it was more accurate than the communities' data.

According to a Milwaukee area office official, some PHAs did not apply initially for section 8 existing housing assistance because the communities' HAPs showed that existing housing was not available. He said HUD convinced the PHAs to apply for existing housing funds, even though HUD had instructed him not to try to base first-year section 8 allocations on communities' housing goals as contained in HAPs.

Milwaukee area office officials told us that many PHAs disagreed with HUD's allocation procedure.

The Congress became concerned about HUD field office allocations of section 8 contract authority which disregarded communities' housing assistance plans. As a result, the Congress enacted the Housing Authorization Act of 1976, Public Law 94-375, on August 3, 1976. The act provides that the Secretary, in using contract authority provided on October 1, 1976, shall assist new, substantially rehabilitated, and existing units to the extent practicable and consistent with section 213(d) of the HCD Act of 1974, in accordance with the goals of local governments for such types of housing, as reflected in their HAPs.

Some communities' allocations reduced because of previous participation in HUD programs

The San Francisco area office excluded two of five indicators of need identified in the act for determining allocations and included an adjustment factor which reduced some allocations because communities had participated in previous HUD-subsidized programs.

Section 213(d)(1) of the HCD Act of 1974 specifies that

" * * * the Secretary, so far as practicable, shall consider the relative needs of different areas and communities as reflected in data as to population, poverty, housing overcrowding, housing vacancies, amount of substandard housing, or other objectively measurable conditions, subject to such adjustments as may be necessary to assist in carrying out activities designed to meet lower income housing needs as described in approved housing assistance plans by units of general local government * * * ."

The Secretary of HUD testified before the Housing Subcommittee on Housing and Community Development in July 1975 that in allocating section 8 contract authority:

"The factors taken into account, consistent with section 213 of the 1974 act, are population, poverty, housing overcrowding, housing vacancies, and amount of substandard housing * * * ."

"The field offices then make a further suballocation to local communities, taking into account the same factors and the housing assistance plans.

" * * * section 213(d) of the Housing and Community Development Act of 1974 specifies the formula by which we make the allocations * * * ."

HUD's central office used the five factors contained in section 213(d)(1) to apportion contract authority to its field offices. Field offices were given statistical tables for guides in computing fair-share allocations of housing assistance funds for local communities. Central office implementing instructions, however, gave field offices authority to change the central office allocation method. According to central office officials, the field offices had a better feel for local housing factors than did the central office.

All five area offices we visited altered the central office allocation formula to some degree--only one office

included all five factors used by the central office. The San Francisco office radically altered the formula by excluding two of the five "indicators of need" and by including an adjustment factor for the amount of Federal assistance a community had received from past federally subsidized programs.

A San Francisco area office official said he excluded the two indicators because he believed they were either irrelevant in the San Francisco area or that available data on the indicators was inaccurate. He said the adjustment factor made up for "inequities in past HUD programs." He said that, because some communities had benefited more than others from past HUD programs, an adjustment provided assistance to the communities that had received less Federal assistance in these programs.

His office's altered formula resulted in 5 counties receiving about \$7.3 million less and 14 other counties about \$7.3 million more than they would have received from the central office allocation formula. One county alone received about \$4.4 million less. The following table shows how much contract authority the five counties would have been allocated had central office statistical tables been used compared to what they were allocated by the San Francisco area office.

| <u>County</u> | <u>Allocation using central office statistical tables</u> | <u>Allocation by San Francisco area office</u> | <u>Difference (decrease)</u> |
|---------------|---|--|----------------------------------|
| Sacramento | \$ 2,355,526 | \$ 879,269 | (\$1,476,257) |
| San Francisco | 5,607,952 | 1,157,870 | (4,450,082) |
| Clark | 1,033,452 | 442,108 | (591,344) |
| Washoe | 602,071 | 180,378 | (421,693) |
| Solano | <u>654,830</u> | <u>252,814</u> | <u>(402,016)</u> |
| | <u>\$10,253,831</u> | <u>\$2,912,439</u> | <u>(\$7,341,392)</u> |

Sacramento PHA officials said the area office penalized PHAs which had participated in Federal programs in the past.

We found nothing in the act or its history indicating that the Congress intended that communities' section 8

contract authority allocations be adjusted because of past Federal assistance. HUD's central office, using section 213(d)(1) criteria, apparently decided that greater comparative housing assistance needs existed in the above communities than the area office contract authority allocations to these communities indicated.

CONCLUSIONS

The section 8 program got off to a slow start, in part, because HUD took 8 months to issue regulations and, during that period, applications for participation could not be solicited or processed nor could field offices advertise for new construction or substantial rehabilitation proposals. Also, according to HUD and PHA officials, the field offices lacked sufficient, experienced staff to implement the program promptly.

The allocations of section 8 funds by the San Francisco and Milwaukee area offices did not meet congressional intent in that allocations of program mix--number of existing housing units versus units of new construction to be assisted--ignored the proposed housing programs set forth in the communities' HAPs. Furthermore, the San Francisco office excluded two of five indicators of need suggested by the act for determining allocations for financial assistance and included an adjustment factor which, in effect, reduced some communities' allocations because they had participated in previous HUD-subsidized programs.

RECOMMENDATIONS

We recommend that the Secretary of Housing and Urban Development implement the section 8 program more promptly and effectively by insuring that HUD field offices (1) have sufficient, trained staff, (2) allocate section 8 funding (contract authority) to communities in accordance with program mixes as contained in local communities' HAPs as required by statutory criteria, and (3) in allocating section 8 funding, justify to the HUD central office use of any factors not specifically identified in section 213(d)(1) of the HCD Act, such as adjustments for past participation in Federal programs.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on our report, HUD agreed that there has been difficulty in some areas in training and retaining adequate, experienced staff and that it was trying to fill critical positions and provide needed support to field offices.

HUD also stated that guidance to its field offices on allocation of housing assistance funds to communities had been improved by regulations issued August 23, 1976. HUD said that section 8 handbooks would include this guidance to assure equitable and more consistent allocation of housing assistance funds.

HUD's August 23, 1976, regulations provide that field office directors, in determining the amount of contract authority (housing assistance funds) to be initially allocated within their jurisdictions, shall use the following procedures "as far as practicable":

- Determine the housing assistance needs county-by-county based on the most recent U.S. Census data available and relevant housing assistance plans.
- Develop for each county a separate housing assistance needs percentage factor, which should represent each county's proportion of the total needs within all metropolitan counties in the field office's jurisdiction. Nonmetropolitan counties are treated similarly.
- Establish regional or other allocation areas, such as standard metropolitan statistical areas or groups of rural counties, broad enough to support economically feasible housing programs.

It appears the above procedures, if implemented, will more equitably allocate section 8 contract authority to communities. However, they do not require field offices to justify to the central office instances where HAPs or housing needs data are not used, as we recommended. Field offices apparently may continue to allocate funds without using housing needs data, or communities' HAPs, when they feel such data is not practicable. We, therefore, believe that the Secretary should adopt our recommendation to require field offices to justify use of any factors not specifically required.

CHAPTER 3

SECTION 8 FAIR MARKET RENTS

MAY BE TOO LOW FOR PROGRAM SUCCESS

Weaknesses in HUD methods for establishing FMR schedules are producing FMRs which seem too low to encourage sufficient owner participation in the section 8 program. The existing housing, new construction, and substantial rehabilitation programs depend on the willingness of private owners to lease properties to lower income persons. A crucial factor influencing owner willingness is the amount of rent offered them in relation to the section 8 requirements, responsibilities, and constraints. The House-Senate Conference report on the HCD Act of 1974 recognized the importance of economic incentives for owners when it stated that "the establishment of realistic fair market rentals will be a prime factor in the success or failure of the new housing assistance program." Various housing officials believe that section 8 will fail to house lower income families unless a "premium" rent is paid. They believe that an extra financial incentive, above the prevailing market rent, is needed to get owners to assume the greater risks and more costly section 8 responsibilities.

In October 1975 a HUD evaluation group concluded that FMRs for section 8 were too low. PHA officials, housing industry representatives, and HUD field office staff said the HUD-established FMRs, including subsequent revisions, were not high enough to induce significant owner participation. Several of these officials gave us recently completed rent surveys that showed the HUD-established FMRs to be significantly lower than the prevailing market rents for the modest-type units intended for section 8 use. For example, the Alameda County, California, PHA had made a rent survey that showed the following differences between private rents and the existing FMRs.

| <u>Bedroom size</u> | <u>Private market rents</u> | <u>Existing FMRs</u> | <u>Difference</u> |
|---------------------|-----------------------------|----------------------|-------------------|
| Efficiency | \$172 | \$157 | \$15 |
| 1 | 200 | 178 | 22 |
| 2 | 230 | 210 | 20 |
| 3 | 281 | 242 | 39 |
| 4 | 321 | 274 | 47 |

HUD's central office said that although FMRs in this example were lower than private market rents, FMRs could exceed the

private market rents through either the 10-percent (area office director's) or 20-percent (central office's) prerogatives to increase FMRs for all the unit sizes listed.

Although the 10-percent option would have increased the efficiency and two-bedroom FMRs above the private rents, HUD decided in February 1975 to let actual program experience--the success or failure of families to get housing without increasing rents--determine the need for increasing FMRs. In addition, HUD field office staff said that, despite numerous requests and justifications submitted for FMR increases, the central office either would not accept them or would approve increases much smaller than requested. As pointed out later in this report, HUD's central office said its nonresponsiveness to such requests was because of "very thin documentation and relevant analysis" and that in many cases documentation consisted "only of PHA representations and opinions."

PHA officials said they believed a "premium" rent rather than the prevailing market rent would be needed to induce significant numbers of owners to participate in section 8. These officials said that the HUD-established FMRs (1) ignored actual market conditions and owners' hesitancy to become involved in a complicated and cumbersome government program which limits their freedom as landlords and (2) perhaps most importantly, failed to overcome landlords' reluctance to rent to lower income families with children who are widely perceived as problem tenants. Later chapters discuss these matters further.

The PHA officials believe the low FMRs could have the following effects:

- Landlords will not participate unless they are encountering vacancy problems.
- Reliance on subsidization of "in-place" lower income tenants--those who qualify for assistance because they are paying a disproportionately high amount for housing and wish to remain in the unit they are residing in--will be excessive.
- Assistance to lower income elderly persons will be disproportionate, to the detriment of the large and very-low-income families, because it is believed that owners will not assume the management risks associated with lower income families with children.

--Lower income families will be unable to find acceptable quality units at or under the FMR ceilings in areas other than those of minority and lower income group concentration ("impacted areas").

--PHAs will be pressured to approve leasing units of marginal or substandard quality because standard units are not available at the FMRs.

HUD published FMR schedules in March 1975 for the new construction and substantial rehabilitation programs and schedules in April 1975 for the existing program. These schedules seek to provide adequate financial incentives to attract owner participation in section 8.

HUD headquarters said it did not believe that a premium rent would be required in the existing program to encourage owners to provide section 8 housing to nonelderly families, pointing out that in the Experimental Housing Allowance Program 1/ about 15,000 units were rented by families without such a premium, even in relatively tight market areas. According to HUD, a greater problem is the lack of available larger units in some market areas and the possibility that FMRs for such units under the existing program may be inadequate.

We believe, however, that HUD's experience under the Experimental Housing Allowance Program is not a sufficient basis for concluding that premium rents will not be required in the section 8 program. The two programs have significant differences. One difference that could warrant premium rents for section 8 housing units is the greater owner responsibility. For example, under the section 8 program the owner is responsible for all ordinary and extraordinary maintenance, including tenant-caused damages. Housing owners under the allowance program, however, generally have little, if any, maintenance responsibility. They generally have the same responsibilities as section 23 program housing owners because the program was initially funded under the section 23 program. PHAs did most maintenance under the section 23 program and, as pointed out in chapter 4, the added section 8 program

1/An experimental program authorized under section 501 and section 504 of the Housing Act of 1970 (12 U.S.C. 1701z-1 and z-3) involving the provision of direct cash assistance to low-income households to enable them to obtain adequate housing of their choice. Renters, and in some cases homeowners, are eligible for the cash payment.

responsibility is a main reason section 23 owners do not want to convert to the section 8 program.

In addition, the vacancy rates in the areas with operating programs seem important in determining availability of units and rental amounts owners demand. Landlords with high vacancy rates would probably demand premium rents less often than landlords with low vacancy rates. Housing vacancies are high in most of the 12 standard metropolitan statistical areas in which the Experimental Housing Allowance Program is being administered. A HUD official told us that eight housing allowance sites with high vacancy rates were selected so that the experiment would not increase local rents. Also, most enrollees in two other housing allowance locations did not have to shop for housing because about 90 percent of them stayed in the units they had occupied before participating in the program. In contrast to the Experimental Housing Allowance Program, the section 8 program will be nationwide, and prospective tenants must compete with nonsubsidized families for housing units in high-vacancy as well as low-vacancy housing markets.

WEAKNESSES IN METHOD USED TO ESTABLISH FMRs FOR EXISTING HOUSING PROGRAM

Much of the difficulty with the existing housing FMRs is due to the method HUD used in 1973 to establish rents for the revised section 23 program, since these rents were subsequently updated for use in the section 8 existing program. HUD's central office established the rents for housing market areas nationwide, using unpublished census data relating to recent movers--those who had moved within the previous 12 months. HUD defined each standard metropolitan statistical area (SMSA) as a separate housing market area and, outside SMSAs, grouped counties to form housing market areas of at least 250,000 population. For these housing market areas, HUD selected a 1-percent sample of gross monthly rents of households moving into rental units between January 1969 and April 1971. It attempted to exclude substandard housing from this sample by including only moves into units possessing complete plumbing facilities and kitchens. The next step was to array the sample rents in rank order (highest to lowest) and select the median rent (50th percentile) as the rent most typical of modest quality, decent, safe, and sanitary housing in the market area. HUD then adjusted the census median rent to current levels using the rent index of the Bureau of Labor Statistics' Consumer Price Index.

The rents HUD derived from recent mover statistics were for two-bedroom walkup units only. These rents were

the basis for calculating rents for units of other types and sizes using various sliding scale formulas, depending on the size of the SMSA, as indicated below.

| <u>Unit bedroom size, nonelevator units</u> | <u>Percent of two- bedroom rent</u> |
|---|---|
| Efficiency | 75 |
| 1 | 85 |
| 2 | 100 |
| 3 | 110 |
| 4 or more | 120 |

HUD used a flat percentage adjustment in establishing the somewhat higher rent schedule applicable to existing housing units with elevators.

Weaknesses in the above methods and assumptions that appear to result in the HUD-established FMRs being lower than prevailing market rents include:

- The 1-percent census sample of recent movers used to calculate FMRs may have included substandard housing units because the census data classified "standard" as having plumbing and kitchen facilities. However, section 8 regulations require that such other factors as structural soundness, thermal conditions, ventilation, and freedom from health hazards be considered in determining eligibility for section 8.
- No precautions were taken to insure that subsidized housing units were excluded in the census sample statistics on recent movers. Including such units, with their lower-than-market-subsidized rents, would tend to lower the FMRs.
- The 1-percent census sample was used without considering rent variation within an SMSA. As a result, the rents may not be representative of rents for non-luxury decent, safe, and sanitary housing. Also, a HUD official in the field office with jurisdiction over the Johnstown, Pennsylvania, SMSA said the small sample, which used only 48 recent mover households to derive an FMR schedule for the entire SMSA, was probably invalid. He said these statistics would be questionable in all areas with lower-than-average turnover. We agree, but only if the 48 rents obtained varied significantly.

- A HUD official involved in developing the FMRs said the sample of recent movers probably included a disproportionate number of lower income families because they generally move more frequently than other income groups. Also, lower income persons generally move more often into marginal or substandard housing because of their incomes. For example, HUD's October 1973 report, "Housing in the Seventies," stated that in 1970, although 32 percent of all renters had incomes below \$3,968, they occupied 63 percent of the substandard rental units.
- HUD selected the median gross monthly rent (50th percentile) as typical of the kind of housing for the section 8 existing housing program. HUD said it wanted to use the 75th percentile to set the existing FMRs, as it did in setting the FMRs for new construction and substantial rehabilitation, but the Office of Management and Budget insisted on the 50th percentile to minimize program cost.
- HUD's sliding scale formulas (see above) for deriving FMRs may have produced rents which discouraged owners from leasing to large low-income families. Various housing officials believe that a premium rent is necessary to encourage most owners to lease to nonelderly families. As the schedule on page 20 demonstrates, however, no such premium is provided. On the contrary, the differential between rents on a two-bedroom unit and a one-bedroom unit is 15 percent compared with 10 percent between a three-bedroom unit and a four-or-more bedroom unit.
- HUD's decision to prepare single FMR schedules for entire SMSAs or for counties grouped into areas totaling 250,000 population is questionable. This approach ignores important distinctions between metropolitan central cities and suburban areas as well as among suburban areas within SMSAs, and it does not adequately consider the economic and demographic differences among non-SMSA counties. For example, the San Francisco-Oakland, California, SMSA had identical FMRs for the counties of Alameda, Contra Costa, Marin, San Francisco, and San Mateo. HUD field office officials said that each of these counties' actual market rents could vary by 30 to 40 percent.
- The Bureau of Labor Statistics' rent index for updating FMRs is conservative and generally lags about 6 months behind actual market changes, according to

HUD officials. Therefore, it appears that the rent index lowers FMRs even further.

WEAKNESSES IN METHOD USED TO
ESTABLISH NEW CONSTRUCTION AND
SUBSTANTIAL REHABILITATION FMRs

FMRs are vital to the new construction and substantial rehabilitation programs. They must be high enough to (1) overcome owners' reluctance to lease to lower income persons, especially families with children, (2) cover any extra cost to an owner participating in a Federal program, and (3) enable a developer to finance, construct or rehabilitate, manage, and maintain a section 8 project profitably. HUD field office and PHA officials and owners said HUD's methods for developing FMRs for new construction and substantial rehabilitation produced low FMRs because they neglected several costs integral to a Federal program, such as Davis-Bacon wage requirements and HUD minimum property standards.

Developers, HUD field office officials, and mortgage banking officials said the section 8 new construction FMRs for their communities were too low. They said the HUD-established FMRs do not reflect the rents needed to finance, construct or rehabilitate, and operate a project in accordance with section 8 requirements.

HUD's central office developed new construction and substantial rehabilitation FMRs based on data supplied by its field offices. HUD guidelines specify that FMRs are expected to be high enough to induce private owners to produce units for lease under section 8 but not high enough to support the production costs of inefficient developers or to encourage the production of ostentatious units. The FMRs were to be based on a sampling of rents paid for comparable, newly constructed modest dwelling units selected by HUD field office personnel in local market areas.

Market areas for establishing new construction and substantial rehabilitation FMRs were defined as the same areas for which HUD had previously established construction prototype ^{1/} costs for public housing. HUD guidelines specify that each sample consist of 12 or more market-comparable rents of units in different projects or developments.

^{1/}HUD defines "prototype area" as a geographic area where trade conditions and economic influences make construction costs similar. The area is usually a city but will generally extend beyond the city's boundaries.

Adjustments were to be made to each comparable unit for differences between it and the HUD-defined modest unit for (1) number of baths, (2) utilities and services furnished, (3) unit size, and (4) time lapse from the date the comparable rent was obtained to the date of construction. Once adjusted, the rents were to be listed in descending order. FMRs for each unit size were the rents closest to the 75th percentile of the rents listed.

HUD guidelines specify that new or revised estimates of FMRs will be made annually following the same method. Bureau of Labor Statistics' rent indexes may be used, however, every second year rather than gathering 12 comparable rents for each unit size. Also, HUD guidelines specify that generally the best data for estimating rental trends are the changes in the rents of newly constructed units over the past 1 to 2-or-more years.

HUD's method did not consider certain factors, such as current financing and construction costs, Davis-Bacon wage rates, and potential additional management and maintenance costs for housing lower income persons. HUD field offices used private market rents in existing buildings to establish FMRs for new construction and substantial rehabilitation projects to be developed in 1976 and 1977. Other procedural weaknesses in the HUD field offices, which further contributed to FMRs being apparently too low to amortize building costs under current conditions, follow.

- One FMR schedule per market area may produce a rent unrepresentative of the rent needed for modest, non-luxury housing in the entire market area.
- The Los Angeles and Chicago area offices used private rents in buildings constructed as early as 1965 for comparable rents in setting FMRs. The rents were adjusted to reflect the construction cost differences between the year built and currently; however, no adjustments were made to reflect additional costs associated with section 8 projects, such as Davis-Bacon wage requirements and HUD minimum property standards, because HUD guidelines do not require adjustments for these costs.

The Pittsburgh area office criticized the method used to develop section 8 new construction FMRs for some of the same reasons mentioned above. In a September 19, 1974, memo to the central office, the Pittsburgh office said using private rents to set FMRs did not reflect the additional costs of a HUD project, such as high wages, due to the

prevailing wage requirements of the Davis-Bacon Act and HUD processing delays. The office suggested that HUD establish FMRs based on the costs to (1) construct and operate a building and (2) meet all HUD's requirements, instead of FMRs based on rents in previously constructed buildings.

A Los Angeles area office official said the FMRs were too low to construct new units in most communities in his jurisdiction. He said HUD needed to base new construction FMRs on the costs necessary to build units in the current market. A Jacksonville area office official said published FMRs were too low for developers to get financing at current interest rates. He recommended that HUD establish a system to adjust FMRs with current interest rates available to developers.

Developers are also apparently concerned that even where FMRs are adequate, HUD's rent comparability, or rent reasonableness, test 1/ will cause section 8 projects to be rejected. The National Leased Housing Association's 2/ developers' committee reported in December 1975 that HUD's "comparable" rent test often resulted in rents too low to make a project feasible. The published FMRs are generally the maximum amounts approvable as contract rents, except that FMRs can sometimes be increased by 10 or as much as 26 percent. Therefore, in addition to determining if a developer's proposed rents are within FMR limits, HUD guidelines require that field offices judge the reasonableness of rents in a developer's proposal in relation to nonsubsidized market rents. This entails comparing the developer's proposed unit rents with the market rents for comparable units--units with equivalent living accommodations and services. HUD field offices must estimate the market rental value of each proposed section 8 unit. In estimating reasonable rents, field office personnel are instructed not to be influenced

1/This is different from the comparable rent test used to establish FMRs. When a developer submits a proposal to build a section 8 project, the proposal must include the estimated rents the owner plans to charge. HUD compares these estimated rents with rents being charged for recently built, comparable unsubsidized units in the area. If the proposed rents are higher, the project would be disapproved unless the owner accepted the lower rents.

2/A nonprofit organization of about 450 members--primarily public housing agencies and developers--that serves as a section 8 and section 23 information clearinghouse.

by the section 8 FMRs. Field offices must respond separately to the question of compliance with published FMRs and reasonableness of proposed rents.

The same arguments against HUD's methods for establishing FMRs are being advanced against HUD's method for determining reasonableness of developers' proposed rents. We believe that basing reasonable rents on comparable rents in the private market rather than on program cost factors overlooks some pertinent factors, including prevailing financing costs, Davis-Bacon wage rates, and potential additional management and maintenance costs. Also, many areas have too-few comparable units to realistically develop fair market rents, according to field office officials. They said in rural areas and inner city areas real comparable rents are frequently nonexistent.

In summary, HUD field offices find themselves dealing with published FMRs by area, a comparable (reasonable) rent determined for each project, a rent based on cost submitted by the developer, and possibly a rent structure related to a HUD mortgage insurance program. Frequently, these rent determinations are incompatible. A Chicago area office official said the concept was ridiculous. He said developers tended to submit proposals with economic feasibilities based on maximum FMRs while the office only considered reasonable rent based on comparable rents. The National Leased Housing Association and the National Association of Home Builders ^{1/} recommended that the Congress adopt an amendment instructing HUD to base comparable rents on the rent for comparable units constructed and financed at the time the section 8 project would be constructed. According to a February 1976 National Leased Housing Association report, this would prevent HUD from using comparable rents obtained from units built several years ago which had less financing and construction costs.

DIFFICULTY IN MODIFYING FMRs

Field office and PHA officials and housing industry representatives told us that the final FMRs published in March and April 1975 were too low, and that a HUD policy and congressional limitations had made it extremely difficult to increase the rents to the levels required for program success.

^{1/}The trade association of the home building industry with more than 73,000 member firms nationwide.

HUD adopted a policy in February 1975 of letting actual program experience--the success or failure of PHA-certified families to secure housing within FMR limits--determine the need for changes to the FMR schedule. A HUD notice dated February 26, 1975, to its field offices stated:

"If there is doubt about the need for modification of fair market rents, program operation without modification should be tried. Necessary modification may be recommended subsequently, if program experience confirms the need for such modification."

Field office staff said that, despite numerous requests and justifications for FMR increases, the central office would either reject their recommendations or would approve increases much smaller than those requested. They said each area office had an economic and market analysis division to maintain updated local housing market data (including rental data) and a cost evaluation section to maintain construction cost data on all HUD-assisted multi-family programs. According to one area office official, despite the fact that the area offices have the most reliable local market data in HUD, the central office often does not grant the FMR increases in order to minimize program costs. For example, the HUD Jacksonville area office, in August 1975, requested a 24-percent increase in the existing housing FMRs for Jacksonville to raise these rents to what it and the Atlanta regional office considered workable levels. The central office approved an increase of 18 percent, saying that a 24-percent increase would have distorted FMR patterns that prevailed in the entire region. Approval of the 24-percent increase would have resulted in the Jacksonville two-bedroom-unit FMR nearly equaling the FMR for the same-sized unit in Atlanta. Jacksonville area and Atlanta regional office officials contend that costs in Jacksonville have little to do with costs in Atlanta. This example demonstrates the wide difference of opinion within HUD as to the basis for and level of FMRs needed for program success in a local community.

HUD's central office said it did not respond to recommendations for FMR increases because "proposals for substantial FMR changes were often submitted with very 'thin' documentation and relevant analysis" and in many cases the documentation consisted "only of PHA representations and opinions."

The Congress, in October 1975, restricted HUD from increasing FMRs published as of September 8, 1975, by more than 20 percent in individual market areas and by more

than 10 percent nationwide. In doing this, the Congress assumed that the published FMRs were generally reasonable and adequate. The limitations were established to insure that the contract authority granted to HUD could continue to assist the 400,000 units HUD initially projected. Despite the limitations, HUD had flexibility in increasing FMRs in individual communities. For example, it could have increased the FMRs published September 8, 1975, by up to 20 percent for an entire market area. In addition, the Secretary of HUD continued to have authority, when circumstances warranted for individual projects or communities, to exceed the published FMRs by as much as 20 percent. As a result, HUD could have granted increases of up to 40 percent. Instead, after our review, HUD said it increased FMRs nationwide by almost 10 percent and, as a result, could make 20 percent increases in individual markets to only a few SMSAs and counties.

In October 1975 a HUD evaluation group concluded that:

--FMRs established by HUD's central office were too low.

--HUD procedures to increase FMRs were time consuming and cumbersome.

--FMRs could best be determined by field office staff familiar with the age and general condition of standard, vacant housing within their jurisdiction.

The group's report said that field offices believed the then-present FMR structure for new construction was too low. The report said also that making developers, especially a small developer building a small project, pay prevailing wages forced an upward rent adjustment--an adjustment not based on the location or quality of the unit. It said the FMRs were not adequate to attract new construction under the section 8 program, and that FMRs needed a rational factor adjustment for (1) financing costs, (2) construction costs, (3) prevailing wage requirements, and (4) additional management and maintenance costs. The report concluded that "the current economic indicators are saying 'no' to new construction," and HUD should, among other things, "start with the original assumption that section 8 was not designed as a production program."

HUD, in revised regulations published April 26, 1976, and May 13, 1976, for the new construction and existing housing programs, respectively, authorized PHAs rather than HUD field offices to approve rents exceeding published FMRs.

PHAs now may approve rents for existing units on a unit-by-unit basis which exceeds FMRs by up to 10 percent, limited to no more than 20 percent of the units under their annual contribution contract. Also, HUD may approve, upon request from a PHA supported by a statement of special circumstances, maximum rents of up to 20 percent above FMRs for all units of a given size or type within a designated municipality, county, or similar locality. Also, the revised regulations authorize HUD regional administrators, instead of the Assistant Secretary for Housing, to increase rents allowed for newly constructed housing by up to 20 percent when special circumstances warrant such higher rent or when it is necessary to implement a local HAP, provided the higher rent meets the reasonableness test.

HUD has recognized that FMRs were too low in some areas and has made certain program changes to overcome the low published FMRs and the congressionally imposed limitations on FMR increases. The section 8 existing housing regulations HUD initially published provided that housing constructed between January 1, 1973, and December 31, 1975, qualified as recently completed housing and could be leased at rents equal to 75 percent of the applicable new construction FMRs rather than at the lower FMRs for existing housing units. HUD changed its definition of "recently completed" units in its May 1976 revised regulations by allowing units constructed 6 years before the date they are leased to qualify for the higher FMRs, rather than only those units built since 1972. Apparently, this redefinition qualifies thousands of additional units for higher rents. For example, two-bedroom nonelevator units built in Chicago before 1973 previously qualified for maximum rents of \$220. HUD's change allows these units to qualify for monthly rents of \$243, a 10-percent increase.

CONCLUSIONS

Weaknesses in HUD's methods for establishing FMR schedules resulted in FMRs which seem too low to encourage sufficient owner participation in the section 8 program. Success in the existing, new construction, and substantial rehabilitation programs depends on private owners' willingness to lease properties to lower income persons. A crucial factor is the rent offered to these owners in relation to the section 8 requirements, responsibilities, and constraints placed upon them.

Section 8 FMRs were based on rents being charged for comparable units in the private market. Indications are that the published FMRs for some market areas do not equal private market rents. Furthermore, various PHA and HUD

field office officials and owners believe that section 8 will not succeed in housing lower income families with children unless a premium rent is paid. They believe that an extra financial incentive above the prevailing market rent is needed to get owners to assume the greater risk and more costly section 8 responsibilities.

RECOMMENDATIONS

We recommend that the Secretary of Housing and Urban Development

- revise HUD procedures to insure that FMRs are at least equal to private rents for similar units,
- insure that FMRs and rent reasonableness tests for new construction and substantial rehabilitation reflect the current costs of producing and financing units as well as meeting section 8 management requirements,
- develop separate FMR schedules for individual housing submarket areas instead of one FMR schedule for an entire SMSA or county group, and
- determine if a premium rent is necessary to encourage owners and developers to provide section 8 housing to nonelderly families, especially those requiring large units (three or more bedrooms). If it is necessary, HUD should take administrative action or, if warranted, seek legislative changes to insure program success.

AGENCY COMMENTS AND OUR EVALUATION

HUD said that its May 13, 1976, section 8 regulations will have the following effect on FMRs for the existing housing program.

- There will be significant variations in rents allowed each county comprising a multicounty SMSA.
- The regulations would substantially broaden field office initiative and ability to increase contract rents by up to 20 percent over published FMRs.
- Modified FMR schedules will include additional unit-size categories, allowing higher rents for five-or-more-bedroom units. In addition, the expiration of Public Law 94-116 on September 30, 1976, will remove

all constraints on FMR modifications. HUD will then begin publishing existing FMRs on a county basis rather than by SMSA or county group and increase FMRs for three- and four-bedroom units because most of these units are detached or semi-detached.

HUD said that, with very few exceptions, it believed the FMR limitations for new construction and substantial rehabilitation would allow economically feasible development. However, it said, the present technique for establishing rent reasonableness was being studied, and if an increase were warranted, HUD would provide for it. We believe section 8 FMRs will improve if HUD implements the above actions.

HUD disagreed that a premium rent was needed. As discussed on page 18, however, we believe HUD should determine if a premium rent is needed to provide section 8 housing to nonelderly families.

CHAPTER 4

IMPEDIMENTS TO TIMELY AND EFFECTIVE IMPLEMENTATION

OF THE SECTION 8 PROGRAM FOR EXISTING HOUSING

Because it uses housing already in place, the section 8 program for existing housing should house families faster than programs for new construction and substantial rehabilitation. It has had limited success, however. (App. II shows program activity as of Dec. 31, 1975, in the three HUD regions we visited.) Over two years after the HCD Act was enacted, HUD statistics show that about 54,277 families were receiving assistance. Another 30,236 families were being assisted under HUD's loan management program, which consists of units in projects with HUD-held mortgages. HUD's revised fiscal year 1976 goal is to reserve contract authority for 275,000 units. This figure is 175,000 greater than the original fiscal year 1976 estimate and reflects increased emphasis on existing housing, as problems have multiplied and prospects have dimmed for newly constructed and rehabilitated housing.

HUD has stressed repeatedly in program guidelines and instructions to field offices and in statements to the Congress that it intends to make maximum use of existing housing. It views the existing housing program as a means of (1) using and conserving the Nation's existing housing stock, (2) speeding the delivery of housing assistance to lower income persons, and (3) housing persons more cheaply than the new construction and substantial rehabilitation programs.

However, the program has failed to deliver quick results. One reason, discussed in chapter 2, was that acceptance and processing of applications for participation in the program was delayed 8 months while HUD developed program regulations and guidelines.

This chapter discusses some other problems limiting program activity, such as:

- Some owners' reluctance to participate because they believe the FMRs will not compensate them for complying with the many section 8 requirements and accepting the heavier management burden which they believe comes with renting to lower income persons.

- Problems in converting units leased under the section 23 program to the section 8 program because some section 23 housing owners believe the section 8 program pays too little and requires greater management responsibilities.
- Refusal or inability of some smaller communities and PHAs to participate in the program due to small section 8 allocations and/or low administrative fees which, they assert, will not support the cost of effective program administration.
- The many complex responsibilities that the regulations assign to lower income participants.
- The regulations limit a lower income participant's shopping range to the jurisdiction of the PHA that issued the certificate of participation.
- Residency requirements imposed by some PHAs on the lower income applicants seeking eligibility certification may keep many of them from leaving an impacted area and moving into another PHA's jurisdiction.

Additional problems or questionable practices noted in implementing the section 8 program for existing housing included HUD's:

- Decision to permit lower income families with children to lease units in high-rise elevator buildings.
- Decision to allow "in-place" tenants to benefit from a shopping incentive credit.
- Use of section 8 contract authority to assist financially troubled projects built under previous HUD-insured or -subsidized programs.

HOW THE PROGRAM FOR EXISTING HOUSING WORKS

Typically, a PHA administers a section 8 program for existing housing, although HUD may administer it directly when no PHA exists or when the Secretary determines that a PHA cannot implement such a program. After approving a

PHA's application for program participation and assuring itself of the PHA's legal, administrative, and financial ability to assume its program responsibilities, HUD enters into an annual contribution contract with the PHA to financially support the program. The PHA, in turn, enters into housing assistance payments contracts with the owners in which it agrees to pay a predetermined portion of the contract rent for one or more existing housing units occupied by families eligible to receive section 8 assistance. Each month the owner of assisted units will receive rent from two sources--the tenant and the PHA.

An important feature of the section 8 existing housing program is the "finders keepers" provision which permits a family to choose where it will live. This provision also permits an eligible family to remain where it lives if its housing unit meets prescribed standards. This provision means that the existing housing program will operate essentially as an income maintenance program for participants already adequately housed but paying a disproportionate amount of their income for housing.

PHA responsibilities for administering the existing housing program include publicizing the program to owners and eligible families, issuing certificates of family participation to eligible families, inspecting units to be leased and approving leases, making monthly housing assistance payments to owners, and periodically reexamining family income and redetermining the rent owed by the family. The HCD Act requires owners to get PHA approval before evicting a tenant.

The owner's responsibilities include selecting tenants (in compliance with equal opportunity requirements), collecting rents (a portion from the tenant family and the remainder from the PHA), and doing all routine and extraordinary maintenance.

The section 8 certificate holder must find his own housing (with PHA aid under specified circumstances) and fulfill his lease and certificate obligations.

RELUCTANCE OF OWNERS TO PARTICIPATE IN THE PROGRAM FOR EXISTING HOUSING

PHA, HUD field office, and housing industry officials said many property owners, especially small, less sophisticated owners, would hesitate to lease their units under the section 8 program. This hesitance was attributed to (1) fear of renting to lower income families with children,

who are believed to be problem tenants because it is difficult to collect rent from them and to evict them and because they frequently destroy and reduce property values and (2) becoming involved in a program having complex regulations, numerous forms and documents, and, most importantly, restricted management prerogatives.

According to the officials, changes which might overcome owner reluctance include (1) increasing the level of FMRs and (2) reducing the requirements and restrictions placed upon participating owners.

Role of economic incentives

Because many owners view lower income families with children as a source of extraordinary management and maintenance problems, PHA officials said that owners believe the rents to house them should reflect the added costs. Owners reportedly believe that rents should include a premium for risking rent loss through collection problems and risking property deterioration through vandalism and excessive wear and tear. As discussed previously, PHA and HUD field office officials told us that HUD's existing housing FMRs often do not equal prevailing market rents, let alone provide for added management and maintenance requirements and a risk premium. Also, as noted earlier, HUD's FMR schedule does not attempt to compensate for the commonly acknowledged owner preference for low-income elderly tenants over low-income family tenants. For example, HUD allows proportionately less rent for a four-or-more-bedroom unit than for a three-or-less-bedroom unit. This disproportion may need correcting to induce owners to serve larger families, especially since HUD is concerned that the program is not meeting the needs of larger families.

PHA officials and some owners wondered how promptly HUD would make the annual and special adjustments to contract rents permitted under the program for actual increases in real property taxes, utility rates, or similar costs. Owners were also concerned about relying on HUD, instead of their own judgment, to make the necessary rent determinations and adjustments.

Owners' responsibilities in the existing housing program

Owners and officials concerned with the program told us that the program's complicated regulations, cumbersome procedures, and limitations on an owner's freedom of action discouraged participation. More specifically, owners objected to:

- The necessity of securing rents from two separate sources--the section 8 tenant and the PHA--as well as the requirement of billing the PHA each month for its portion of the contract rent.
- The provision which makes a section 8 owner responsible for all extraordinary maintenance necessitated by tenant-caused damage to his unit.
- The requirement that a housing inspection and certification of quality be performed by the prospective tenant, the owner, and the PHA.
- The inability of the owner to evict tenants without the approval of the PHA administering the assistance contract.

One owner, whose view was similar to some officials, charged HUD with pretending that the owner-tenant relationship under the program is no different from that of the private market while at the same time imposing nonprivate market requirements and restrictions on the property owner. The requirement that an owner get PHA approval before evicting a tenant was especially troublesome to owners. The above owner said that this requirement puts him in the intolerable position of being unable to terminate the lease of a tenant who is behind in rent payment, is creating a nuisance, or is damaging or destroying property.

Some PHA officials said they would be reluctant to approve an owner's termination of tenancy solely for rent delinquency. One pointed out that from a taxpayer's standpoint it would be preferable not to evict such a tenant because social service agencies would have to pay to move the tenant, store his effects until suitable housing could be located, and then pay the probably higher rent of a new housing unit. He said also that owners feel that PHA refusal

to approve the eviction of tenants in arrears in rent payment would result in nonpayment and in late payments becoming common. It might save tax money by not evicting rent-delinquent tenants, but this argument is not likely to persuade owners who already have doubts about the program.

One owner complaint--that owners submit monthly billings to a PHA for its share of the rent due the owner--was eliminated by HUD's May 1976 revised regulations. Now the owner is paid monthly and his endorsement on the check is his certification entitling him to the payment.

PROBLEMS IN CONVERTING SECTION 23 UNITS TO SECTION 8 PROGRAM

The HCD Act of 1974 incorporated in the section 8 existing housing program the basic features of the revised section 23 existing housing program. Also, HUD used the published revised section 23 FMRs in developing FMRs for the section 8 existing housing program.

With the establishment of the section 8 program, HUD decided to end the section 23 program. The original section 8 regulations stated that

"PHAs are encouraged to develop plans for the orderly conversion of their section 23 housing to the section 8 program ***" and "*** lease renewals and extensions may be entered into with respect to occupied units only, but the terms of such lease renewals may not be extended beyond June 30, 1978, except under special circumstances as authorized by HUD, and then only until June 30, 1979."

HUD's announcement to terminate the section 23 program elicited protests from owners, PHA officials, and others in the housing industry and gave rise to predictions that many, if not most, owners of section 23 leased units would drop out of HUD's assisted housing program rather than convert to the section 8 program, which they viewed as less attractive.

Owners, PHA administrators, National Association of Housing and Redevelopment Officials representatives, and others have described the section 8 program as unattractive to owners of section 23 units and predicted that HUD's

phasing out the program would cause most section 23 owners to rent their units on the unsubsidized market. The reasons most often given for reluctance to convert fall under two general headings, lack of financial incentives and increased management responsibilities, and include the following specific complaints.

- In some cases the FMRs published for the section 8 program are lower than those under which many section 23 units were originally leased. Owners reportedly do not want to be in a program offering less rent but requiring considerably more day-to-day involvement in property management.
- HUD's section 23 regulations provide that responsibility for management and maintenance of leased units should coincide with prevailing local practices. As a result, section 23 owners often let the PHAs administering the housing assistance payments contract manage and maintain all leased units, according to PHA officials. PHAs often perform such functions as tenant selection, rent collection, and eviction. However, under the section 8 regulations, the agency administering the housing assistance payments contract is not permitted to perform such management functions. Under section 23, the PHA performs extraordinary and, in some cases, all maintenance and repair to leased units; under section 8 such matters are the owners' responsibility. The fear of many section 23 owners that their units may be damaged or destroyed by irresponsible tenants and the financial burden fall solely upon them is reportedly enough in itself to discourage owner participation in the program.
- Many section 23 owners are investors who have little day-to-day involvement in managing their units. Such individuals are reported to be not at all interested in giving up the security of the section 23 leasing arrangement and becoming actively involved in property management. Section 8 rents, moreover, are said to be too low to permit contracting for management.
- Many section 23 owners feel that their authority and independence should be commensurate with their program responsibilities. They said they are very unhappy with the section 8 provision requiring

PHA approval of evictions. They said that an entire project could be jeopardized without the ability to evict rent-delinquent, unruly, or destructive tenants.

--Section 23 owners object to section 8 regulations which limit rent payments for vacant leased units to 80 percent of the contract rent for a maximum of 60 days. In the section 23 program, an owner receives rent for his unit whether it is occupied or not, and finding a tenant for the unit is the PHA's concern.

If many section 23 owners refuse to convert their units to the section 8 program, many lower income tenants could be displaced with no other suitable housing. Recognizing the potential consequences of its conversion policy, HUD's revised regulations--published in the Federal Register May 13, 1976--amend the requirement that all section 23 units vacant at the date of lease renewal or extension be converted to section 8 or no longer be subsidized. The revised regulations allow lease renewals and extensions for vacant section 23 units if they are reoccupied within 30 days. Also, initial regulations stated that "no leases for additional units shall be entered into." Revised regulations permit leasing additional units, under certain circumstances, as part of the initial effort to rent units in projects for which annual contribution contracts were approved but not executed by December 31, 1974.

RELUCTANCE OF PHAS TO PARTICIPATE IN THE SECTION 8 PROGRAM FOR EXISTING HOUSING

A number of communities and PHAs--23 under the San Francisco area office's jurisdiction alone--did not participate in the section 8 program in its first year. Many PHAs we contacted which are participating said they had serious reservations about the program's structure and prospects for success. Some PHAs believed the program had been deliberately designed to fail, the object being either to pave the way for a direct cash allowance program or get the Government out of the business of providing housing assistance to lower income families.

One PHA official said he was participating because HUD has made section 8 virtually the only subsidized housing program for PHAs and because local governmental leaders thought participation was necessary to participate in the Title I Community Development Block Grant Program. Another PHA official said he had agreed to participate because the

HUD area office director had led him to believe that badly needed section 8 new construction assistance would be made available if the PHA administered a section 8 existing program. As of April 1, 1976, no new construction assistance had been allocated to the PHA.

PHA officials and HUD field office staff members said some communities and PHAs which had been allocated section 8 units and invited by HUD to apply for program participation had declined. In most cases this decision was attributed to community and/or local PHA officials' beliefs that HUD's administrative fee allowances would not support program administration. PHA administration of a section 8 existing housing program is supported by an administrative fee equal to 8-1/2 percent of the FMR for a two-bedroom, nonelevator unit. A PHA is entitled to this fee for every unit under a housing assistance payments contract, regardless of size or type. A PHA in a locality where the FMR for a two-bedroom, nonelevator unit is \$200 would thus be entitled to a monthly administrative fee of \$17 a unit. In addition, a PHA also gets a one-time, lump sum allowance of up to \$275 for each authorized unit. This allowance is intended to defray the PHA's expenses in publicizing the program, receiving and screening applications, certifying participants' eligibility, organizing and briefing certified participants, inspecting units before lease, and other related activities. Administrative overhead costs, including equipment, supplies, and executive salaries, are also included in this allowance.

Some communities and PHAs, especially small, rural ones with limited housing program activities and limited staffs, have not participated in the section 8 program because the small number of section 8 units allocated to them makes participation economically infeasible. Since administrative fees are tied directly to the number of units involved, money for program administration has been insufficient in some cases to pay staff wages and other administrative costs. HUD officials in the San Francisco area, for example, told us that within their jurisdiction 23 communities declined HUD's invitation to participate in the program. Three of these communities had housing authorities and the remaining 20, to participate, would have had to create housing authorities or entrust program administration to another agency or instrumentality of local government authorized to operate as a PHA. According to HUD area office officials, the principal reason these communities gave for not applying for participation was their belief

that allowable administrative fees would not justify the "start-up" of a housing program or support ongoing program administration. The number of unit allocations available to these communities ranged from 6 to 150. The median allocation was 31 units.

HUD field office and PHA officials told us that a minimum allocation of 50 to 100 existing housing units is needed for effective and economical program administration by a PHA. HUD central office officials estimated that a PHA needs one additional staff member for each 100 units added, exclusive of staffing needs for initially briefing and certifying tenants and inspecting units. Consequently, programs involving fewer than 100 units could be feasible and be operated effectively only as "add-ons" to other PHA program activity and only insofar as "slack" in PHA budgets, staffing, and overhead would permit.

To overcome the problem of too-small allocations, HUD is considering encouraging (1) PHAs that have broad jurisdiction and (2) the formation of PHAs that would have broad jurisdiction to administer the programs. Such PHAs would have countywide or State-wide jurisdiction. Aggregating separate small community program unit allocations and having one PHA with regional or State-wide jurisdiction would make such small allocations more financially feasible to administer.

Some communities are not participating in the section 8 program; in those that have no operating PHA, lower income persons cannot get section 8 units. The HCD Act authorizes HUD to administer the program in areas where no PHA is organized or where a PHA is unable to administer the program. However, HUD has not administered and has no immediate plans to administer section 8 in such areas, citing staffing shortages as its principal reason.

Many participating PHAs said the program is fundamentally flawed. They explained that it was likely to prove far more expensive than previous programs, such as the section 23 program and the conventional public housing program, and that it could very well involve the PHAs in unfavorable publicity, controversy, and litigation in such areas as alleged discrimination, eviction, and subsidy payments. Several PHA officials expressed concern about the ambiguity of section 8 regulations dealing with alleged discrimination and eviction and feared that HUD would require them to become involved in such matters beyond their financial capability. According to them, HUD's administrative

fees barely cover their administrative responsibilities, let alone legal fees and potential liabilities.

Regarding subsidy payments, several PHA officials predicted public resentment over the high cost of housing eligible families through section 8. PHA officials also cited the potential controversy and negative publicity inherent in the following situation: Under HUD's original section 8 regulations, if a family paid utility costs directly and if the combined payment for rent and utilities exceeded the appropriate family contribution, an owner would have to pay the family for the difference between its actual cash outlay and its appropriate contribution. Perhaps recognizing the potential for controversy, HUD revised section 8 regulations May 13, 1976, to require the PHA rather than the owner to reimburse the tenant family for any excess payment. According to HUD, this change was made to reduce owner responsibilities.

Despite their objections and misgivings, some PHAs were confident the program could work because high vacancy rates had created a buyer's market in their areas. Other PHAs felt the program could work largely by ignoring HUD's regulations and administering the program as they saw fit. Essentially, this meant making it as much like the section 23 program as possible, with the PHAs assuming many responsibilities that section 8 regulations assigned to owners and tenants.

PROGRAM REQUIREMENTS TOO COMPLEX FOR MANY LOWER INCOME PERSONS

Most PHA officials interviewed believed that a lower income certificate holder could not, on the basis of a single briefing by PHA officials, understand the provisions of the existing housing program and, in turn, explain them to an owner. Under the section 8 regulations in effect since May 6, 1975, the lower income participant shops for his own housing and explains the program to an owner. He inspects housing to determine its quality and acceptability under program regulations, bargains with the owner over rent, and negotiates a lease. Many PHA officials who doubt the typical participant's ability to do these tasks feel that participants would quickly drop out of the program after a few unsuccessful attempts to find a unit or persuade an owner to rent to them.

Some PHAs have taken or plan to take the following steps to simplify the process for lower income persons:

- Initiate an active outreach program to owners and community leaders to inform them of the existence of the section 8 program, explain it, and encourage their participation and support.
- Provide participants with lists of available section 8 units.
- Develop a simple checklist for participants in their initial inspection of a unit.
- Develop a model lease document to simplify negotiations with owners and minimize a PHA's need to review each lease for compliance with HUD guidelines.

Some other PHA officials have apparently concluded that the only way the program can work is to avoid "shopping" and, instead, emphasize subsidization of eligible "in-place" tenants. One PHA director explained that he planned to use his community's entire section 8 existing housing allocation to subsidize elderly in-place tenants. As of February 23, 1976, about 58 percent of all tenants occupying section 8 units in California were in-place tenants and 57 percent were elderly. According to a HUD central office official, about two-thirds of the 88,880 tenants as of September 30, 1976, were in-place tenants.

IMPEDIMENTS TO FURTHERING THE
DECONCENTRATION GOAL OF THE HCD ACT

An objective of the HCD Act of 1974 is to reduce concentration of lower income housing and promote greater freedom of choice in housing location for all eligible income groups, especially those at the lower end of the income scale. Section 101 of title I of the act provides for

"*** the reduction of the isolation of income groups within communities and geographical areas and the promotion of an increase in the diversity and vitality of neighborhoods through the spatial deconcentration of housing opportunities for persons of lower income ***."

Section 104 of the HCD Act, which described the function, form, and content of community housing assistance plans--the vital link between title I (community development) and title II (assisted housing)--likewise addresses the deconcentration goal by requiring that the plans have the objective of

*** promoting greater choice of housing opportunities and avoiding undue concentrations of assisted persons in areas containing a high proportion of low-income persons."

Finally, section 8 of title II of the act says the purpose of providing lower income housing assistance is one of "aiding lower income families in obtaining a decent place to live and of promoting economically mixed housing."

Since section 8 is generally viewed as the principal Federal program for housing lower income persons, it will be the major vehicle for deconcentration. However, some PHA officials and HUD field staff believe the program will not deconcentrate areas with a high proportion of lower income families. Following are some reasons cited for this conclusion.

- Low FMRs for the program will, in many cases, restrict shoppers' choices to housing of marginal quality in minority and lower income areas.
- Section 8 regulations restrict a participant's shopping range to the geographical limits of the PHA which issued the certificate of participation.
- PHA-imposed residency requirements on applicants seeking eligibility certification may keep many families from leaving an impacted area and moving into another PHA's jurisdiction.

HUD said another reason the program may have limited effect on deconcentration is that many recipients may wish to remain in minority or low-income areas because of racial, ethnic, family, or religious ties.

PHA officials and HUD field staff agreed that low FMRs would result in acceptable units being available only in minority and lower income areas. Most PHA officials admitted to being caught in a dilemma. Some stated that they would not approve leasing units in impacted areas (especially

blighted areas, high-crime areas, and areas characterized by air pollution, rodent infestation, and other serious environmental deficiencies) because they believed it violated congressional intent and HUD program regulations. Others saw little choice but to approve such leases, provided the units in question could meet the program's quality standards.

Mobility of certificate holders was, at the time of our review, generally limited because they could not search for housing units outside the jurisdictional boundaries of the PHA that issued the certificates. This limited their choice of housing to the city, suburban community, or whatever part of the area or region in which the PHA operated. In addition, as previously discussed, many communities have no active section 8 program. For example, in the Chicago area, the communities of Arlington Heights, Berwyn, Cicero, Des Plaines, and Oak Lawn are not participating in the program. In the San Francisco area, the communities of Piedmont, Ross, Atherton, Burlingame, Woodside, and Hillsborough are not participating.

The minimum residency requirement some PHAs used to determine section 8 eligibility also limits mobility of participants. This requirement excludes all but those presently residing within the PHA's geographical jurisdiction. HUD, however, revised its section 8 regulations in May 1976 to generally prohibit PHAs from imposing residency requirements on those applicants who (1) are already working in the community or (2) have been notified that they have been hired to work in the community but reside elsewhere. Also, HUD's revised regulations allow a certificate holder to find a unit in any area where the PHA is not legally barred from entering into contracts. PHAs are encouraged to promote greater choice of housing by

- seeking participation of owners in any area in which the PHA is not legally barred from entering into contracts,
- advising families of their opportunity to lease housing in all such areas,
- cooperating with other PHAs by issuing certificates to families already receiving section 8 assistance who wish to move from one PHA to another, and

--developing administrative arrangements with other PHAs to permit certificate holders to seek housing in the broadest possible area.

In allocating funds, HUD will give preference to PHAs which give families the broadest geographical choice of units, according to the revised program regulations.

HUD's central office, however, did not favor prohibiting all PHA residency requirements. It said PHAs feel responsible for housing their own families and HUD considers this appropriate provided those who live and work in a locality are treated equally.

A family that wishes greater mobility, however, will have to qualify and be certified in each PHA jurisdiction in which it plans to shop for housing and will have to fulfill a number of duplicative requirements, such as completing PHA forms and attending briefing sessions.

To illustrate the effects of limited mobility, a lower income person living in Chicago at the time of our review was unable to use a Chicago Housing Authority certificate to shop for housing closer to his place of employment in suburban Cook County. Similarly, a New York City certificate holder was unable to use his certificate to get housing in neighboring Long Island, Connecticut, or New Jersey. Unless these and other PHAs permit families from other PHAs to shop for housing in their jurisdictions as HUD suggests, families' mobility will remain limited.

OTHER PROBLEMS RELATED TO THE EXISTING HOUSING PROGRAM

Other problems or questionable practices noted during our review which hindered implementing the existing housing program included HUD's:

--Decision to permit lower income families with children to lease units in high-rise elevator buildings.

--Decision to allow in-place tenants to benefit from a shopping incentive credit.

--Use of section 8 contract authority to assist financially troubled projects built under previous HUD-insured or -subsidized programs.

Families with children in
high-rise elevator buildings

The Housing and Urban Development Act of 1968 established, as a general policy, that families with children should not live in high-rise elevator buildings. The policy was reaffirmed in section 6(a) of title II of the Housing and Community Development Act of 1974 which states that

*** except in the case of housing predominantly for the elderly, high-rise elevator projects shall not be provided for families with children unless the Secretary makes a determination that there is no practical alternative."

This policy was adopted because of previous failures in family projects, such as the Pruitt-Igoe project in St. Louis. Many housing officials we interviewed believe it is socially undesirable to use high-rises to house lower income families with children.

However, HUD has decided to put no restrictions on leasing family units in high-rises under the section 8 existing housing program. HUD has based this policy determination on the "finders keepers" provision of the section 8 existing housing regulations which provides that:

"A holder of a certificate of family participation shall be responsible for finding an existing housing unit suitable to the holder's needs and desires in any area within the PHA's jurisdiction. A holder of a certificate may select the dwelling unit which the holder already occupies if the unit qualifies as Existing Housing ***."

HUD believes that the restriction against family housing in high-rises contained in section 6(a) of the HCD Act does not apply to section 8 existing housing because it is inconsistent with the program's basic policies. HUD points out that section 8(h) of the HCD Act provides that

*** the provisions of section 3(1), 5(e), and 6, and any other provisions of this act, which are inconsistent with the provisions of this section shall not apply to contracts for assistance entered into under this section."

HUD's view, contained in an October 20, 1975, memorandum from the assistant general counsel for public housing to all regional and area counsel, is that the restriction contained in section 6(a):

"*** applies only where a project is to be 'provided for families with children.' In the section 8 Existing Housing Program, each family which receives a Certificate of Family Participation is free to choose a unit from the existing housing stock anywhere within the PHA's jurisdiction, so that the number of families, if any, who may choose units in high-rise elevator buildings is entirely a matter of their individual needs and desires and in no way subject to the control of the PHA. Accordingly, the PHA cannot be said to be 'providing' a 'high-rise elevator project' or, indeed, any other specific type of projects, for the Certificate Holders.

"In the Section 8 New Construction and Substantial Rehabilitation Programs, however, the section 6(a) limitation does apply. The project itself is undertaken only on the basis of a commitment that a Housing Assistance Payments Contract covering units in the project will be entered into upon the satisfactory completion of the work. Accordingly, projects are being 'provided' as a result of Owners' participation in the New Construction and Substantial Rehabilitation Programs."

Despite the statements quoted above relating to the section 8 new construction program, HUD has liberally interpreted the language contained in section 6(a) as it related to housing families with children in newly constructed high-rises. In a December 12, 1975, memorandum to regional and area counsel, the assistant general counsel for public housing said that in a new construction high-rise project primarily for the elderly, up to 33 percent of the units could be used to house families with children. He said this percentage would vary on a case-by-case basis, but that a project in which two-thirds of the units were for the elderly could reasonably be regarded as a project "predominantly" for the elderly.

Shopping incentive credit
for in-place tenants

Section 8 existing housing regulations contain a "shopping incentive credit" provision to encourage participants to shop carefully and wisely for housing below the published FMR ceilings and to negotiate with owners so as to save themselves and the Government money. The regulations state:

"As an incentive to families to find the most economical decent, safe, and sanitary housing suitable to their needs and approvable under this part, if a family selects a unit *** for which the owner's proposed contract rent plus any applicable allowance is below the applicable fair market rent, the family will be given credit (Shopping Incentive Credit) by a reduction in its required monthly gross family contribution."

Some PHA officials we interviewed predicted that the primary effect of the shopping incentive would be to encourage participants to lease substandard or marginal units and/or units in areas of minority or lower income concentration.

Perhaps the most ironic aspect of the shopping incentive, however, is that it may benefit most those who have done the least to earn it--the in-place tenants. HUD considers all tenants eligible for the shopping incentive. Therefore, PHAs are administering the program to provide in-place tenants with the shopping incentive credit. For example, of the PHAs in California that had section 8 units occupied as of February 1976, all considered in-place tenants eligible for the shopping incentive. Of about 1,200 tenants who had found section 8 housing in California, 58 percent were in place. In Orange County, California, 313 tenants were receiving section 8 assistance; 207, or 66 percent, of these were in place. About 48 percent (150 tenants) were receiving shopping incentives ranging from \$2 to \$27.

By making the shopping incentive credit available to in-place tenants, HUD is and will be rewarding people who have done no "shopping" at all. Although we agree with the intent of the shopping incentive credit, we question the reasonableness of extending it to in-place tenants.

Perhaps recognizing that shopping incentive credits were being provided to in-place tenants, HUD revised its section 8 regulations in May 1976 to change the title from shopping incentive credit to "rent reduction incentive." The revised regulations state that the new title is more appropriate because

- the purpose of the "rent credit" is to provide for more efficient use of available funds and
- the "rent credit" is equally available to a family which negotiates a lower rent for the unit it already occupies, although it is not "shopping" for a unit in the usual sense.

We still question extension of this credit to in-place tenants and whether the agreed-upon rent would have been any higher if the credit did not exist. HUD regulations provide that

- to be eligible for the section 8 program the rent demanded by the owner cannot exceed published FMRs, except in certain circumstances, and
- to participate in the program the unit rent must meet HUD's rent reasonableness test; that is, the owner cannot charge a rent which is higher than that for comparable units in the area.

In addition, an owner generally is not permitted to charge a higher rent than that charged before entering the program, unless he can justify it. It thus appears that these program requirements would automatically make rents sought by owners wishing to participate in the program less than published FMRs. Also, there appears to be no incentive for an owner who already has an in-place tenant to negotiate a lower rent with the tenant just to participate in the program, especially considering the owner's added responsibilities once his unit is leased. To give a rent credit to a tenant who already lives in a unit, which the owner wishes to lease under section 8, seems unwarranted in view of the above requirements. Furthermore, HUD regulations do not prohibit in-place tenants from receiving rent credits even if no negotiating were done. Instead, it appears rent credits will be provided in any case when the agreed-upon rent is less than the published FMRs.

HUD's central office said it is reconsidering rent reduction credits and may eliminate them altogether or assure that they provide a greater incentive to shop. In HUD's view, in-place assistance is essential to the concept of a family's freedom to choose where to live. HUD said that although in-place assistance was quite common, accounting for more than half of the units assisted in some localities, this did not justify our statement that the section 8 program for existing housing would essentially be an income maintenance program for families already adequately housed but paying a disproportionate amount of their income for housing. We disagree. Because these tenants are not required to improve their housing, the section 8 subsidy becomes essentially additional income for them to use for other expenses.

Use of section 8 assistance in financially troubled projects

The Senate Committee on Banking, Housing and Urban Affairs has questioned HUD's plan to use section 8 funds to assist 220,000 standard, nonluxury units in financially distressed projects with HUD-insured mortgages. The committee believes that HUD's plan will detract from the Congress' intent that such funds be used to provide additional housing to lower income persons. To the extent tenants living in financially troubled projects are assisted, section 8 will not result in moving other families into standard housing. Also, we believe that the existing housing program's concepts of "freedom of choice" and "greater mobility" will be altered if lower income persons are limited to units in specific projects rather than being able to lease anywhere in the private market.

At the time of our review, HUD planned to assist 220,000 units through fiscal year 1977--110,000 units by September 30, 1976, and 110,000 units in fiscal year 1977. The 220,000 units represent about 27 percent of HUD's initial projected goal of 800,000 units. This percentage could be much larger if the "regular" (not-financially distressed) existing housing, newly constructed, and substantial rehabilitation programs continue to experience the problems noted in this report.

HUD's proposed regulations for using section 8 funds to assist financially distressed projects specify that eligible projects include

"*** any existing subsidized or unsubsidized multifamily residential project which is subject to a mortgage insured pursuant to any section of the National Housing Act, any such project the mortgage for which has been assigned to the Secretary, any such project acquired by the Secretary and thereafter sold under a Secretary held purchase money mortgage, or a project for the elderly financed under section 202 of the Housing Act of 1959."

HUD expects most of the assisted projects to be ones subsidized under the provisions of section 236, section 221(d)(3), and section 202. The 110,000 units to be assisted under these new loan management and property disposition programs by September 30, 1976, do not include the 165,000 units to be assisted under the regular section 8 existing program. (See p. 4.)

Under its property disposition program, HUD estimated that 10,000 foreclosed multifamily units in HUD-owned multifamily projects should be placed under contract reservation for section 8 assistance by September 30, 1976. This estimate was subsequently revised to 6,000 units; the other 4,000 units were added to the loan management program goal. HUD planned to offer these properties for sale with section 8 subsidies to attract investors. As of September 30, 1976, however, no units had been placed under contract reservation.

Under the loan management program, HUD estimated that up to 29,000 units in projects whose mortgages were held by the Secretary could be provided with section 8 assistance by September 30, 1976. Also, HUD anticipated assisting 75,000 units in projects which were in default but which had not had their mortgages assigned to the Secretary. As of September 30, 1976, 30,236 units were being assisted and contract authority had been reserved for about 116,700 units.

HUD maintains that the basic goals and anticipated benefits of the loan management program are (1) the reduction of claims on HUD's insurance funds by making projects likely to be assigned or now assigned to HUD financially viable, thereby preventing their foreclosure, and (2) the continued use of the units to house lower income persons. Program regulations provide criteria to guide the selection of projects eligible for section 8 assistance. These criteria aim at insuring that selected projects have identifiable problems that can be solved with section 8 assistance and that such assistance will contribute to long-term project viability.

According to HUD's April 1976 statistics, 69 percent (26,659) of all 38,487 subsidized HUD-insured units in default were section 236 units. Also, 63 percent (4,730) of all 7,506 subsidized HUD-insured units in the process of assignment or foreclosure were section 236 units.

HUD has authority to assist financially distressed section 236 projects exclusive of the section 8 program. Section 212 of the HCD Act created an operating subsidy program for making payments to assist owners of section 236 projects to meet higher operating costs resulting from increased property taxes and utility costs. HUD, however, had not implemented it at the time of our review and, according to HUD officials, did not intend to implement it. The Secretary of HUD, testifying before the Senate Committee on Banking, Housing and Urban Affairs on October 5, 1975, stated that such subsidies cannot solve multifamily housing problems because they represent an open-ended financial commitment by HUD which could reach astronomical proportions.

On June 8, 1976, a U.S. District Court ruled that HUD pay operating subsidies for all eligible section 236 projects. HUD appealed the ruling 8 days later.

In May 1976 HUD rejected a New York City proposal to use up to 80 percent of its section 8 funds to assist about 8,000 city-owned public housing units. This would have reduced the city's contribution to these units by about \$40 million. HUD subsequently proposed revising its section 8 regulations to prohibit PHAs from giving preference to families occupying or expected to occupy specific units in specific projects. This proposal would allow families freedom in selecting places to live, according to a HUD official. However, it does not apply when HUD assists specific projects, even though families' housing choices may be restricted in the same way as when a PHA assists a specific project.

HUD field office officials told us that, when they first suggested to HUD's central office that section 8 funds be used to aid financially distressed HUD-insured projects, they were told that tying subsidies to housing units rather than to eligible families would oppose the "finders keepers" policy of the section 8 existing housing program.

The Senate Committee on Banking, Housing and Urban Affairs, in its April 12, 1976, report on S. 3295, Housing Amendments of 1976, said HUD's plan to help these projects had merit, but using section 8 funds detracted from the Congress' basic intent that such funds be used to provide additional housing units for low- and moderate-income families. The report also said the committee wanted to avoid mixing funds for additional housing with funds for reducing HUD foreclosure losses. The committee's bill, S. 3295, tried to add a new program to the National Housing Act which would have its own housing assistance funds appropriated to assist these projects. This proposal was deleted, however, in a June 1976 joint House-Senate conference on the bill.

HUD's use of section 8 funds to assist financially troubled projects may solve some of these projects' financial problems; however, we believe the following issues should be considered in determining whether section 8 funds should be so used.

- To the extent that section 8 is used to subsidize the rents of tenants presently occupying units in assisted multifamily projects, it will not move families out of substandard housing into decent, safe, and sanitary housing.
- Under the regular section 8 existing housing program, the subsidy is for the family rather than for the unit which the family occupies. This is the finders-keepers provision which permits a family to choose where it will live. The loan management/property disposition programs depart from the finders-keepers concept in that the subsidy is for a specific project and unit rather than for the family which occupies the unit. Lower income participants will not have the freedom to shop for these units as in the regular existing housing program but will either be in-place tenants or be recruited by the project owner.
- The loan management/property disposition programs may be more expensive than if tenants leased existing units in the private market. A HUD official said many projects which the programs will assist have rent requirements higher than the FMRs that have been published for the regular section 8

existing housing program. For example, HUD plans to use the new construction FMRs rather than the lower existing housing FMRs for the property disposition program.

Some form of assistance may be appropriate for financially troubled projects to prevent foreclosures and the resultant loss of lower income housing units. But, if HUD uses the authority it already has (see p. 52) to assist section 236 projects, which make up over 60 percent of the financially troubled projects, section 8 assistance may not be needed.

CONCLUSIONS

The section 8 existing housing program has had limited success in assisting lower income persons to obtain housing. Many problems may impede its success, including:

- Owners' reluctance to participate because they believe they are not adequately compensated for complying with section 8 requirements and accepting the greater management burden and risks which, they feel, come with renting to lower income families.
- Refusal or inability of some communities to participate because of small section 8 allocations and/or low administrative fees which, they felt, were insufficient to support program administration.
- The number and complexity of responsibilities assigned to families and the requirements and limitations placed on owners.
- The program may not be dispersing and deconcentrating lower income housing enough, according to PHA officials and HUD field office staff. Section 8 is the principal means of carrying out these goals, since it is the major subsidized housing program for lower income persons.
- HUD's requirement that section 23 leased units be converted to the section 8 program may result in many section 23 owners withdrawing their units from the lower income housing program, since many of them are reportedly unwilling to accept many of section 8's requirements and responsibilities.

--The program appears to be emphasizing subsidization of in-place and/or elderly tenants.

--Extension of shopping incentive credits (or rent reduction incentives) to in-place tenants results in needless Government expense and unearned benefits for assisted families.

RECOMMENDATIONS

We recommend that the Secretary of Housing and Urban Development:

--Consider, as an alternative to increasing FMRs, reducing some of the owners' section 8 responsibilities to overcome their reluctance to participate in the program. Specific changes could include:

1. Eliminate the need for certificate holders and owners to prepare housing inspection reports, since PHAs must formally inspect all properties.
2. Seek a legislative change which would allow owners to terminate tenancy as they do in the private rental market and in the section 8 new construction program.

--Provide PHAs with authority and funding to permit them to actively solicit owner participation in the program.

--Continue the section 23 leasing program until the section 8 program proves viable.

--Allocate sufficient section 8 funds to a community to permit effective, efficient, and economical program administration. One way of obviating the problem of too-small allocations would be to aggregate allocations for several communities or jurisdictions and to invest program administration in a PHA with areawide responsibility. Alternatively, HUD could administer the program itself, as provided for in section 8(b)(1) of the HCD Act.

- Encourage the formation of PHAs with regional, metropolitan, and/or State-wide jurisdiction to give certificate holders greater mobility and freedom of choice within market areas.
- Prohibit PHAs from making residency a program requirement.
- Not permit payment of shopping (rent reduction) incentives to in-place tenants.

AGENCY COMMENTS AND OUR EVALUATION

HUD stated that it will:

- Recommend a legislative change to eliminate the authorization-to-evict provision of the 1974 Housing Act as it relates to the section 8 existing housing program.
- Publish regulations which eliminate the requirement of tenant and landlord inspections.
- Clarify its regulations to allow landlords to negotiate flexible lease terms, including month-to-month leases.
- Consider increasing the tenant contribution to the security deposit.
- Clarify its handbooks, publications, and training to assure that landlords understand their prerogatives in selecting tenants.
- Emphasize the importance of "landlord outreach" (publicizing the program to as many landlords as possible), which internal studies have found to have a very favorable impact on landlord participation.

HUD also stated that:

- It is reviewing its current policies and procedures with regard to section 23 conversions.
- The regulations for allocating housing assistance funds published August 23, 1976, require establishing

allocation areas, as far as practicable, "broad enough to support economically feasible housing programs."

--The PHA handbook will include a simplified form for the administrative plan of small PHAs which will minimize their expenses before executing the annual contribution contract. The handbook for existing housing has been amended so that the administrative fee will be 8-1/2 percent or \$15 per unit per month, whichever is higher.

--It will emphasize to its field offices that front-end administrative funding is not limited to the \$275/unit figure when that amount is not enough to start the program.

HUD said that where early experience has indicated impediments to a family's choice of housing in various neighborhoods, program modifications, including the following, were made.

--FMRs have been raised, within the limits of the Fiscal Year 1976 Appropriations Act.

--Program changes published in the May 13, 1976, Federal Register have significantly increased PHA and HUD flexibility in approving rents, allowing rents to better reflect the variety of housing submarkets that exist within an SMSA, thereby expanding housing opportunities. In addition, the proposed publication of FMRs for counties, single-family units, and five-bedroom units will expand unit selectivity.

HUD is also considering recommending a statutory change in the maximum amount that a family may pay toward rent, waiving the current 25-percent limit. Although HUD's contribution to rent would remain unchanged, a family could rent a unit whose rent exceeded the published FMR. This would expand the housing available to recipients by allowing them to decide what proportion of their income will be allocated to housing.

HUD stated that, in support of the dispersal objectives, it had recently awarded \$20 million of supplemental section 8 housing assistance to seven selected jurisdictions participating in approved Areawide Housing Opportunity Plans.

These are plans developed by areawide planning organizations for allocating housing assistance which gives greater opportunity for lower income households to move outside areas of low-income concentration. The plans must include a detailed assessment of low-income housing assistance needs on an areawide basis for each jurisdiction within the area served by the planning organization.

In addition, HUD has recently entered into an agreement for a demonstration in which 400 section 8 existing housing units will be made available in the Chicago metropolitan area. The demonstration's purpose is to test the concept of an SMSA-wide section 8 existing housing certificate.

We believe the actions HUD plans to take should improve the existing housing program significantly.

MATTERS FOR CONSIDERATION
BY THE CONGRESS

The Congress should determine whether HUD's policy of permitting families with children to live in high-rise elevator buildings is appropriate, considering the provisions of the Housing and Urban Development Act of 1968 and the HCD Act's reaffirmation of these provisions.

CHAPTER 5

LIMITED ACTIVITY BY PRIVATE DEVELOPERS

IN NEW CONSTRUCTION AND SUBSTANTIAL

REHABILITATION PROGRAMS

In addition to the problems encountered in the section 8 program for existing housing, HUD has attracted only limited developer participation in the new construction and substantial rehabilitation programs. (App. III shows the limited program activity as of Dec. 31, 1975, for the three HUD regions we visited.) As of September 30, 1976, private developers were constructing and rehabilitating about 10,000 units, and about 1,306 units were occupied.

Because of the limited activity as of January 1976, HUD reduced its new construction/substantial rehabilitation contract authority reservations goal for private developers from 200,000 units to 105,000 units. Developers, mortgage banking officials, and HUD officials cited (1) lack of financing, (2) the complexity of the program, and (3) owners' numerous program responsibilities compared with the low financial rewards, low fair market rents (see ch. 3), and low rents resulting from HUD's rent comparability test (see ch. 3) as the major reasons for the limited activity.

Other problems noted which have also hindered implementation of new construction were:

- In some communities, especially rural ones, HUD advertised for such a small number of units that developers thought construction would be unprofitable.
- Inadequate incentives are offered to obtain projects with an economic mix of tenants (projects in which 20 percent or less of the units are to receive section 8 assistance).
- Developers will provide housing mainly for the elderly because they believe the FMRs are too low to house families and because the elderly require minimal housing management and maintenance.
- Difficulties in coordinating the Farmers Home Administration's rural rental housing loan program and HUD's section 8 program.

HOW THE PROGRAMS ARE DESIGNED TO WORK

HUD regulations provide that the new construction program is to be used in communities where the existing housing inventory is inadequate. The substantial rehabilitation program is to be used to upgrade the existing housing stock. When there is need for new construction, HUD area offices are required to publish in a local newspaper(s) a "Notification of Fund Availability" inviting proposals from developers. Developers submit preliminary proposals to HUD, and HUD then requests developers with the best acceptable preliminary proposals to submit final proposals.

After the final proposal is approved and the developer submits an architect's drawings and certification, the developer and HUD enter into a housing assistance payments agreement, at which time construction or rehabilitation begins. At completion, HUD and the owner execute a housing assistance payments contract. The term of the assistance payments contract is limited to 20 years when the developer is a private owner and 40 years when the developer is a PHA.

The developer (owner) can be any private person or entity, including a cooperative or a PHA. The developer can use almost any type of available financing, including conventional financing, HUD mortgage insurance programs, bonds, and Farmers Home Administration loans.

DIFFICULTY IN OBTAINING FINANCING

Various developers, HUD officials, and mortgage bankers told us that conventional financing for section 8 new construction nonelderly projects was almost impossible to obtain. Developers have also stated that alternative financing through HUD mortgage insurance programs was too costly because of delayed processing and the site and marketability tests applied to the projects.

In an October 22, 1975, statement before the House Subcommittee on Housing and Community Development, a National Association of Home Builders official cited inadequate financing as one of the most serious problems of the section 8 program. An official of the National Association of Housing and Redevelopment Officials said the same thing to the committee. Our discussions with developers and mortgage banking officials revealed that the major reason for the lack of conventional financing was the relatively low return on investment for section 8 projects coupled with the high risk in constructing lower income housing. As one developer

said, "Why would a conventional lender want to lend for a social experiment? The program lacks any incentive for him to do it." A mortgage banker stated that available conventional financing would probably be used for unsubsidized projects rather than section 8 projects. He explained that, because construction of unsubsidized rental units had been minimal over the last 2 or 3 years, these units were now in great demand. Therefore, if a developer could get conventional financing for a project, he generally would build unsubsidized projects. Other program features cited as discouraging investment were:

--Section 8 regulations place a 20-year limit on the term of housing assistance payments contracts when a private developer is involved. Developers could see no basis for this limit and stated it almost guarantees that financing will be unavailable. As one developer said, the HUD-established FMRs were not high enough to amortize a mortgage over 20 years. Developers must amortize their costs over a 30- to 40-year period, which is the normal term for new construction financing. However, developers are finding financial institutions unwilling to provide financing over the 30- to 40-year period when HUD section 8 subsidies are guaranteed for only 20 years.

--Section 8 regulations limit the housing assistance payment on a leased unoccupied unit to 80 percent of the contract rent for up to 60 days. After 60 days the owner receives no Federal subsidy for an unoccupied unit. Some financial institutions were reluctant to finance a lower income housing program when the owner had no guarantee of payment of a subsidy for vacant units. National Association of Home Builders and National Leased Housing Association officials recommended that HUD change its section 8 regulations to permit housing assistance payments on all vacant units to be at least sufficient to cover an owner's cost of financing. Subsequently, the Housing Authorization Act of 1976, Public Law 94-375, August 3, 1976, amended section 8 to authorize payments for vacant units for up to 1 year beyond the 60-day period in amounts equal to debt service (principal and interest) if

--the project is not covered by a HUD-insured mortgage;

--the project is approved under section 8 as newly constructed or substantially rehabilitated;

- a "good faith" effort is being made to fill units;
- the units provide decent, safe, and sanitary housing; and
- the cash flow of the project does not exceed cash expenses.

Section 8 new construction projects are eligible for financing under various HUD mortgage insurance programs. However, developers have stated that these programs were not feasible because of the increased costs associated with HUD processing delays and the site and marketability tests applied to developers' proposed projects for insurance eligibility.

Developers stated that, even though HUD mortgage interest rates were lower than conventional rates, conventional financing was much faster. According to a HUD study, a HUD financing commitment may take up to 240 days to obtain. A commitment from a private lender may be obtained in 30 to 60 days, according to one lender. Developers feel the time saved results in less costs for material and labor, and offsets the high rates.

Projects to be financed through HUD mortgage insurance programs must meet certain market and site acceptability criteria exclusive of section 8 program requirements. The extent of the mortgage insurance review and evaluation of a preliminary proposal is limited to determining (1) location and design eligibility for mortgage insurance and (2) unit rents. This will include inspecting a site, initiating an environmental clearance, estimating the rent of each unit, and determining the marketability of the units. The proposed project must be of a quality to successfully compete for unassisted occupants in a balanced market. The rents for the units must not be higher than those for unassisted units of comparable size, as determined by HUD through its mortgage insurance program marketability test. If they are higher, the proposed project will not be approved. Similarly, HUD will not approve a proposed section 8 project that does not meet mortgage insurance site criteria even if it meets section 8 site requirements.

Some developers are not getting HUD financing because their proposals cannot meet the acceptability criteria of the HUD insurance programs. For example, 13 of the 14 section 8 proposals submitted to the Jacksonville area office requesting financing through HUD mortgage insurance programs were turned down by the Tampa insuring office because they could not meet the marketability and/or site acceptability criteria of the

insurance program. Jacksonville area office officials expected that all 24 proposals sent to the Coral Gables insuring office would probably also be rejected for the same reason. One official said that, even though the need for a section 8 project exists and the project meets section 8 criteria, it may not be built because it does not qualify under the mortgage insurance criteria used for the program under which insurance is requested. He recommended trying to coordinate the programs when evaluating proposed section 8 projects.

To stimulate construction of multifamily projects, in January 1976 HUD initiated the Government National Mortgage Association (GNMA) tandem plan making \$3 billion available for purchase of mortgages on HUD-insured multifamily projects, including section 8. Under the program, HUD-approved mortgagees will be able to secure 7-1/2 percent financing for eligible HUD-insured multifamily projects. HUD estimated the plan could finance approximately 30,000 of its goal of 105,000 section 8 assisted units. Mortgages financed through conventional sources were not made eligible for the tandem plan because HUD fears windfall profits for developers who take advantage of the low interest rates and believes the housing industry will be on its way to recovery by the time it could start a program for conventional mortgages. In September 1976, however, developers and financial institutions recommended that HUD allow GNMA to also purchase conventional mortgages to help make more conventional financing available for section 8 projects.

PROGRAMS TOO COMPLEX IN
COMPARISON WITH FINANCIAL
INCENTIVES OFFERED

Several developers and mortgage bankers said the new construction and substantial rehabilitation programs' complexity was discouraging participation and the financial incentives did not encourage developers to assume the numerous administrative and management responsibilities involved in the programs.

A developer interested in constructing section 8 units must first submit a preliminary proposal to HUD. If HUD approves it, the developer is requested to submit a final proposal. The final proposal must contain an affirmative fair housing marketing plan; evidence of management capability and a management plan; the lease the developer proposes to use; and numerous other forms, documents, specifications, and plans.

Developers whose final proposals are approved face more management responsibilities than are involved in operating private rental units. They include determining the program eligibility of lower income persons, verifying and annually reexamining tenants' incomes, and insuring that tenants pay their part of the rent as outlined in section 8 guidelines.

These extra responsibilities may be discouraging developers. For example, officials of a large firm that is heavily involved in other HUD programs said that they did not plan to participate in privately developed section 8 new construction because of these responsibilities. They also criticized the section 8 bidding process because it made them compete with developers who built very cheaply designed section 8 projects to make quick profits. One developer said his proposals stress good management, which is expensive and crucial to project success, but the FMRs were too low to cover the cost of such management. Also, a lawyer working with developers putting proposals together said the section 8 regulations were overly complicated and not too well understood by developers.

The lengthy time taken by HUD field offices to review preliminary proposals may also discourage developer participation. Developers at a recent National Association of Home Builders workshop stated that subjecting every proposal to the same rigorous processing was time consuming and discouraged experienced builders. At a recent National Leased Housing Association workshop, developers recommended that HUD (1) adopt a mandatory 90-day deadline for processing preliminary proposals and (2) strengthen its proposal review criteria to screen out unacceptable proposals at the outset. They recommended also that HUD negotiate for proposals when competitive procedures failed to elicit adequate ones.

To encourage submission of more acceptable proposals and to facilitate processing proposals submitted, HUD, on April 26, 1976, published in the Federal Register revisions to its section 8 new construction regulations. One revision replaces the initial screening process for evaluating proposals and provides for a more complete preliminary review process designed to identify and exclude obviously deficient proposals.

INSUFFICIENT NUMBER OF UNITS ADVERTISED

HUD's advertisements for new construction units in some communities have been for such a small number of units that developers have not participated in the program. HUD field office officials and some developers told us that developers cannot profitably construct such small projects.

The following schedule shows the low developer response to certain HUD advertisements for such projects.

| <u>Community</u> | <u>Total units advertised for construction</u> | <u>Number of developers submitting a proposal</u> |
|---------------------------------------|--|---|
| Caldwell County, North Carolina | 6 | 0 |
| Clearwater, Florida | 12 | 0 |
| St. Marys, Georgia | 12 | 1 |
| Glenwood, Alabama | 10 | 0 |
| Kings County, California | 12 | 1 |
| Mendicino County, California | 32 | 1 |
| Napa County, California | 43 | 0 |
| Inyo and Mono Counties, California | 29 | 0 |

Developers and HUD officials agreed that these advertisements were for too-few units. HUD officials said 50 should be the minimum number of units advertised for construction in a community. Developers, however, said the minimum should be 150 to 200.

On April 26, 1976, HUD published in the Federal Register revised section 8 regulations; however, no minimum was set on the number of units a project must contain.

INCENTIVES INADEQUATE TO OBTAIN
PROJECTS WITH AN ECONOMIC MIX

The new construction and substantial rehabilitation programs' guidelines provide that HUD give priority processing to those proposals in which 20 percent or less of a project's units are to receive section 8 assistance. This is to encourage economic mix and further the HCD Act objective of avoiding concentrations of lower income persons. Most of the developers and mortgage banking officials we spoke with felt such a priority was unrealistic and would not encourage developers to submit proposals for partially subsidized projects. They

pointed out that any developer who could rent 80 percent of his units in the private, nonsubsidized market could rent all of them. They questioned whether nonsubsidized tenants would stay in a project containing 20 percent subsidized tenants because of the stigma they believe most nonsubsidized tenants associate with low-income housing. They said HUD must offer more financial incentives to developers and possibly to nonsubsidized tenants if mixed-income projects were to become a reality.

DEVELOPERS WILL PROVIDE HOUSING MAINLY FOR ELDERLY

Of the 12 developers interviewed, 6 stated that, if they participated in the section 8 program under the then-current FMRs and program guidelines, it would be to build and manage projects exclusively for the elderly, whose units require minimal management and maintenance. Also, FMRs of units built for the elderly or handicapped can be as high as 126 percent of the published FMRs.

On the other hand, developers viewed lower income, nonelderly families as high risks requiring more costly unit management without benefit of the high FMRs obtainable from leasing to elderly tenants. For this reason, they believed that few developers would want to construct and manage section 8 units for nonelderly tenants. This belief has been reflected in preliminary proposals approved by HUD. For example, 76 percent, or 10,209 of the 13,520 new construction units approved by HUD as of December 26, 1975, were for the elderly. September 30, 1976, HUD statistics showed that 75 percent (15,474) of the 20,800 units under construction were for the elderly.

LIMITED HUD/FARMERS HOME ADMINISTRATION ACTIVITY IN RURAL COMMUNITIES

HUD's section 8 program and the Farmers Home Administration's section 515--rural rental housing loans--program can be used in tandem to provide rural housing. (The HCD Act of 1974 requires that at least 20 percent but not more than 25 percent of the financial aid allocated each fiscal year be to nonmetropolitan areas.)

According to HUD and Farmers Home Administration officials, difficulties in coordinating numerous program procedures and requirements for the two programs had hindered the tandem approach in rural communities. As of January 12, 1976, the 2 programs in tandem had produced only 4 new construction projects, containing 316 units, and had approved

only 6 proposals for construction. Meanwhile, the 2 agencies were considering 120 more proposals.

A Farmers Home Administration official said that the two main problems delaying the tandem approach were HUD's advertising practices and its published section 8 rents. He said that HUD area offices were slow to advertise for new construction proposals in many rural areas and that HUD was emphasizing advertising in urban or metropolitan areas rather than in rural areas. He said the section 8 rents were often not high enough to support section 515 construction costs. (The Farmers Home Administration bases loans for section 515 projects on proposed construction and operating costs, whereas HUD bases section 8 assistance on a totally different approach--contract rent, 1/ including utilities, which is limited by HUD-established FMRs for the area.) The official acknowledged, however, that his agency had gotten some HUD section 8 rents increased or had obtained exception to them.

The Farmers Home Administration official also said the tandem arrangement had suffered because HUD and Farmers Home Administration field staffs often were in different cities. He stated that, because HUD and the Administration concurrently reviewed all proposals, obtaining proposals that satisfied both agencies' requirements, and processing them, often took extra time. He also blamed differing agency viewpoints on such matters as types of structures for limiting tandem activity. For example, Administration guidelines do not allow loans for subsidizing high-rises, but HUD guidelines do.

According to the Administration official, program complexities and inexperienced Administration staff also delayed tandem activity. The Administration recently proposed a plan to eliminate concurrent processing to reduce coordination problems with HUD. The plan provides that HUD set aside a specific amount of section 8 contract authority for the Administration to use with its section 515 rural subsidy program and that the Administration process all developers' proposals. Administration officials estimated that 13,000 units could be assisted annually if this plan were used.

As of March 23, 1976, no agreement on these proposals had been reached between HUD and the Administration. However, a HUD official said both agencies agreed to establish task forces to study these and related proposals. Also, he said

1/Total rent an owner can receive for leasing.

HUD had agreed "in principle" to setting aside section 8 funds for the section 515 program. However, such funds had not been made available to the Administration as of March 23, 1976.

CONCLUSIONS

Section 8 new construction and substantial rehabilitation programs are having little success primarily because of developers' difficulty in obtaining financing for section 8 projects, low FMRs, HUD's rent comparability test, and financial rewards inconsistent with program responsibilities. Other problems appear to be inadequate financial incentives offered to obtain housing units or an economic mix of tenants, program complexity, and sometimes advertising for such an insufficient number of units that their construction would be unprofitable.

RECOMMENDATIONS

We recommend that the Secretary of Housing and Urban Development:

--Consider the following alternatives which, individually or together, may enhance a developer's ability to obtain financing and therefore accelerate program activity:

1. Seek legislative authority to extend housing assistance payments contracts for privately owned new construction up to 40 years, as is the case under State agency regulations.
2. Make available GNMA tandem funds for purchasing conventional section 8 assisted project mortgages.

--Consider the following changes in program requirements and procedures which, individually or together, would increase developer interest in the program:

1. Use negotiation to obtain new construction proposals when competitive bid procedures have failed to elicit adequate developer participation.
2. Solicit new construction proposals for a sufficient number of units to make construction economically feasible for developers.

--Coordinate more aggressively with the Farmers Home Administration to resolve section 8 and section 515

program differences so that rural areas can get more housing assistance.

--Consider providing stronger financial incentives to developers to encourage construction of projects with a mixture of subsidized and nonsubsidized units.

Also, we recommend that the Secretary of Agriculture have the Administrator, Farmers Home Administration, coordinate more aggressively with HUD to resolve section 8 and section 515 program differences so that rural areas can get more housing assistance.

AGENCY COMMENTS AND
OUR EVALUATION

HUD stated that regulations published in April 1976, after our review was completed, "effectively" allow its field offices to negotiate new construction proposals when competitive bid procedures have failed (as we recommended).

HUD also stated that it and the Farmers Home Administration entered into a "Memorandum of Understanding" on June 23, 1976, and have been developing regulations to implement the section 8/515 new construction program. HUD said funds for 10,000 units would be set aside for this program in fiscal year 1977, and 1,321 units had been approved as of September 7, 1976.

HUD agreed that some field offices may have been slow in advertising in rural areas. Also, it said it would consider additional incentives which may encourage developers to construct projects containing a mixture of subsidized and nonsubsidized units.

We believe these actions, if implemented, should improve the section 8 new construction and substantial rehabilitation programs.

HUD disagreed with some of our recommendations. It said its new regulations (August 23, 1976) for allocating housing assistance funds and handbook changes implement our recommendations regarding soliciting new construction proposals for a sufficient number of units to make construction economically feasible for developers. HUD stated, however, there were no plans to establish minimum numbers of units a developer must build to assure economic feasibility. In view of the problems experienced to date, as discussed on pages 64 and 65, we continue to believe minimum limits are needed.

HUD said that obtaining financing has been a major impediment to the new construction and substantial rehabilitation programs and that, although the financing picture is improving, it remains a matter of major concern. Despite this problem, however, HUD said it continues to receive more proposals than it is able to fund.

Although HUD now may be receiving more proposals than it can fund, when we visited its field offices most of them were not getting many proposals. Where several proposals were received, most were being rejected because of HUD's rent reasonableness test--developers were asking for rents which HUD thought were too high--or because developers' rents or proposed building sites did not meet HUD mortgage insurance program marketability or acceptability criteria.

In response to our recommendation that HUD seek legislative authority to extend housing assistance payments contracts for privately owned new construction up to 40 years, instead of the current 20-year limit, HUD said that until the success of the developers' proposals now being received has been ascertained, extending all contracts to a potential 40 years seemed excessive. As stated in our report, developers generally must amortize their costs over a 30- to 40-year period--the normal term for new construction financing. The 20-year limit appears to force developers to request higher rents if they want to amortize their costs in that time. We, therefore, believe HUD should seriously consider seeking the recommended legislative change.

With regard to our recommendation that HUD consider making GNMA tandem funds available for purchasing conventional section 8 mortgages, HUD said that the Secretary must first find that conditions--in the economy generally, and in the housing market particularly--are bad enough to warrant Federal financial aid. Thus, HUD said, any program for purchasing conventional project mortgages would have to be open to all projects, not simply section 8. In addition, HUD said the major problem with a conventional multifamily purchase program is the potential for windfall profits to the developer deriving from the below-market-rate financing. This is due to two factors, according to HUD: (1) infeasibility of controlling rents to reflect below-market-rate financing (not a problem on section 8 projects) and (2) accepted appraisal methods would reflect a value based on market interest rates rather than the below-market rate available under the GNMA program. HUD said another mitigating factor

is GNMA's lack of expertise in conventional multifamily underwriting. As a result, HUD said, it had "relied on the FHA process to assure feasible projects. The added complication that the section 8 program involves providing low-income housing reinforces the need for reliance on FHA." As pointed out in this report, however, mortgage insurance does not appear to be a viable method of financing section 8 projects because of mortgage insurance programs' marketability and site acceptability requirements.

HUD acknowledged that the Emergency Housing Act of 1975, Public Law 94-50, enacted July 2, 1975, amended section 313 of the National Housing Act to permit GNMA to purchase conventionally financed multifamily project mortgages. Because (1) HUD has legal authority to provide this financing assistance, (2) the Secretary apparently decided in January 1976 that housing industry conditions warranted this assistance--as stated, \$3 billion was made available--and (3) the reasons HUD gave, in commenting on this report, for not providing financing assistance to conventionally financed multifamily project mortgages appear surmountable, we believe HUD should reassess its position and seriously consider making such assistance available.

CHAPTER 6

LIMITED STATE AGENCY ACTIVITY

State agencies have been unable to sell bonds to obtain financing for section 8 projects. Therefore, HUD has changed its State agency production goal for fiscal year 1976 from 100,000 units to 20,000 units. As of September 30, 1976, State agencies had 10,792 units under construction and 3,061 completed units ready for occupancy. (App. IV shows the status of the program in each HUD region as of Jan. 31, 1976.) HUD believed that the 40 State agencies would provide the early construction success in the section 8 program because of their prior housing and financing experience. To facilitate State agency activity, HUD allocated funds specifically to State agencies and exempted them from many of the more time-consuming processing procedures and other regulations which apply to non-State agencies. Lack of financing, however, has also limited State agency program activity.

HOW THE PROGRAM WORKS

State agencies encourage the construction and substantial rehabilitation of housing for lower income persons by making short-term construction loans and providing permanent financing to developers of section 8 projects. State agencies' programs are financed primarily by issuing tax-exempt bonds. State agencies, like private developers, can provide new or substantially rehabilitated housing only in communities needing more housing.

State agencies can either advertise or negotiate for new construction or substantial rehabilitation proposals. The State agency is responsible for supervising an owner's development and operation of a section 8 project. The HUD field office is required to see that the owner complies with Federal requirements for equal opportunity, environmental policies, and Davis-Bacon wage rates. After HUD and a State agency approve a project for construction, HUD and the State agency enter into an annual contribution contract, although HUD payments do not begin until occupancy. When construction is completed, the State agency and the owner enter into a HUD-approved housing assistance payments contract for up to 40 years.

LACK OF FINANCING

The future of the State agency section 8 program appears jeopardized because of States' failure to obtain financing in the tax-exempt bond market. Investors apparently have

lost interest in State agency bond offerings, despite their tax-exempt status and record-high interest rates, because the bonds lack the security and the higher return available in the corporate bond market. The continuing possibility of the New York State agency defaulting on its obligations and the fact that State agencies' obligations generally are not secured by a pledge of full faith and credit on the part of the States has made both underwriters and investors skeptical.

As of December 31, 1975, the Wisconsin Housing Finance Agency was the only State agency able to sell bonds exclusively to finance section 8 housing projects. During our review, the Pennsylvania Housing Finance Agency withdrew a bond sale of approximately \$17 million for financing four section 8 projects because of the high interest rate demanded in the tax-exempt market.

HUD initially estimated that State agencies would finance construction and substantial rehabilitation of one-fourth of the fiscal year 1976 section 8 goal of 400,000 units to be assisted. The State agencies, however, doubted that they could raise the necessary \$2.5 billion needed to finance the 100,000 units without some sort of Federal guarantee. Limited State agency activity through January 1976 seems to support their belief that financing would be unavailable.

Some State agencies' section 8 program activity has been severely limited by their failure to obtain voter approval of bond referendums which are required by local laws before public housing can be constructed. This happened in both Ohio and New Jersey. Several agencies are considering returning their section 8 contract authority allocations to HUD because they see no way of using them in the near future. Others are using part of their contract authority to assist projects that had been approved for construction as unsubsidized, moderate-income projects (section 221(d)(4) projects). The Illinois Housing Development Authority converted 743 units in 15 of its revised section 23 ^{1/} projects to section 8 because of the deteriorating bond market.

^{1/}The revised section 23 program replaced the original section 23 leased-housing program authorized by the Housing and Urban Development Act of 1965 (42 U.S.C. 1421b). The President, in his September 19, 1973, housing message to the Congress, called for revising the original program to bring it more in line with the direct cash-assistance method of housing low-income people. The revised section 23 program was implemented in early 1974.

Because of its inability to find buyers for its bonds, the sponsor of one State agency project made an often-heard statement regarding section 8--"unless financing is soon made available, section 8 will only be an empty promise for many low-income families." HUD and State agency officials concur that lack of financing because of the poor bond market is the biggest hurdle in implementing the new construction and substantial rehabilitation programs.

State agency officials have recommended several changes in the section 8 program to improve the marketability of their bonds, including:

- Provide Federal-State coinsurance under which HUD would assume a major part of the risk of State agency loans. Section 244 of the National Housing Act (12 U.S.C. 1715z-9) as added by section 307 of the HCD Act provided that the principal amount of mortgages and loans insured under this section in any fiscal year shall not exceed 20 percent of the aggregate principal amount of all mortgages and loans insured under this title during such fiscal year. State agency officials believed HUD should seek legislative authority to exceed the 20-percent limit on the annual volume of mortgages that it can coinsure so that more coinsurance could be provided to them. Many State agency and HUD officials believe that coinsurance is the best way to overcome financing problems in the State agency program.
- Amend section 302(b)(1) of the National Housing Act to permit State housing finance agencies to sell mortgages directly to GNMA as they do to the Federal National Mortgage Association (FNMA). Under present law, public agencies can sell mortgages to FNMA or GNMA only if they go through a private lender. State agencies believe that selling their mortgages directly to FNMA or GNMA would be faster and cheaper. They claim this power is needed so that when they provide mortgage financing to developers they can readily sell the mortgages to FNMA or GNMA.
- Implement the interest subsidy program authorized in section 802 of the HCD Act of 1974. This section permits HUD to pay up to one-third of the interest paid by State housing finance agencies on their bonds. State agencies say this is needed so that they can improve the marketability of their bonds by offering higher, and thus more competitive, interest rates in the bond market. The Congress approved \$15 million

for HUD to implement section 802 in fiscal year 1976. The President submitted a rescission proposal to the Congress requesting cancellation of the \$15 million. On December 9, 1975, the House Appropriations Subcommittee on HUD-Independent Agencies reported unfavorably on the rescission proposal. State agencies claim the \$15 million could be used to subsidize about \$400 million in State agency bonds.

Subsequent to our review, The Housing Authorization Act of 1976, Public Law 94-375, August 3, 1976, amended section 244 of the National Housing Act to exempt HUD-insured public housing agency mortgages from the 20-percent statutory coinsurance limitation. This will permit HUD to coinsure State agency mortgages without being concerned that mortgages insured under this section cannot exceed 20 percent of the aggregate principal amount of all mortgages and loans insured under this title. HUD said that final regulations implementing the coinsurance provisions would be published shortly.

HUD said that there was no need to change section 302(b)(1) to allow State agencies to sell their mortgages directly to GNMA. According to HUD, the rationale behind the prohibition appears to be to assure that State and local governments take some responsibility in the residential finance field. In addition, HUD said, it restricts the absolute volume of GNMA purchases and focuses resources on the private sector.

HUD also implemented the section 802 interest subsidy provisions of the HCD Act of 1974. It initially requested State agencies to submit applications for interest subsidy assistance in August 1976. As of September 30, 1976, HUD had received and tentatively approved applications for about \$11.2 million of the \$15 million of contract authority authorized by the Congress.

Although HUD disagreed that State agencies have been unable to sell bonds to obtain financing for section 8 projects, HUD mentioned only one State besides Wisconsin that had been able to sell bonds for this purpose, and this sale was only very recently. HUD said State agency bonds sold extremely poorly during the summer of 1975 but the market had improved substantially since then.

CONCLUSIONS

State agency activity has been limited and the future of the section 8 State agency program appears to be in jeopardy unless financing through the bond market becomes more readily available. Financing by State agencies is vital if there is to be significant new construction and substantial rehabilitation program activity. We believe the recent actions taken by the Congress and HUD--exempting public housing agencies from the statutory coinsurance limitation and implementing the section 802 interest subsidy program--should increase State agencies' ability to get needed financing.

CHAPTER 7

SCOPE OF REVIEW

We evaluated HUD's implementation of the section 8 program at the HUD central office, Washington, D.C.; its regional offices in San Francisco, Atlanta, and Chicago; and its field offices in San Francisco, Los Angeles, Chicago, Milwaukee, Jacksonville, and Tampa.

We also visited public housing agencies participating in the section 8 program in San Francisco, San Jose, Richmond, Alameda, Santa Rosa, Los Angeles, Anaheim, San Mateo County, Santa Clara County, Marin County, Contra Costa County, Sacramento County, San Joaquin County, and Orange County, California; Atlanta and Jonesboro, Georgia; Jacksonville, Gainesville, St. Petersburg, and Pinellas County, Florida; Gary, Indiana; Chicago, Joliet, and Cook County, Illinois; and the Illinois Housing Development Authority.

We interviewed HUD central office and field office officials, reviewed and evaluated HUD's program procedures, examined program files and records, and studied pertinent legislation.

We also interviewed mortgage banking industry officials and developers, owners, and managers of subsidized housing.



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

OFFICE OF THE ASSISTANT SECRETARY FOR
HOUSING—FEDERAL HOUSING COMMISSIONER

SEP 7 1976

IN REPLY REFER TO:

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

Dear Mr. Eschwege:

Secretary Hills has asked me to respond to your August 9 letter transmitting a draft report on the Section 8 Housing Assistance Payments Program. We have read your report with interest and have attached comments on both the body of the report and the recommendations made.

While we would be the first to acknowledge that Section 8 has not been without problems, we believe that portions of the body of the report significantly overstate those problems or misinterpret present available data in such a way as to cast an unnecessary shadow on the program. We have no desire to hide any problems Section 8 has encountered in the early phases of implementation. We do hope, however, that the problems will be expressed concisely and accurately to assure that both HUD and the Congress direct their attention to those areas where it is most needed. In contrast, the recommendations appear to be quite reasonable and of high quality. As noted in our comments, many of these are already being implemented.

We have provided, first, general comments which apply to the broader aspects of the report. Then, under "Findings," we have provided comments on the body of each chapter to cover matters which might not appear if we confined our responses to the recommendations alone. Finally, we addressed the recommendations and indicated where the Department has already taken steps to implement certain recommendations. We would appreciate the inclusion of this information, as well as the updated statistical information we have provided, in the final report.

If we can provide any additional assistance to you in the completion of the report, please contact us.

Sincerely,

James I. Young
James I. Young
Assistant Secretary

GAO note: HUD provided numerous detailed comments which were considered in the final preparation of the report, but are not included in these appendixes.

GENERAL COMMENTS

1. The title of the report - "Major Changes Needed to Make the New Leased-Housing Program Workable" - reflects a judgement with which this Department cannot agree. Though the Section 8 program, like any other program in its early years, warrants improvements based on greater operating experience, it can hardly be called unworkable. This judgement seems particularly harsh in light of the limited field study which was done, possibly providing locational bias, and the learning curve which is inherent in every new program. Our comments on goals, below, would also support a much more favorable consideration. We would strongly prefer, and accuracy would require, a title which refers to "improvements" rather than workability.
2. There is some confusion in the report as to HUD's cumulative goal for Section 8 through September 30, 1976. It is correctly stated on page 3 of the report that HUD's original goal of 200,000 units in FY 1975 was reduced. Though the 40,000 unit figure was the projection at one time, the actual accomplishment was 92,000 units under reservation in FY 75. This, added to the 400,000 unit goal for FY 76, would give a cumulative goal by September 30 of 492,000. We have every reason to believe that that goal will be met. Our reporting system (which tends to reflect lower-than-actual figures) indicates that funds were reserved by July 30, 1976, for 433,612 units. There are sufficient additional proposals and applications in the pipeline to meet the September 30, 1976 goals. These figures should be reflected in your final report.
3. In addition to the numeric confusion with regard to Section 8 goals, there appears to be substantial misinterpretation of the meaning of those goals. The second sentence of the Digest (page i) states, "although the Departments' goal is to obtain 440,000 assisted housing units by September 30, 1976, only about 18,400 lower income families were receiving program assistance as of May 1, 1976." This is grossly misleading. The implication appears to be that the unit goal (which should be 492,000) was intended to mean "occupied units". This was not the case. The goal was for contract authority reservations for 492,000 units and should be compared to the 433,612 unit contract authority reservation of July 30, 1976, and not to an occupancy figure.

Even if Section 8 had encountered no problems, and this is not the case, occupancy must always lag behind contract authority reservations. In New Construction and Substantial Rehabilitation the lag is due to proposal review and construction periods of as much as two years. In the Existing program, the lag will result from the required scheduling

of rent ups throughout the first full year. Nonetheless, we note that there were 48,556 occupied units as of July 30, 1976, and we anticipate that occupancy will rise to meet reservations faster in this program than in the previous low and moderate income housing programs. We request that your final report reflect the current figures for contract authority reservations and that the misleading comparisons which are cited be deleted.

4. In the initial pages, and at some other points in the report, it is unclear whether comments apply to the New Construction and Substantial Rehabilitation programs of Section 8 or to the Existing program, or all three. Wherever Section 8 is referenced, the particular program should be stated, unless all are intended.
5. Though portions of the report are relatively clearer on this point, we are extremely concerned that the "Fair Market Rents" and "Contract Rents" are being confused. For example, page ii references "the total rent paid, which is based on the Fair Market Rent". The total rent paid is limited by the Fair Market Rent (FMR), but not based on that rent. The Contract Rent is established using the "reasonable rent test" which is referenced (for New Construction) on page 35 of the draft report. This distinction is particularly pertinent with regard to the New Construction and Substantial Rehabilitation programs where very limited numbers of requests to increase the Fair Market Rents have been received, but where rents determined "reasonable" are frequently cited as a problem. (The reverse has been true in the existing program and thus stresses the need to distinguish the separate programs as noted in item 4 above.) In addressing the various segments of the report, we will comment in detail on other instances where the FMR's and Contract Rents seem confused. We would hope, so that the attention of both the Congress and the Department can be properly directed, that this will be clarified in the final report.
6. Finally, we note that many of the recommendations are appropriate and helpful and that the Department has already taken steps to implement a number of these. We feel it would be useful to distinguish more clearly between those recommendations which require simply regulation or handbook changes and those which require statutory changes. It should be made clear which actions the Department may take on its own to improve the program and which would require much longer and more complex Congressional action.

STATUS OF THE EXISTING HOUSING PROGRAM(NON-STATE AGENCY)IN THREE HUD REGIONSAS OF DECEMBER 31, 1975

| Région and area office | First invitations made to PHAs | Total invitations made | | Applications received from PHAs | | ACCs executed | | Units occupied |
|---------------------------|-----------------------------------|---------------------------|---------------|---------------------------------------|---------------|---------------|---------------|-------------------|
| | | Number | Units | Number | Units | Number | Units | |
| San Francisco region: | | | | | | | | |
| San Francisco | 5-22-75 | 83 | 11,250 | 39 | 10,075 | 9 | 3,007 | 22 |
| Los Angeles | 5-21-75 | <u>36</u> | <u>16,314</u> | <u>32</u> | <u>14,587</u> | <u>13</u> | <u>6,041</u> | <u>a/330</u> |
| Total | | <u>119</u> | <u>27,564</u> | <u>71</u> | <u>24,662</u> | <u>22</u> | <u>9,048</u> | <u>352</u> |
| Chicago region: | | | | | | | | |
| Chicago | 5-16-75 | 11 | 1,702 | 11 | 1,702 | 1 | 602 | - |
| Indianapolis | 6- 4-75 | 17 | 2,429 | 10 | 1,039 | b/5 | b/401 | - |
| Detroit | 4-25-75 | 31 | 1,199 | 20 | 998 | - | - | - |
| St. Paul | 5-15-75 | 20 | 2,195 | 20 | 2,195 | c/12 | c/1,925 | 324 |
| Columbus | 5-23-75 | 10 | 1,820 | 8 | 1,729 | - | - | - |
| Milwaukee | 5-25-75 | <u>120</u> | <u>4,500</u> | <u>23</u> | <u>2,670</u> | - | - | - |
| Total | | <u>209</u> | <u>13,845</u> | <u>92</u> | <u>10,333</u> | <u>18</u> | <u>2,928</u> | <u>324</u> |
| Atlanta region: | | | | | | | | |
| Birmingham | 8- 7-75 | 90 | 3,799 | 23 | 2,015 | - | - | - |
| Jacksonville | 5- 5-75 | 76 | 7,917 | 27 | 5,536 | 11 | 2,709 | 131 |
| Atlanta | 5- 8-75 | 30 | 4,033 | 15 | 3,426 | 6 | 2,172 | 124 |
| Louisville | 5-19-75 | 24 | 2,197 | 16 | 2,850 | 10 | 2,548 | 19 |
| Jackson | 5-20-75 | 1 | 100 | 1 | 100 | 1 | 100 | 47 |
| Greensboro | 6- 2-75 | 67 | 5,570 | 55 | 5,015 | - | - | - |
| Columbia | 5-16-75 | 15 | 1,156 | 8 | 746 | 1 | 65 | - |
| Knoxville | 6-18-75 | <u>12</u> | <u>746</u> | <u>6</u> | <u>549</u> | - | - | - |
| Total | | <u>315</u> | <u>25,518</u> | <u>151</u> | <u>20,237</u> | <u>29</u> | <u>7,594</u> | <u>321</u> |
| Total | | <u>643</u> | <u>66,927</u> | <u>314</u> | <u>55,232</u> | <u>69</u> | <u>19,570</u> | <u>997</u> |

a/As of 1-5-76.

b/Section 23 conversions.

c/Six ACCs and 1,055 units were section 23 conversions.

STATUS OF THE NEW CONSTRUCTION PROGRAM(NON-STATE AGENCY)IN THREE HUD REGIONS AS OFDECEMBER 31, 1975 (note a)

| Region and area office | First advertisement made | Advertisements made as of 12-31-75 | | Number of proposals received | Preliminary proposals approved | | Final proposals received | | HAPs executed (note b) |
|------------------------------|--------------------------------|--|--------|------------------------------------|--------------------------------------|-------|--------------------------------|-------|------------------------------|
| | | Number | Units | | Number | Units | Number | Units | |
| San Francisco region: | | | | | | | | | |
| San Francisco | 9-21-75 | 13 | 1,836 | 43 | - | - | - | - | - |
| Los Angeles | 9- 3-75 | 30 | 3,731 | c/133 | - | - | - | - | - |
| Total | | 43 | 5,567 | 176 | - | - | - | - | - |
| Chicago region: | | | | | | | | | |
| Chicago | 5- 6-75 | 24 | 3,285 | 50 | 4 | 406 | - | - | - |
| Indianapolis | 4-15-75 | 29 | 3,405 | 107 | 19 | 957 | 14 | 409 | - |
| Detroit | 7-11-75 | 3 | 1,775 | 98 | 1 | 180 | - | - | - |
| St. Paul | 5-18-75 | 3 | 1,683 | 102 | 32 | 1,688 | 9 | 616 | - |
| Columbus | 5- 7-75 | 9 | 8,500 | 231 | 33 | 2,815 | 9 | 500 | - |
| Milwaukee | 5-29-75 | 36 | 2,551 | 106 | 5 | 232 | 2 | 80 | - |
| Total | | 104 | 21,199 | 694 | 94 | 6,278 | 34 | 1,605 | - |
| Atlanta region: | | | | | | | | | |
| Birmingham | 6- 3-75 | 40 | 1,713 | 64 | 2 | 257 | - | - | - |
| Jacksonville | 5- 2-75 | 15 | 2,327 | 78 | 1 | 69 | - | - | - |
| Atlanta | 6-23-75 | 33 | 1,555 | 59 | - | - | - | - | - |
| Louisville | 7-17-75 | 8 | 1,334 | 37 | 6 | 380 | - | - | - |
| Jackson | 5-27-75 | 28 | 940 | 99 | 10 | 274 | - | - | - |
| Greensboro | 6- 2-75 | 56 | 4,219 | 107 | 2 | 208 | - | - | - |
| Columbia | 5-26-75 | 37 | 2,128 | 43 | 4 | 256 | - | - | - |
| Knoxville | 5-20-75 | 48 | 3,321 | 123 | 6 | 656 | - | - | - |
| Total | | 265 | 17,537 | 610 | 31 | 2,100 | - | - | - |
| Total | | 412 | 44,303 | 1,480 | 125 | 8,378 | 34 | 1,605 | - |

a/Includes substantial rehabilitation activity.

b/Indicates units ready for occupancy.

c/As of 1-29-76.

STATUS OF THE SECTION 8STATE AGENCY PROGRAMIN ALL HUD REGIONSAS OF JANUARY 31, 1976

| Region | Applications | | | | Housing assistance payments agreements approved (note a) | | Housing assistance payments contracts executed (note b) | |
|---------------|--------------|---------------|------------|-----------------|--|--------------|---|------------|
| | Received | | Approved | | Projects | Units | Projects | Units |
| | Projects | Units | Projects | Units | | | | |
| Boston | 113 | 8,571 | 89 | 5,700 | 6 | 150 | - | - |
| New York | 107 | 22,149 | 85 | 17,405 | - | - | - | - |
| Philadelphia | 70 | 7,509 | 38 | 4,146 | 2 | 279 | c/3 | 279 |
| Atlanta | 17 | 1,001 | 10 | 447 | - | - | - | - |
| Chicago | 164 | 17,817 | 129 | 16,072 | 7 | 1,099 | - | - |
| Dallas | 1 | 900 | - | - | - | - | - | - |
| Kansas City | 9 | 690 | - | - | - | - | - | - |
| Denver | 19 | 1,105 | 9 | 320 | - | - | - | - |
| San Francisco | - | - | - | - | - | - | - | - |
| Seattle | 23 | 636 | - | - | - | - | - | - |
| U.S. total | <u>523</u> | <u>60,378</u> | <u>360</u> | <u>d/44,090</u> | <u>15</u> | <u>1,528</u> | <u>3</u> | <u>279</u> |

a/Construction started.

b/Construction completed.

c/Includes one housing assistance payments contract for an existing housing program; units for this contract were not available.

d/35,874 new construction, 4,592 substantial rehabilitation, and 3,624 existing units.

PRINCIPAL HUD OFFICIALS
RESPONSIBLE FOR ADMINISTERING
ACTIVITIES DISCUSSED IN THIS REPORT

| | Tenure of office | |
|--|------------------|-----------|
| | From | To |
| SECRETARY OF HOUSING AND URBAN DEVELOPMENT: | | |
| Carla A. Hills | Mar. 1975 | Present |
| James T. Lynn | Feb. 1973 | Feb. 1975 |
| ASSISTANT SECRETARY FOR HOUSING PRODUCTION AND MORTGAGE CREDIT-FHA COMMISSIONER (note a): | | |
| James L. Young | June 1976 | Present |
| David S. Cook | Aug. 1975 | June 1976 |
| David M. DeWilde (acting) | Nov. 1974 | Aug. 1975 |
| Sheldon B. Lubar | July 1973 | Nov. 1974 |
| ASSISTANT SECRETARY FOR HOUSING MANAGEMENT (note a): | | |
| James L. Young | Mar. 1976 | Present |
| Robert C. Odle, Jr. (acting) | Jan. 1976 | Mar. 1976 |
| H. R. Crawford | Apr. 1973 | Jan. 1976 |

a/On June 14, 1976, HUD combined the functions of these two Assistant Secretaries under a single Office of Assistant Secretary for Housing FHA Commissioner.

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