



089899

B-171308
4-16-71

COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON, D. C. 20548

by the Distribution Section, Administrative Branch, OAS

B-171308

RELEASED

APR 16 1971



LM089899

Dear Mr. Daniels:

In accordance with your request of November 9, 1970, and subsequent discussions with your office, we have examined into the propriety of rental increases authorized by the Department of Housing and Urban Development (HUD) at the Washington Towers Apartments in Union City, New Jersey, and the Park Hudson Apartments in North Bergen, New Jersey.

HUD regulations provide in general that the rental income of a project which has a mortgage loan insured pursuant to the National Housing Act, as amended (12 U.S.C. 1701), be established at a level which will maintain the economic soundness of the project and which will provide the owner with a reasonable return on his investment consistent with reasonable rents to the tenants.

HUD regulations do not provide for the establishment of maximum rents for each type of apartment in a project but instead provide for establishment of a maximum gross rental income for the project. Generally, increases in the maximum gross rental income requested by a project owner may be authorized only to compensate the owner for increases in operating costs. In reviewing requests for increases, HUD determines whether the operating cost increases are bona fide. HUD also requires the project owner to submit annual financial statements which HUD reviews to ensure that the gross rental income of the project does not exceed the maximum gross rental income which it had authorized. When the reported rental income exceeds the approved rental income, HUD is required to take appropriate action to obtain necessary adjustments, including the refund of any excess rental charges to tenants.

Our review was made principally at HUD headquarters; at its Newark, New Jersey, insuring office; and at the management offices of the projects. Our review included an examination of the applicable laws and regulations and the project owners' accounting records and financial statements. We also compared the authorized rental incomes for the two projects with the rental incomes reported by the project owners and with those authorized for similar projects in neighboring areas.

Rental increases at the two projects were not uniformly applied to all tenants nor made at the same time; therefore, we could not determine precisely the rental increases applicable to the various sizes of apartment units without a considerable amount of work, which would have delayed our reporting to you. Further, we did not think such determinations were necessary to respond to your request.

914773

089899

WASHINGTON TOWERS APARTMENTS

The mortgage loan for the Washington Towers project is insured pursuant to section 220 of the National Housing Act, which authorizes mortgage insurance for housing in urban renewal areas. The section 220 program is similar to the program authorized by section 207 of the act, in that it is an unsubsidized program for the general public rather than for any specific income group.

Our review showed that HUD authorized increases in the rental income in accordance with applicable regulations and that HUD based the increases upon increased operating costs reported by the project owner. The rents charged by the project owner were within the authorized maximum amounts for the project, and the authorized amounts compared favorably with those for similar projects in the area.

Although HUD had authorized two increases in the maximum gross rental income since the project began operating in 1965, our review did not show, as the tenants alleged to you, that there were three rent increases to the tenants within a 14-month period.

The maximum gross rental incomes authorized by HUD for the project were, as follows:

<u>Date of authorization</u>	<u>Authorized monthly rental income</u>	
	<u>Total</u>	<u>Per room</u>
November 1965 (initial)	\$52,741	\$37.13
July 1969	57,175	40.26
December 1970	64,595	45.48

With respect to the contention of the tenants that rent increases were caused, in part, by HUD's refusal to extend the mortgage period when ownership of the project was transferred, we noted that the project had a 40-year mortgage loan which was the maximum period prescribed by HUD, and the factor for amortization of the mortgage loan used in the rent formula was as low as possible under HUD regulations.

PARK HUDSON APARTMENTS

The mortgage loan for the Park Hudson project is insured pursuant to section 221(d)(4) of the act. At the time HUD approved the project for

mortgage loan insurance, HUD's criterion for approval of a 221(d)(4) project was that the initial rental rates necessary to make the project economically sound should generally be above those for projects insured pursuant to the section 221(d)(3)--the below-market-interest-rate program--and below those for projects insured pursuant to the section 207 program--an unsubsidized program intended for the general public. The initial monthly gross rental income authorized for the project and the subsequent increases are shown below.

<u>Date of authorization</u>	<u>Authorized monthly rental income</u>	
	<u>Total</u>	<u>Per room</u>
November 1968 (initial)	\$42,000	\$47.38
February 1970	54,525	61.51
July 1970	64,366	72.61

Our review showed that (1) the rents charged by the project owner exceeded the authorized limits during the initial 14 months of operation, (2) procedures followed by the Newark insuring office in approving the project owner's first request for an increased-rent authorization were not in accordance with HUD's regulations, and (3) rental rates authorized for the project in July 1970 exceeded the rents authorized for neighboring section 207 projects.

Authorized rental limits exceeded

During the initial 14 months of operation (January 1969 through February 1970), the rents established by the project owner would have resulted in, at full occupancy, monthly gross rental income of about \$47,000 or about \$5,000 in excess of the monthly income authorized by HUD in November 1968. The average rent for a room, based on the rents established by the project owner, was \$53 compared with the average of \$47 a room under the maximum gross rental income authorized by HUD.

Apparently the Newark insuring office failed to detect the excess rental charges because it compared the reported rental income for 1969 with the increased-rent authorization approved in February 1970 rather than with the initial gross rental income approved in November 1968. HUD headquarters' officials have informed us that the mortgagor may be required to refund all excess rental charges collected during the 14-month period.

Rent increase not authorized in
accordance with HUD regulations

Generally, increases in rental income can be authorized only for increases in operating costs. In February 1970, however, HUD authorized an increase from \$42,000 to \$54,525 a month, an average increase of \$14 a room. The increase was achieved primarily by increasing the factors used in the rent authorization formula for replacement cost of the project and amortization of the mortgage loan.

About \$10 of the \$14 increase was attributable to an increase of about \$1 million in the replacement cost and an increase of one half of one percent in the amortization factor for repayment of the mortgage loan. The increase in the replacement cost represented an overrun of construction costs which were not allowed by HUD in the original rent authorization. The remaining portion of the increased-rent authorization (\$4) was principally for increased operating costs.

It should be noted that, although the authorized rent increase was greater than it should have been, the gross rental income of the project during the period from March to July 1970 was below the maximum amount authorized in February 1970.

The increase in July 1970 in the authorized maximum gross rental income was approved by HUD to offset increased operating costs of the project.

Comparison of authorized rental rates
with those of other projects

As requested by your office, we compared the most recent authorized rental rates for the Park Hudson project with those of nearby similar projects. There were no other section 221(d)(4) projects in the area, therefore the comparison was made with neighboring projects insured pursuant to section 207 of the act.

Although HUD's criterion for approval of a section 221(d)(4) project was that the initial rental rates should generally be lower than those for section 207 projects, this criterion is not applicable in the approval of subsequent increases in rental rate authorizations. The average rent, \$73 a room, authorized for the Park Hudson project in July 1970 exceeded the most recent average rent, \$56 to \$65 a room, for the section 207 projects.

Rent escalation clause

One of the conditions that apparently contributed to tenant dissatisfaction was the rent adjustment made by the project owner in accordance with an escalation clause contained in the lease agreements, which provided that rents could be increased retroactively to cover increased property taxes. During 1970, property taxes increased by \$44,441, to \$140,291, and the project owner imposed this increase on the tenants in three stages during an 8-month period. The resulting increased rental income, however, remained within the limits authorized by HUD for the project.

Agency actions


We discussed the rental rates charged by the project owner during the initial 14 months of operation with HUD headquarters' officials who stated that the project owner was not entitled to any rental income which exceeded the amount authorized by HUD. With respect to the rent increase approved in February 1970, these officials stated that the increase in the replacement value and amortization factor for repayment of the mortgage was contrary to existing regulations. HUD officials advised us that, as a result of our inquiries, HUD had initiated a review of these matters with a view toward requiring the refunding of rental overcharges and the rescinding of any unwarranted increases in rental authorizations.

We did not obtain formal written comments from HUD officials or from the project owners concerning the matters discussed in this report, and this fact should be taken into consideration in any use made of the information presented.

In accordance with our agreement with you, we are sending a copy of this letter to the Secretary, Department of Housing and Urban Development. We plan to make no further distribution of this report.

We trust that the information furnished will serve the purpose of your request.

Sincerely yours,


Assistant
Comptroller General
of the United States

The Honorable Dominick V. Daniels
House of Representatives