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DEPARTMENT OF
HOUSING AND URBAN
DEVELOPMENT

Opportunities to Improve
Management of Mortgage
Insurance and Rental
Assistance Programs

Statement of Mathew J. Scirè, Director
Financial Markets and Community Investment



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Highlights of [GAO-13-439T](#), a testimony before the Subcommittee on Transportation, Housing and Urban Development, and Related Agencies, Committee on Appropriations, House of Representatives

Why GAO Did This Study

HUD operates programs that provide mortgage insurance to homebuyers and subsidize the rents of low-income households. In recent years, HUD's FHA has experienced dramatic growth in its insurance portfolio. Expenditures for HUD's rental voucher program also have risen substantially. Through the MTW demonstration program, HUD has sought to reduce costs and achieve greater cost-effectiveness in federal expenditures for rental housing.

This testimony discusses (1) the financial condition of FHA's insurance fund and FHA's risk management, (2) the costs of the voucher program and options to increase its efficiency, and (3) HUD's efforts to evaluate and monitor the MTW program.

This testimony draws from GAO reports on FHA's insurance fund and oversight capacity ([GAO-10-827R](#) and [GAO-12-15](#)), HUD's voucher program ([GAO-12-300](#)), and HUD's MTW program ([GAO-12-490](#)). GAO also reviewed updated information on the insurance fund and voucher subsidy reserves as of the end of 2012.

What GAO Recommends

GAO has made a number of recommendations to improve FHA's risk management, and FHA has taken some actions. GAO also recommended that HUD consider proposing to Congress options for improving the efficiency of the voucher program. HUD neither agreed nor disagreed and has not yet proposed such options. In addition, GAO recommended that HUD improve MTW information and monitoring. HUD partially agreed with these recommendations and has taken initial steps to improve performance data.

View [GAO-13-439T](#). For more information, contact Mathew Scire` at (202) 512-8678 or Sciremj@gao.gov.

March 2013

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Opportunities to Improve Management of Mortgage Insurance and Rental Assistance Programs

What GAO Found

The Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA) faces financial and risk-management challenges. For the fourth straight year, capital reserves for FHA's Mutual Mortgage Insurance Fund are below the statutory minimum. Also, declining balances in the fund's capital reserve account have heightened the possibility that FHA will require additional funds to have sufficient reserves for all future insurance claims on its existing portfolio. Further actions could help to restore FHA's financial soundness. For example, GAO previously concluded that Congress or HUD needs to determine the economic conditions the fund would be expected to withstand without drawing on Department of the Treasury funding. With regard to risk management, FHA has made or plans improvements. For example, FHA implemented an initiative in 2009 to strengthen internal controls and risk assessment for single-family housing and created a risk office in 2010. However, FHA has only recently begun to integrate these activities and conduct annual risk assessments in accordance with HUD guidance. Without integrated and updated risk assessments that identify emerging risks, as GAO recommended, FHA lacks assurance that it has identified all its risks.

Congress and HUD have taken steps to limit cost increases in the Housing Choice Voucher (voucher) program while maintaining assistance for existing program participants. Nonetheless, between 2003 and 2010, program expenditures grew about 9 percent (after adjusting for inflation), mainly due to rising rents, declining household incomes, and decisions to expand the number of assisted households. GAO identified options that, if implemented effectively, could reduce the need for new appropriations, cut expenditures, or increase the number of households assisted. These options include (1) reducing the subsidy reserves (unspent funds) of state and local housing agencies that administer the program, (2) streamlining administrative requirements, and (3) implementing rent reforms and consolidating voucher administration. These options would also involve trade-offs, such as higher rent burdens for low-income households.

Opportunities exist to improve how HUD evaluates and monitors the Moving to Work (MTW) program, which is intended to give state and local housing agencies flexibility to design and test innovative strategies for providing housing assistance. HUD's guidance does not specify that performance information collected from participating housing agencies be outcome-oriented, and HUD has not identified performance indicators for the program. In addition, HUD has not developed a systematic process for identifying lessons learned from the program, which limits HUD's ability to promote useful practices for broader implementation. HUD also has not taken key monitoring steps set out in internal control standards, such as issuing guidance that defines program terms or assessing compliance with all the program's statutory requirements. As a result, HUD lacks assurance that agencies are complying with statutory requirements. Also, without more complete information on program effectiveness and compliance, it will be difficult for Congress to know whether an expanded MTW program would benefit additional agencies and the residents they serve. Consistent with GAO recommendations, HUD has begun to revise guidance on MTW performance reporting.



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United States Government Accountability Office
Washington, DC 20548

Chairman Latham, Ranking Member Pastor, and Members of the Subcommittee:

I am pleased to be here today to discuss our work on the Department of Housing and Urban Development's (HUD) programs, including the single-family mortgage insurance programs that the Federal Housing Administration (FHA) administers and HUD's Housing Choice Voucher (voucher) and Moving to Work (MTW) programs. To help provide access to mortgage financing, FHA insures private lenders against borrower defaults on mortgages that meet FHA criteria. FHA insures almost all of its single-family mortgages under the Mutual Mortgage Insurance Fund (insurance fund). To help very low-income households afford rental housing in the private market, the voucher program pays landlords subsidies that generally equal the difference between the unit's rent and 30 percent of the household's income. The MTW program, among other purposes, is intended to give participating state and local housing agencies flexibility to design and test innovative strategies for providing housing assistance and achieving cost-effectiveness.

Today's constrained budget environment makes it especially important that HUD manage these programs as efficiently and effectively as possible. Our reviews of these programs have highlighted opportunities for management improvements. My statement today is based on four GAO reports: a September 2010 report on FHA's financial condition, a November 2011 report on FHA's risk assessment and human capital management, a March 2012 report on the voucher program, and an April 2012 report on the MTW program.¹ Specifically, I will discuss (1) the financial condition of FHA's insurance fund and FHA's risk management, (2) the costs of the voucher program and options to increase its efficiency, and (3) HUD's efforts to evaluate and monitor the MTW program.

¹See GAO, *Mortgage Financing: Opportunities to Enhance Management and Oversight of FHA's Financial Condition*, [GAO-10-827R](#) (Washington, D.C.: Sept. 14, 2010); *Federal Housing Administration: Improvements Needed in Risk Assessment and Human Capital Management*, [GAO-12-15](#) (Washington, D.C.: Nov. 7, 2011); *Housing Choice Vouchers: Options Exist to Increase Program Efficiencies*, [GAO-12-300](#) (Washington, D.C.: Mar. 19, 2012); and *Moving to Work Demonstration: Opportunities Exist to Improve Information and Monitoring*, [GAO-12-490](#) (Washington, D.C.: Apr. 19, 2012).

To do this work, we analyzed actuarial reviews of the insurance fund and federal budget documents, and interviewed FHA officials, staff from FHA's actuarial review contractor, and housing market researchers. We also analyzed data on FHA's business volume, market share, workload, and staff and contractor resources. We reviewed documentation on the proposed structure and functions of FHA's Office of Risk Management and Regulatory Affairs and the Office of Single Family Housing's internal quality control initiative. Further, we reviewed documentation related to workforce and succession planning. For this testimony, we also reviewed updated information on the insurance fund's condition as of September 30, 2012. For our study of the voucher program, we reviewed and analyzed appropriations legislation, budget documents, and HUD's annual guidance on the allocation of the program's appropriation to state and local housing agencies. We used HUD data to analyze subsidy reserves and the implications of three types of programmatic reform options for the voucher program: increasing minimum rents, changing the percentage of income tenants pay toward rent, and requiring tenants to pay a percentage of fair market rent. For this testimony, we also reviewed updated information on housing agency subsidy reserves as of December 31, 2012. For MTW, we reviewed the annual reports (as of January 2012) for 30 state and local housing agencies, compared HUD's guidance on the type of performance information participating agencies should report with the GPRA (Government Performance and Results Act) Modernization Act of 2010 (GPRA Modernization Act), and reviewed documentation of HUD's monitoring activities.² Our prior reports each include a detailed description of our scope and methodology.

We performed the work on which this statement was based in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

²According to HUD data, as of January 2012, 35 agencies were in the MTW program. Of these, 30 had submitted an annual report to HUD and the other 5 had not been in the program long enough to report on their accomplishments.

Background

Single-Family Mortgage Programs

FHA's single-family mortgage programs have played a prominent role in mortgage financing in the wake of the 2007-2009 financial crisis, the housing downturn, and the contraction of the conventional mortgage market. In 2012, FHA insured about \$227 billion in single-family mortgages, and the overall insurance portfolio was about \$1.1 trillion.

The Omnibus Budget Reconciliation Act of 1990 required HUD to take steps to ensure that the insurance fund attained a capital ratio of at least 2 percent by November 2000 and maintained at least that level thereafter.³ The capital ratio is the fund's economic value divided by the insurance-in-force (outstanding insurance obligations). The act also required an annual independent actuarial review of the economic net worth and soundness of the insurance fund. The annual actuarial review is now a requirement in the Housing and Economic Recovery Act of 2008, which also requires an annual report to Congress on the results of the review.

Under the Federal Credit Reform Act of 1990 (FCRA), FHA and other federal agencies must estimate the net lifetime costs—known as credit subsidy costs—of their loan insurance or guarantee programs and include the costs to the government in their annual budgets. Credit subsidy costs represent the net present value of expected lifetime cash flows, excluding administrative costs.⁴ When estimated cash inflows (such as borrower insurance premiums) exceed expected cash outflows (such as insurance claims), a program is said to have a negative credit subsidy rate and generates offsetting receipts that reduce the federal budget deficit. When the opposite is true, the program is said to have a positive credit subsidy rate—and therefore requires appropriations. Generally, agencies must produce annual updates of their subsidy estimates—reestimates—on the basis of information about actual performance and estimated changes in future loan performance. FCRA recognized the difficulty of making credit subsidy estimates that mirrored actual loan performance and provides

³Pub. L. No. 101-508.

⁴For a mortgage insurance program, cash inflows consist primarily of fees and premiums charged to insured borrowers and proceeds from sales of foreclosed properties, and cash outflows consist mostly of payments to lenders to cover the cost of claims.

permanent and indefinite budget authority for reestimates that reflect increased program costs.⁵ Upward reestimates increase the federal budget deficit unless accompanied by reductions in other government spending or an increase in receipts.

Housing Choice Voucher Program

In recent years, HUD's voucher program annually helped provide affordable rental housing to about 2 million households with very or extremely low incomes.⁶ Approximately 2,400 state and local housing agencies administer the voucher program on HUD's behalf. Under the program, an assisted household pays 30 percent of its monthly adjusted income or the housing-agency established minimum rent—up to \$50—toward its monthly rent. The remainder of the rent—the difference between (1) the lesser of the unit's gross rent (rent plus utilities) or a local "payment standard" and (2) the household's payment—is paid through a HUD-subsidized "voucher." The payment standard is based on the HUD-determined fair market rent for the locality, which HUD annually estimates for metropolitan and nonmetropolitan areas.⁷ Participating housing agencies can set payment standards (that is, pay subsidies) between 90 and 110 percent of the fair market rent for their areas.

Each year, Congress appropriates funding for subsidies for renewal (existing) and incremental (new) vouchers and administrative expenses. HUD then allocates the program funding to housing agencies, which are expected to use all allocated subsidy funding for authorized program expenses. However, if housing agencies' allocated amounts exceed the total cost of their program expenses in a given year, their unused subsidy funds must be maintained in subsidy reserve accounts. HUD also pays administrative fees to housing agencies based on the number of units leased (vouchers used) as of the first of each month. As with subsidy

⁵Budget authority is the authority federal law provides to enter into financial obligations that will result in immediate or future outlays involving federal funds. Permanent budget authority is available as the result of previously enacted legislation and is available without further legislative action. Indefinite budget authority is budget authority that, at time of enactment, is for an unspecified amount.

⁶Very low-income households are those with incomes at or below 50 percent of the area median income; extremely low-income households are those with incomes at or below 30 percent of the area median income.

⁷Under 42 U.S.C. 1437f(c)(1), HUD annually must publish fair market rents for the voucher program. See related regulations at 24 C.F.R. Part 888.

funding, if the appropriated amount does not fully cover agencies' fees, HUD will reduce the amount of funding each housing agency receives to fit within the appropriated amount.

The voucher program is not an entitlement program; thus, the amount of budget authority Congress provides through annual appropriations limits the number of households that the program can assist. Historically, appropriations for the voucher program (or for other housing programs) have not been sufficient to assist all households that HUD identified as having worst-case housing needs—households with very low incomes that pay more than 50 percent of their incomes in rent, live in substandard housing, or both.

Moving to Work Program

HUD implemented the MTW demonstration program in 1999.⁸ As of February 2013, 35 housing agencies were participating.⁹ To put in place the innovations intended under the program's authorizing legislation, agencies may request waivers of certain provisions in the United States Housing Act of 1937, as amended.¹⁰ For example, housing agencies may combine the funding they are awarded annually from different programs—such as public housing capital funds, public housing operating funds, and voucher funds—into a single, authoritywide funding source.

The act that created the program requires participating agencies to address three purposes and meet five requirements. The purposes are to (1) reduce costs and achieve greater cost-effectiveness in federal housing expenditures, (2) give families with children incentives to obtain employment and become self-sufficient, and (3) increase housing choices for low-income families.

In making these changes, MTW agencies must (1) serve substantially the same total number of eligible low-income families that they would have served had funding amounts not been combined; (2) maintain a mix of families (by family size) comparable to those they would have served

⁸The program as authorized by the Omnibus Consolidated Rescissions and Appropriations Act of 1996. Pub. L. No. 104-134, 110 Stat. 1321, 1321-281.

⁹While 39 housing agencies are authorized to participate in the program, 35 have signed contracts with HUD and are actively participating.

¹⁰42 U.S.C. 1437 et seq.

without the demonstration; (3) ensure that at least 75 percent of households served are very low income; (4) establish a reasonable rent policy to encourage employment and self-sufficiency; and (5) assure that the housing provided meets HUD's housing quality standards.

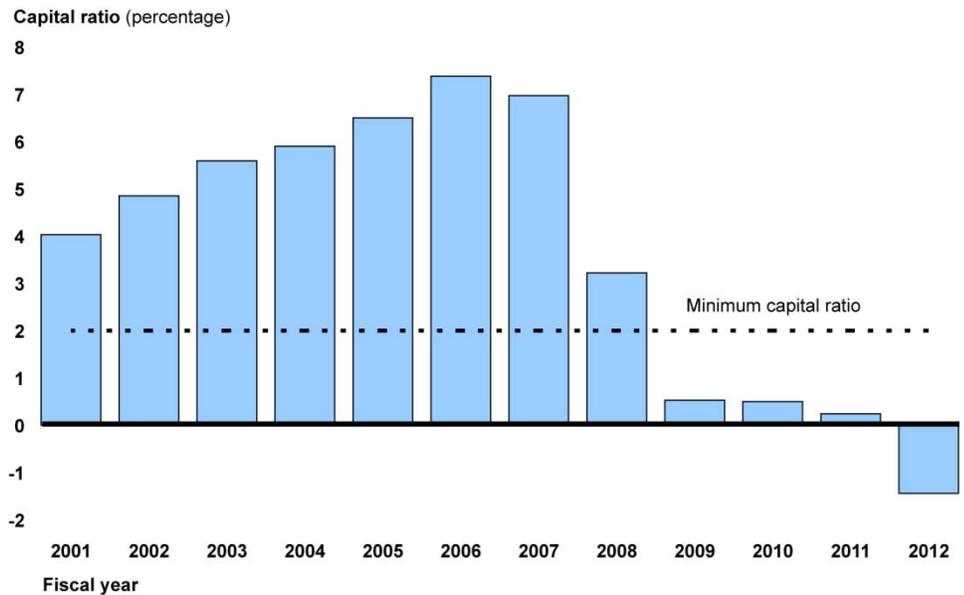
The Condition of FHA's Fund Has Worsened, and FHA's Risk Assessment Mechanisms Are Not Fully in Place

FHA's Insurance Fund Has a Negative Capital Ratio

The insurance fund's capital ratio dropped sharply in 2008 and fell below the statutory minimum in 2009, when economic and market developments created conditions that simultaneously reduced the fund's economic value (the numerator of the ratio) and increased the insurance-in-force (the denominator of the ratio).¹¹ According to annual actuarial reviews of the insurance fund, the capital ratio fell from about 7 percent in 2006 to 3 percent in 2008 and below 2 percent in 2009 (see fig. 1). In 2012, the ratio fell below zero to negative 1.44 percent.

¹¹Unless otherwise noted, references to years are fiscal years.

Figure 1: Estimates of the Fund's Capital Ratio, 2001-2012



Source: GAO analysis of FHA data.

In its November 2012 report to Congress, HUD cited several reasons for the declines from 2011 to 2012. These included the following:

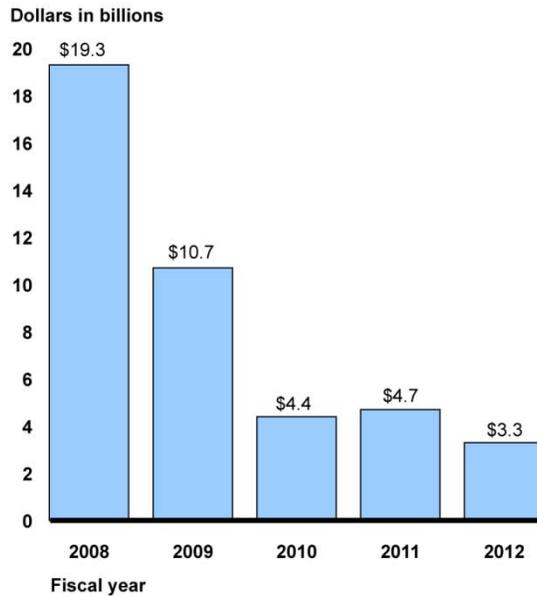
- First, the estimates of house price appreciation for the 2012 actuarial study were significantly lower than those used for 2011. The difference accounted for an estimated \$10.5 billion reduction in the value of the insurance fund compared with the actuary's 2011 projection of what the fund's economic value would be at the end of 2012.
- Second, the continued decline in interest rates causes a substantial loss of revenue. Premium revenues from an existing portfolio go down when more borrowers pay off their mortgages to refinance into lower rates. The capital ratio calculation does not include those borrowers who refinance into new FHA-insured loans. In addition, actuarial projections include higher claim expenses when interest rates stay low because borrowers who are unable to refinance become more willing to default. The effects of continued low interest rates resulted in a reduction of \$8 billion in the estimated economic value of the insurance fund (versus the previous year's projections).
- Third, FHA directed the actuary to adjust the way losses from defaulted loans and reverse mortgages were reflected in the economic value of the insurance fund. This resulted in an estimated

\$10 billion reduction to the economic value, compared with the 2011 projections.

As the capital ratio declined, the insurance fund's condition also worsened from the federal budgetary perspective. FHA annually estimates the subsidy costs of new activity for its loan insurance program and also reestimates, or annually updates, prior subsidy cost estimates. Historically, FHA estimated that its loan insurance program was a negative subsidy program. On the basis of these estimates, FHA accumulated substantial balances in a capital reserve account, which represents amounts in excess of those needed for estimated credit subsidy costs and helps cover reestimates reflecting unanticipated increases to those costs (such as higher-than-expected claims). Funds needed to cover estimated subsidy costs are accounted for in the insurance fund's financing account.¹² In recent years, FHA has transferred billions of dollars annually from the capital reserve account to the financing account, reflecting increases in estimated credit subsidy costs (upward subsidy reestimates). As a result, balances in the capital reserve account fell dramatically, from \$19.3 billion at the end of 2008 to an estimated \$3.3 billion at the end of 2012 (see fig. 2). At the end of 2012, the financing account held approximately \$35.1 billion.

¹²Balances in the capital reserve and financing accounts may not equal the insurance fund's economic value, as defined in the actuarial review, in part because FCRA requires the Office of Management and Budget to use certain economic assumptions. The independent actuarial review may not use the same assumptions.

Figure 2: End-of-Year Balances in the Fund's Capital Reserve Account, 2002–2012



Source: GAO analysis of FHA data.

If the capital reserve account were to be depleted due to additional upward reestimates, FHA would need to draw on permanent and indefinite budget authority to have sufficient reserves for all future insurance claims on its existing portfolio. The President's budget for 2013 contained a \$9.3 billion upward reestimate in FHA's credit subsidy costs for the insurance fund. The budget indicated that the reestimate would deplete FHA's capital reserve account in 2012, potentially causing FHA to draw on \$688 million in permanent and indefinite budget authority. However, according to FHA, the agency ultimately did not need to draw on this authority because of premium increases and higher-than-anticipated loan volumes. In its 2012 report to Congress, HUD noted that information (the insurance fund valuation) in the forthcoming President's budget for 2014 will determine the adequacy of the capital balance in the insurance fund and thus the need to draw on permanent and indefinite budget authority in the current fiscal year. The President's budget is expected to be released in the spring of 2013.

The 2012 actuarial analysis projects that the capital ratio will be positive by 2014 and return to above the statutory 2 percent minimum in 2017. This forecast was based on assumptions such as the level of future lending activity and house prices for multiple years, which are difficult to

predict. The forecast also assumed no changes in policy or other actions by FHA that might accelerate “recovery” time.

FHA plans policy changes that may accelerate increases to the ratio, including premium increases. For example, effective April 1, 2013, FHA announced that it will increase the annual insurance premiums most new borrowers pay between 0.05 and 0.10 percentage points. The annual premium for loans of \$625,500 or more will be set at the statutory maximum of 1.5 or 1.55 percent, depending on the loan-to-value ratio.¹³ Effective June 3, 2013, for new loans FHA also announced that it will require borrowers to continue to pay annual premiums, regardless of loan value. Previously, premiums could be eliminated after loans (principal amounts) declined to 78 percent of their original value.

Further actions could help to restore FHA’s long-term financial soundness and define its future role. For example, we previously concluded that Congress or HUD needs to determine the economic conditions the insurance fund would be expected to withstand without borrowing from Treasury (drawing on permanent and indefinite budget authority).

Considering the importance of defining the economic conditions FHA should withstand, as well as continuing uncertainty over the resolution of Fannie Mae and Freddie Mac and the potential impact of their resolution on FHA, in February 2013 we included FHA in a high-risk area called “modernizing the U.S. financial regulatory system and the federal role in housing finance.”¹⁴

¹³The loan-to-value ratio is the loan amount divided by the value of the home at mortgage origination.

¹⁴Every 2 years, we provide Congress with an update on our High-Risk Program, which highlights major areas that are at high risk for fraud, waste, abuse, or mismanagement, or need broad reform. We previously had identified “modernizing the U.S. financial regulatory system” as a high-risk area and included a discussion of concerns about the resolution of Fannie Mae and Freddie Mac. See GAO, *High-Risk Series: An Update*, [GAO-13-283](#) (Washington, D.C.: Feb. 14, 2013).

Actions to Improve Risk Assessment and Human Capital Management Are Still in Process

In November 2011, we reported on several weaknesses in FHA's risk-assessment efforts.¹⁵ Specifically, we noted that:

- FHA's risk-assessment strategy was not integrated throughout the organization. Although a consultant's report recommended that FHA integrate risk assessment and reporting throughout the organization, the Office of Single Family Housing's 2009 quality control initiative (designed to strengthen internal controls and risk assessment) and the Office of Risk Management's activities remained separate efforts.¹⁶ FHA officials noted that until the Office of Risk Management (which was created in 2010) set up a governance process, such integration would not be possible. FHA officials stated they were making every effort to help ensure that Office of Risk Management activities complemented program office activities.
- Contrary to HUD guidance, the Office of Single Family Housing had not conducted an annual, systematic review of risks to its program and administrative functions since 2009. According to an official in this office, management intended to conduct an annual assessment but changes in senior leadership in the office and the few staff available to perform assessments (because of attrition and increased workload) hampered these efforts.
- The Office of Single Family Housing's risk-assessment efforts did not include procedures for anticipating potential risks presented by changing conditions. The consultant's report proposed a reporting process and templates for identifying emerging risks. Office of Risk Management officials told us that once they were operational, risk committees would determine the exact design and content of these reports and templates.

We concluded that all these factors limited FHA's effectiveness in identifying, planning for, and addressing risk. Based on the consultant's findings, as well as our internal control guidance and HUD guidance, we recommended that FHA (1) integrate the internal quality control initiative

¹⁵[GAO-12-15](#).

¹⁶To provide assistance in developing a risk management strategy and organizational structure and establishing risk management policies and processes, FHA hired a consultant to produce a comprehensive report and recommend best practices for its operation. The consultant's December 2010 report outlined a consolidated framework for the risk assessment activities carried out in different parts of the organization. McKinsey & Company, *Building the ORM Organization, Close-out Materials*, a report prepared at the request of the Department of Housing and Urban Development, December 2010.

of the Office of Single Family Housing into the processes of the Office of Risk Management, (2) conduct an annual risk assessment, and (3) establish ongoing mechanisms—such as using report templates from the consultant’s report—to anticipate and address risks that might be caused by changing conditions.¹⁷ HUD agreed with our recommendations.

FHA has begun addressing recommendations made by the consultant. For instance, in June 2012 it finalized the delegations of authority needed for the Office of Risk Management and Regulatory Affairs to establish and maintain risk-management policies, activities, and controls for FHA. It also formed a Single Family Credit Risk Committee and an Operational Risk Committee.¹⁸

FHA also has begun addressing our November 2011 recommendations by taking the following actions:

- FHA has begun integrating its quality control initiatives into the processes of the Office of Risk Management. For example, the Office of Risk Management and Regulatory Affairs is reviewing the results of quality control activities as it prepares baseline operational risk assessments.
- FHA developed a plan for conducting an inaugural annual risk assessment (including preparing baseline operational risk assessments) for the Office of Single Family Housing.
- As previously noted, FHA has created committees to address credit and operational risks. The charters for both committees indicate that they are to discuss and address emerging risks. And, as part of the annual risk-assessment process mentioned above, FHA plans to identify emerging risks.

However, some of the initiatives taken in response to our recommendations have not been completed or put fully in place. For example, FHA does not expect to complete its inaugural risk assessment until September 2013. These initiatives are critical to FHA’s efforts to assess and manage risk.

¹⁷GAO, *Internal Control Management and Evaluation Tool*, [GAO-01-1008G](#) (Washington, D.C.: August 2001).

¹⁸Credit risk is risk related to borrower default or lender default. Operational risk is risk related to people, processes, technology, external events, and reputation.

Our November 2011 report also identified weaknesses in FHA's human capital management. Specifically, we noted that

- leading organizations use workforce planning practices that include defining critical skills and skill gaps, but FHA's approach did not have mechanisms for doing so or a current workforce plan.¹⁹
- contrary to our internal control standards and HUD guidance, FHA also did not have a current succession plan.²⁰ We noted that succession planning was particularly important because, as of July 2011, almost 50 percent of Single Family Housing staff at headquarters were eligible to retire in the next 3 years. The percentage of staff eligible to retire at the homeownership centers was even higher—63 percent. Additionally, while single-family loan volume grew significantly from 2006 to 2010, staffing levels for the Office of Single Family Housing remained relatively constant.

We concluded that without a more comprehensive workforce planning process that included succession planning, FHA's ability to systematically identify future workforce needs and plan for upcoming retirements was limited. We recommended that FHA develop workforce and succession plans for the Office of Single Family Housing. HUD agreed with our recommendations.

Since our November 2011 report, FHA has developed a workforce analysis and succession plan that identifies gaps in critical competencies and additional steps that need to be taken, although the timing of many of these steps is not specified. Completing these steps remains critical to ensuring that the agency has adequate staff to effectively oversee its mortgage insurance programs.

¹⁹GAO, *Human Capital: Key Principles for Effective Strategic Workforce Planning*, [GAO-04-39](#) (Washington, D.C.: Dec. 11, 2003).

²⁰GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

Opportunities Exist to Increase Efficiencies in HUD's Voucher Program

We reported in March 2012 that appropriations for the voucher program increased from \$14.8 billion in 2005 to \$18.4 billion in 2011 (about 24 percent).²¹ HUD disburses appropriated funds to housing agencies for program expenses such as subsidy payments to landlords and administrative costs. From 2003 through 2010, housing agencies' expenditures increased from approximately \$11.7 billion to \$15.1 billion (about 29 percent). After adjusting for inflation, total expenditures grew by 8.8 percent over this period.

Several factors affected voucher program costs from 2003 to 2010, including (1) increases in subsidy costs for existing vouchers, (2) subsidy costs for new vouchers, and (3) administrative fees paid to housing agencies. After adjusting for inflation,

- subsidy costs for existing vouchers grew 2.4 percent. Two factors generally explain this growth—increasing rents and decreasing incomes. First, rents outpaced inflation. As rents increase, HUD and housing agencies must pay larger subsidies to cover the increases, assuming no changes to household incomes. Second, tenant incomes declined. Specifically, the median annual income of voucher-assisted households fell about 3 percent (from about \$11,000 to \$10,700, in 2011 dollars). As incomes decline, assisted households pay less towards rent, requiring larger subsidies to cover the difference between rents and tenant payments.
- subsidy costs for new vouchers grew 4.4 percent, accounting for half the overall constant dollar increase in expenditures. Congress increased the size of the program by adding new vouchers for groups such as homeless veterans and nonelderly disabled households.
- administrative fees paid to housing agencies grew about 2 percent, although the fees housing agencies have received over the years have been less than the amount for which they were eligible due to reductions in appropriations. Housing agencies noted that the cost of doing business increased. For example, higher gasoline prices contributed to higher inspection costs, especially for housing agencies administering vouchers over large areas.

²¹ [GAO-12-300](#). In 2005 Congress created a specific budget account (Tenant-based Rental Assistance) for the voucher program. Prior to this, Congress provided a combined appropriation for both the voucher and Project-based Section 8 programs through the Housing Certificate Fund. As a result, it is not possible to distinguish the voucher program's appropriations and outlays from those of the Project-based Section 8 programs prior to 2005.

The design and goals of the voucher program also contributed to overall program costs. The voucher program has various features to give priority to the poorest households, and serving these households requires greater subsidies. For instance, housing agencies must lease 75 percent of their new vouchers to extremely low-income households. Despite increases in program costs, our work and other published studies have found that vouchers generally were more cost-effective in providing housing assistance than federal programs designed to build or rehabilitate low-income housing.²²

Steps Congress and HUD Took to Manage Cost Increases

Since 2003, Congress and HUD have taken some actions to limit the extent of increases, while maintaining assistance for existing program participants. For example, in 2003, Congress changed the voucher program's funding formula to tie renewal funding for vouchers to actual costs and leasing rates, rather than the number of authorized vouchers (used or unused). Also, each year since 2004, Congress has provided administrative fees that were at least 6 percent lower than the 2003 rate.

HUD has also taken steps to increase program efficiencies. For example, according to HUD reports, steps taken by the agency have reduced improper payments (subsidy over- and underpayments) from \$1.1 billion in 2000 to \$440 million in 2009. These steps include providing housing agencies with fraud detection tools, such as the Enterprise Income Verification system, which makes tenant income and wage data available to housing agencies. This system was fully implemented in 2005. In 2010, HUD began studying the administrative fee structure for the voucher program to ascertain how much it costs a housing agency to run an efficient program. Because the study is ongoing, the extent to which it will identify ways to improve efficiency is not yet clear.

Options to Reduce Program Costs or Increase Efficiencies

We identified several options that if implemented effectively, could reduce voucher program costs or allow housing agencies to assist additional households. Each option would require congressional action to implement. These options, which include rent reform and administrative

²²However, many of these studies noted that production programs provide benefits, including supportive services, that the voucher program typically does not provide. For example, see GAO, *Federal Housing Assistance: Comparing the Characteristics and Costs of Housing Programs*, [GAO-02-76](#) (Washington, D.C.: Jan. 31, 2002).

Improve Information on
Subsidy Reserves of Housing
Agencies

consolidation, also involve difficult policy decisions that will affect some of the most vulnerable members of the population and alter long-standing program priorities and practices.

Improved information on the level of subsidy reserve funding housing agencies should maintain could aid budget decisions and reduce the need for new appropriations. Housing agencies have accumulated subsidy reserves (unspent funds) that Congress could use to (1) reduce program appropriations (through a rescission and offset) and potentially meet other needs or (2) direct HUD to assist more households.²³ Housing agencies may under-lease or receive more funding than they can spend in a year. Unless rescinded and offset, housing agencies can keep unused subsidy funding in reserve accounts and spend it (for authorized expenses) in future years. As of December 31, 2012, 2,178 housing agencies had a total of approximately \$1.2 billion in subsidy reserves.

HUD has requested the authority to offset and, in some cases, redistribute “excess” reserves (those beyond what is needed to fund defined contingencies). But HUD has not developed specific or consistent criteria defining what constitutes excess reserves or how it would redistribute funding among housing agencies. For example, HUD officials told us that housing agencies should retain approximately 8.5 percent (or 1 month’s worth) of their annual funding allocations in reserves. However, in its 2010 and 2011 budget proposals, HUD defined excess reserves as those above 4 and 6 percent, respectively, of allocated amounts.

In our March 2012 report, we concluded that providing Congress with better information on subsidy reserves could help ensure that disbursed funds would be used to assist households rather than remain unused.²⁴ We recommended that HUD provide information to Congress on (1) the estimated amount of excess subsidy reserves and (2) criteria for how it will redistribute excess reserves among housing agencies. HUD neither agreed nor disagreed with our recommendations. However, HUD officials

²³A rescission is legislation enacted by Congress that cancels the availability of budget authority previously enacted before the authority would otherwise expire.

²⁴We have previously indicated that agency reporting about key areas such as financial management or program reforms should inform congressional decision making. See GAO, *Government Performance: GPRA Modernization Act Provides Opportunities to Help Address Fiscal, Performance, and Management Challenges*, [GAO-11-466T](#) (Washington D.C., Mar. 16, 2011).

Implement Administrative Reform

subsequently told us that, upon request, they provide information to HUD's Appropriations Committee on subsidy reserve levels, including balances above certain minimum reserve levels. We will continue to monitor the agency's progress in implementing our recommendations.

As we indicated in our March 2012 report, in various budget requests for 2004 through 2012, HUD requested the authority to put in place reforms that could decrease voucher program subsidy costs, administrative costs, or both. These reforms include streamlining complex and burdensome requirements and improving the delivery and oversight of rental assistance. For example, housing agencies must re-examine household income and composition at least annually. HUD wants to extend the time between re-examinations from 1 year to 3 years and between unit inspections from 1 year to 2 years. According to one program administrator, annual re-examinations and inspections account for more than 50 percent of administrative costs in the voucher programs the agency administers. Although some of the changes needed to simplify and streamline the voucher program would require congressional action, HUD's forthcoming study of the program's administrative fee structure and the experiences of housing agencies in the MTW program may provide insight into specific reforms to ease administrative burden.

We recommended in our March 2012 report that HUD consider proposing to Congress options for streamlining and simplifying the administration of the voucher program and making corresponding changes to the administrative fee formula to reflect any new or revised administrative requirements.²⁵ We stated that such proposals should be informed by results of HUD's ongoing administrative fee study and the experience of the MTW program. HUD neither agreed nor disagreed with our recommendations. As of March 2013, HUD had not made such proposals to Congress.

²⁵In that report, we noted that efforts to identify specific reforms are in line with the goals of the Government Performance and Results Act of 1993 (GPRA), which Congress enacted, in part, to inform its decision making by helping to ensure that agencies provide objective information on the relative effectiveness and efficiency of their programs and spending. GPRA, § 2(b)(5). The GPRA Modernization Act of 2010 updated the federal government's performance measurement framework established in GPRA.

Implement Rent Reform and Consolidate Voucher Administration

If implemented, rent reform (that is, changes to the calculation of households' payment toward rent) and the consolidation of voucher administration under fewer housing agencies could yield substantial cost savings, allow housing agencies to serve additional households if Congress were to reinvest annual cost savings in the voucher program, or both. Furthermore, these options are not mutually exclusive; that is, cost savings or additional households served could be greater if both options were implemented.

Because about 90 percent of voucher program funds are used to pay subsidies, decreasing the subsidy (or, alternatively stated, increasing the household contribution toward rent) will yield the greatest costs savings. As shown in table 1, our March 2012 report estimated the effect of several options that change the minimum rents households must pay or different formulas for calculating what tenants pay. For example, increasing minimum rents to \$75 would yield an estimated \$67 million in annual cost savings or allow housing agencies to serve an estimated 8,600 additional households. Requiring assisted households to pay 30 percent of their gross income (rather than net income) in rent would yield an estimated annual savings of \$513 million or allow housing agencies to serve an estimated 76,000 additional households.

Table 1: Estimated Annual Effect of Selected Rent Reform Options on Program Costs and Number of Voucher-Assisted Households Served

Reform option	Estimated annual cost savings ^a	Estimated additional households served
Increase minimum rents to ^{b, c}		
\$50 ^d	\$11 million	1,400
75	67 million	8,600
100	124 million	16,000
150	318 million	43,000
200	602 million	85,000
250	1.1 billion	167,000
300	1.8 billion	287,000
Require households to pay ^e		
35 percent of adjusted income in rent	\$1.1 billion	164,000
30 percent of gross income in rent	513 million	76,000
35 percent of the fair market rent ^f	927 million	136,000

Source: GAO analysis of HUD data.

^aTo estimate the effect of these options on program costs and households assisted, we analyzed household characteristic and rent data as of December 2010. These estimates illustrate the relative effects of the options if fully implemented in one year. Actual implementation of such options likely would be done gradually and not all of the savings or efficiencies would be realized in the first year.

^bWe assumed that all households paid the greater of the minimum rent or 30 percent of adjusted income. Our minimum rent calculations did not take into account any payment households received for utility assistance.

^cOn January 31, 2012, the House Subcommittee on Insurance, Housing, and Community Opportunity released a revised draft of the Section 8 Savings Act entitled the Affordable Housing and Self-Sufficiency Improvement Act of 2012. The draft bill proposes implementing a minimum rent of at least \$69.45 (adjusted annually). We estimated that this increase would save approximately \$56 million annually or could be used to serve an additional 7,100 households if Congress chose to reinvest the savings.

^dWe assumed all applicable households paid \$50 in rent. As previously discussed, although housing agencies are permitted to set a minimum rent of up to \$50, not all do and many offer hardship exemptions from the requirement.

^eFor the adjusted and gross income options, we did not impose a minimum rent requirement.

^fFor this option, we evaluated the effect of requiring households to pay 12, 15, 20, 30, and 35 percent of the fair market rent and no minimum rent. Only the 35 percent option resulted in cost savings or additional households served on an annual basis—all other percentages resulted in cost increases and fewer households served.

While each of these options could reduce costs or create administrative efficiencies—each also involves trade-offs. Under each option, some households would have to pay more in rent than they currently pay. From 2 to 92 percent of households would experience an increase in their monthly payment: setting a minimum rent of \$50 would affect the fewest households and increasing rent to 35 percent of adjusted income would affect the most. The options also would have varying effects on different types of households (such as families with children, persons with disabilities, and the elderly). We noted disparities by geographic area (such as high-cost versus low-cost rental markets) as well. For example, setting household rental payments based on a percentage of the applicable fair market rent would place greater burdens on households in high-cost areas.

We concluded in our March 2012 report that consolidating voucher program administration under fewer housing agencies could yield a more efficient oversight and administrative structure and cost savings for HUD and housing agencies. HUD spends considerable resources in overseeing the more than 2,400 housing agencies that administer the voucher program. According to a 2008 HUD study, the department dedicated from more than half to two-thirds of its level of oversight to 10 percent of its units (generally, housing agencies that administered 400 or fewer vouchers and about 5 percent of total program funds). According to agency officials, consolidating voucher administration under fewer agencies would decrease HUD's oversight responsibilities. However,

current information on the magnitude of these savings was not available when we conducted our 2012 review.

Opportunities Exist to Improve Information on and Monitoring of the MTW Program

As we reported in April 2012, HUD has not identified standard performance data and indicators needed to evaluate the MTW program.²⁶ Housing agencies in the MTW program report annually on their activities, which include efforts to reduce administrative costs and encourage residents to work. However, the usefulness of this information is limited because, in some cases, it is not outcome-oriented. For example, for similar activities designed to promote family self-sufficiency, one MTW agency reported only the number of participants, which is generally considered an output, and another did not provide any performance information. In contrast, a third agency reported on the average income of program graduates, which we consider an outcome. To be consistent with the GPRA Modernization Act, HUD's guidance on reporting performance information should indicate the importance of outcome-oriented information.²⁷ Without more specific guidance on the reporting of performance information—for example, to report quantifiable and outcome-oriented information—HUD cannot be assured of collecting information that reflects the outcomes of individual activities.

Our April 2012 report also noted that HUD has not identified the performance data that would be needed to assess the results of similar MTW activities or of the program as a whole. Researchers and others have noted the limitations of the program's initial design in terms of evaluation. Specifically, it lacks standard performance data. Obtaining performance information from demonstration programs that are intended to test whether an approach (or any of several approaches) can obtain positive results is critical.²⁸ This information helps determine whether the program has led to improvements consistent with its purposes. HUD started collecting additional data from MTW agencies (including household size, income, and educational attainment), but has not yet analyzed the data. And since 2009, HUD required agencies to provide

²⁶GAO-12-490.

²⁷Pub. L. No. 111-352, 124 Stat. 3866 (2011). The GPRA Modernization Act amends GPRA, Pub. L. No. 103-62, 107 Stat. 285 (1993).

²⁸GAO, *Program Evaluation: Improving the Flow of Information to the Congress*, GAO/PEMD-95-1 (Washington, D.C.: Jan. 30, 1995).

information on the impact of activities, including benchmarks and metrics, in their annual MTW reports. While these reports are informative, they do not lend themselves to quantitative analysis because the reporting requirements do not call for standardized data, such as the number of residents who found employment. Whether these data are sufficient to assess similar activities and the program as a whole is not clear, and HUD has not identified the data it would need for such an assessment.

HUD also has not established performance indicators for the MTW program. The GPRA Modernization Act requires that federal agencies establish efficiency, output, and outcome indicators for each program activity as appropriate.²⁹ Internal control standards also require the establishment of performance indicators.³⁰ As we noted in 2012, specific performance indicators for the MTW program could be based on the three statutory purposes of the program. For example, agencies could report on the savings achieved (reducing costs). However, without performance indicators HUD cannot demonstrate the results of the program.

The shortage of analysis and performance indicators has hindered comprehensive evaluation efforts, although such evaluations are key to determining the success of any demonstration program. We recommended that HUD (1) improve its guidance to MTW agencies on providing performance information in their annual reports by requiring that such information be quantifiable and outcome-oriented, (2) develop and implement a plan for quantitatively assessing the effectiveness of similar activities and for the program, and (3) establish performance indicators for the program. HUD generally agreed with our recommendations. Consistent with our recommendations, HUD has taken initial steps to revise performance reporting requirements for MTW agencies, but these requirements had not yet been finalized as of March 2013.

Furthermore, as we indicated in our 2012 report, while HUD has identified some lessons learned on an ad hoc basis, it does not have a systematic process in place for identifying such lessons. As previously noted, obtaining impact information from demonstration programs is critical.³¹

²⁹Pub. L. No. 111-352, 124 Stat. 3866 (2011).

³⁰[GAO/AIMD-00-21.3.1](#).

³¹[GAO/PEMD-95-1](#).

Since 2000, HUD has identified some activities that could be replicated by other housing agencies. For example, a HUD-sponsored contractor developed five case studies to describe some of the issues involved in implementing the MTW demonstration. However, these and subsequent efforts have shortcomings. In most cases, the practices were chosen based on the opinions of HUD or contracted staff and largely involved anecdotal (or qualitative) data rather than quantitative data. Also, HUD has not established criteria, such as demonstrated performance, for identifying lessons learned or made regular efforts to review and identify lessons learned. Because HUD does not currently have a systematic process for identifying lessons learned, it is limited in its ability to promote useful practices that could be implemented more broadly. Thus, we recommended that HUD create a process to systematically identify lessons learned. In response to this recommendation, HUD stated that once its revised reporting requirements were implemented, the resulting data would inform an effort to establish lessons learned.

HUD Could Strengthen Monitoring Policies and Procedures

HUD has policies and procedures in place to monitor MTW agencies but could do more to ensure that MTW agencies demonstrate compliance with statutory requirements and to identify possible risks relating to each agency's activities. For example, as noted in our 2012 report, HUD has not issued guidance to participating agencies clarifying key program terms, including definitions of the purposes and statutory requirements of the MTW program. Internal control standards require the establishment of clear, consistent goals and objectives.³² Agencies also must link each of their activities to one of the three program purposes cited in the MTW authorizing legislation. However, HUD has not clearly defined what the language in some of these purposes means, such as "increasing housing choices for low-income families." HUD officials told us that they plan to update their guidance to MTW agencies to more completely collect information related to the program's statutory purposes and requirements. They acknowledged that the guidance could be strengthened. As a first step, they noted that they planned to require agencies to define "self-sufficiency" by choosing one of the definitions provided by HUD or creating their own. Without clarifying key terms and establishing a process for assessing compliance with statutory requirements, HUD lacks assurance that agencies are complying with the statute.

³²[GAO/AIMD-00-21.3.1](#).

Additionally, our 2012 report indicated that HUD only recently assessed agencies' compliance with two self-certified requirements (to serve substantially the same total number of eligible low-income families that they would have served had funding amounts not been combined and ensure that at least 75 percent of households served are very low income).³³ Further, HUD has not assessed compliance with the third self-certified requirement (to maintain a comparable mix of families). Internal control standards require control activities to be in place to address program risks.³⁴ In addressing these risks, management should formulate an approach for assessing compliance with program requirements.³⁵ Without a process for systematically assessing compliance with statutory requirements, HUD lacks assurance that agencies are complying with them.

Furthermore, as we reported in 2012, HUD has not annually assessed program risks, despite its own requirement to do so, and has not developed risk-based monitoring procedures. HUD's internal control standards require program offices to perform an annual risk assessment of their programs or administrative functions using a HUD risk-assessment worksheet.³⁶ By not performing annual risk assessments or tailoring its monitoring efforts to reflect the perceived risk of each MTW agency, HUD lacks assurance that it has properly identified and addressed risks that may prevent agencies from addressing program purposes and meeting statutory requirements. HUD also lacks assurance that it is efficiently using its limited monitoring resources.

Finally, our 2012 report indicated that HUD does not have policies or procedures in place to verify the accuracy of key information that agencies self-report, such as the number of program participants and the average income of program graduates. Internal control standards and guidance emphasize the need for federal agencies to have control activities in place to help ensure that program participants report

³³MTW agencies must self-certify compliance with three of the five statutory program requirements.

³⁴[GAO/AIMD-00-21.3.1](#).

³⁵[GAO-01-1008G](#).

³⁶HUD, Office of the Chief Financial Officer, *Departmental Management Control Program, Handbook 1840.1 Rev-3* (Washington, D.C.: 1999).

information accurately.³⁷ For example, HUD staff do not verify self-reported performance information during their reviews of annual reports or annual site visits. GAO guidance on data reliability recommends tracing a sample of data records to source documents to determine whether the data accurately and completely reflect the source documents.³⁸ Because HUD does not verify the accuracy of any reported performance information, it lacks assurance that this information is accurate. To the extent that HUD relies on this information to assess program compliance with statutory purposes and requirements, its analyses are limited.

To improve HUD's oversight over the MTW program, we recommended in April 2012 that HUD (1) issue guidance that clarifies key program terms, such as the statutory purposes and requirements MTW agencies must meet; (2) develop and implement a systematic process for assessing compliance with statutory requirements; (3) conduct an annual risk assessment for MTW and implement risk-based monitoring policies and procedures; and (4) implement control activities to verify the accuracy of a sample of the performance information that MTW agencies self-report. HUD partially agreed with our recommendations, citing potential difficulties in verifying MTW performance data. HUD also described steps it was taking to improve its guidance to MTW agencies and implement risk-based monitoring procedures. As of March 2013, this guidance had not yet been finalized. Without more complete information on program effectiveness and compliance, it will be difficult for Congress to know whether an expanded MTW program would benefit additional agencies and the residents they serve.

Mr. Chairman, Ranking Member Pastor, and Members of the Subcommittee, this concludes my prepared statement. I would be happy to respond to any questions that you may have at this time.

³⁷[GAO/AIMD-00-21.3.1](#) and [GAO-01-1008G](#).

³⁸GAO, *Assessing the Reliability of Computer-Processed Data*, [GAO-09-680G](#) (Washington, D.C.: July 2009).

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