

March 2000

HUD REFORM ACT

Information on the Department's Response to the Act's Requirements



GAO

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United States General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-284623

March 27, 2000

The Honorable Christopher S. Bond
Chairman
The Honorable Barbara A. Mikulski
Ranking Minority Member
Subcommittee on VA, HUD, and Independent Agencies
Committee on Appropriations
United States Senate

The Honorable James T. Walsh
Chairman
The Honorable Alan B. Mollohan
Ranking Minority Member
Subcommittee on VA, HUD, and Independent Agencies
Committee on Appropriations
House of Representatives

In the late 1980s, problems in the management of the Department of Housing and Urban Development (HUD) triggered the enactment of the HUD Reform Act of 1989 (Reform Act). The Reform Act required HUD to institutionalize policies and procedures to ensure that the identified abuses would not be repeated. For example, title I of the act directed HUD to be transparent in its granting of competitive funds through notices in the *Federal Register*. Ten years after the Reform Act, in the conference report accompanying the emergency supplemental appropriations act for fiscal year 1999, the Congress required us to report on the extent to which HUD complied with the HUD Reform Act in fiscal years 1997 and 1998.

As agreed with your offices, this report discusses HUD's actions in response to (1) title I of the Reform Act, which is the title principally concerned with addressing the ethics, management, and Federal Housing Administration issues raised during the late 1980s, and (2) four other titles in the act—II, III, VII, and VIII—that address other changes in HUD's management of federally assisted housing.¹ As agreed, we will report on our more detailed assessment of HUD's compliance with certain provisions in title I of the Reform Act concerning HUD's process for announcing and awarding competitive grants in a separate report.

Results in Brief

The Department of Housing and Urban Development has developed policies and regulations to comply with the Reform Act. In response to the ethics, management, and Federal Housing Administration reforms required by title I of the Reform Act, the Department has, among other things, (1) required the publication of a notice in the *Federal Register* of the availability of competitive grants, including the criteria for selection, announced its award decisions in the *Federal Register*, and maintained documents for public scrutiny on these decisions; (2) established ongoing program monitoring and evaluation activities of certain housing programs identified in the Reform Act within its Office of Policy Development and Research; and (3) issued regulations that impose civil money penalties on parties who submitted false information in the process of originating property improvement loans.

For the other Reform Act titles we examined, the Department of Housing and Urban Development has complied with title II's requirements to annually assess and report to the Congress on the management and preservation of multifamily projects it holds. The Department has also established a policy and a regulation to comply with title III's directive to extend the time a family is eligible to receive rental subsidies. Furthermore, it has complied with title VII's requirement that it take possession of a foreclosed property financed under its Rehabilitation Loan Program, regardless of a borrower's right to redeem the property under state law. And finally, to comply with title VIII's requirement that rent subsidies are based on comparable private sector rents, the Department has provided

¹ Titles V and VI required HUD to establish national commissions—one on severely distressed public housing and one on Native American, Alaska Native, and Native Hawaiian housing. Title IV applied to the U.S. Department of Agriculture's implementation of rural housing requirements.

instructions to public housing agencies on how to adjust rents to keep pace with comparable rents in the area and to conduct studies to determine rents that can be reasonably charged to low-income renters.

Background

The purpose of the Reform Act was to help prevent waste, fraud, abuse, and political favoritism in HUD programs. Among other things, it required HUD to publish in the *Federal Register* information on funding availability, selection criteria, and funding decisions. It also required that most housing program funds be distributed geographically on the basis of a needs-based fair-share formula and awarded to localities through open competition.

HUD administers a wide array of programs to help people buy homes, create affordable rental housing, spur community and economic development, and enforce fair housing laws. The principal housing programs are the following:

- The Section 8 Housing Assistance Program is a rent subsidy program that assists eligible low-income families in obtaining decent, safe, and sanitary housing. Families receive a subsidy that is equal to the difference between their share of the rent and the rent charged by the owner. The section 8 program provides assistance in several ways. For example, under the Certificate Program, public housing agencies issue certificates to very low-income families² and a limited number of families with incomes up to 80 percent of an area's median income to help them obtain housing within the jurisdiction of the public housing agency.
- Under the Public and Indian Housing Program, HUD gives grants to public housing agencies to finance the capital cost of the construction, rehabilitation, or acquisition of public housing developed by the agencies. For example, in fiscal year 1999, HUD made over \$600 million available for revitalization and demolition grants under one of the rehabilitation funds operating under this program.
- Under the Mortgage Loan Insurance Program, administered through HUD's Federal Housing Administration (FHA), HUD insures certain mortgages and loans made by eligible private lenders for single-family and multifamily properties, manufactured homes, and certain health-related facilities, such as hospitals and nursing homes. The program is

² Families whose incomes are no higher than 50 percent of the area's median income level.

designed to encourage private lenders to make mortgage credit available to areas and to borrowers who might not otherwise qualify for conventional loans on affordable terms, such as first-time home buyers. Down payment requirements vary by program but are generally less rigorous than those required by lenders of conventional mortgages. Borrowers pay interest on the loan at a rate that is negotiated with the lender.

HUD Has Instituted Policies and Regulations to Satisfy Title I's Ethics, Management, and Housing Requirements

Title I is the title principally designed to institutionalize policies and procedures to prevent fraud, waste, and abuse. It focuses on three areas for reform: (1) ethics, which includes, among other things, HUD's accountability and allocation of housing assistance; (2) management, including monitoring a number of programs specified in the Reform Act; and (3) FHA reforms, including civil money penalties for specific violations. We found that the Department has taken action to comply with the 25 provisions contained in that title.

For example, with respect to the provisions instituting changes to address the ethics questions related to HUD's accountability, title I requires HUD to announce the availability of grant funds, application procedures, and selection criteria in the *Federal Register* and to make documentation on its award decisions available to the public for at least 5 years. In response, HUD published a regulation requiring the Secretary to publish information in the *Federal Register* on application procedures and selection criteria and to maintain documentation on award decisions for at least 5 years. The Reform Act's requirements and HUD's regulation are intended to address the problem identified in the late 1980s of favoritism in awarding HUD grants. In fiscal years 1997 and 1998, HUD issued approximately 50 notices in the *Federal Register* announcing the availability of over \$11 billion in grant funds.

The ethics provisions also require HUD to develop and use a formula that ensures that the Department allocates housing assistance funds on the basis of need. This provision is designed to address the problem of concentration in funding that occurred between 1984 and 1988, when 10 states received over 51 percent of all funding to upgrade substandard rental housing. In April 1989, HUD's Inspector General reported that a properly administered funding formula would have resulted in these states' receiving only about 16 percent of available funds. The Department developed and implemented a formula to allocate funds under section 213 of the Housing and Community Development Act of 1974 on the basis of

need, which it announced in the March 7, 1991, *Federal Register*. Since then, HUD reports that it has fine-tuned this formula.

Concerning management reforms, title I authorized funds for HUD to evaluate and monitor a number of programs specified in the act, such as rental assistance programs, and report to the Congress on the use of these funds each fiscal year. In fiscal year 1991, the Congress appropriated \$10 million for this effort. According to HUD, the Department used these funds to provide the required report at the end of fiscal year 1991. Although HUD noted that it has not received appropriated funds under this provision of the act since 1991, in fiscal year 1992, it established ongoing program monitoring and evaluation activities in the Office of Policy Development and Research. To do this, HUD used funding provided through its appropriation for Research and Technology.

Finally, under the provisions concerning FHA, title I allows, among other things, the Secretary of Housing and Urban Development to impose civil money penalties on anyone having a financial interest in making a loan who knowingly submits false information for a property improvement loan insured by FHA. HUD issued a regulation to allow for the initiation of civil money penalties. Furthermore, HUD's Enforcement Center³ has educated its staff on the use of civil money penalties to deter future violations and to force loan dealers and loan brokers, who for a fee bring together borrowers and lenders, into compliance with HUD's regulations. HUD reports that the Enforcement Center is not aware of any referrals in fiscal years 1998 and 1999 to initiate a civil money penalty under this section.

HUD Has Instituted Changes Required by Other Reform Act Titles

In order to comply with (1) title II—Housing Preservation—HUD submitted annual reports to Congress; (2) title III—Housing Programs Extensions and Changes—HUD issued a notice in the *Federal Register*; (3) title VII HUD—Miscellaneous—HUD is not allowing any period of redemption on foreclosed properties; and (4) title VIII—Section 8 Rent Adjustments—HUD instituted policies and regulations.

³ The Enforcement Center is responsible for providing aid for reducing HUD's troubled multifamily housing inventory to a level comparable to the private sector by taking aggressive actions on violations referred to the Center.

Title II

Title II focuses on the preservation of public housing. For example, one provision authorizes HUD's Secretary to enter into rental assistance contracts with a property owner, contingent upon the availability of future appropriations for renewing expiring contracts. If HUD cannot extend the expiring contracts because of inadequate funding, the Secretary is authorized to cancel or modify the property owner's contract for providing housing at affordable rents. According to HUD, it has not been necessary to relieve property owners of this responsibility because the Department has had appropriate resources for contract renewals. In addition, title II requires the Secretary to annually provide the Congress a report on the management and preservation of HUD-owned and -held multifamily projects. HUD submits this report annually; it provided us with a copy of the report for fiscal year 1998.

Title III

Title III—"Housing Program Extensions and Changes"—modifies some requirements in several federal housing laws. For example, one provision extended from 3 to 5 years the time a tenant in public housing is allowed to pay the ceiling rent—the maximum rent for shelter and a reasonable portion of utilities. After 5 years, the rent could be adjusted to a normal level. HUD announced its plans to enact this requirement in the December 16, 1991, *Federal Register*, and it issued a notice to public housing authorities on February 7, 1992, to implement the requirement.⁴

Title VII

Title VII addresses a number of HUD issues. For example, one provision is intended to help the marketing and rehabilitation of HUD-foreclosed properties. Laws in some states allow a borrower to redeem a foreclosed property up to 18 months after foreclosure. These laws seriously hinder the sale of the foreclosed properties and in turn their rehabilitation and improvement. To address this problem, the act nullifies the borrower's rights of redemption under state law. In selling foreclosed properties that were financed under HUD's Rehabilitation Loan Program, HUD is no longer allowing a redemption period unless it is determined to be in the best interests of the government. In these cases, HUD is now requiring either full payment of the loan or payment of all past amounts due. Since foreclosure sales began in mid-1998 on Rehabilitation Loan Program

⁴ The provision was superseded by subsequent amendments. Currently, the public housing authorities have discretion within certain limitations to implement ceiling rents.

properties, 338 single-family properties have been subject to foreclosure sale, and since January 1997, 118 multifamily properties have been offered at foreclosure sales.

Title VIII

Title VIII—“Section VIII Rent Adjustments”—is designed to correct HUD’s past problems in not allowing appropriate increases in section 8 rents. The title sets a formula for paying retroactive rent adjustments for public housing projects that had not been increased to the full allowable amount permitted under an annual adjustment factor. The title also required HUD to issue regulations for conducting studies of reasonable rents—in comparison with rents for housing units of similar quality, type, and age in a particular market area. On the basis of these studies, HUD was to develop another formula for rent adjustments. In response, HUD published a formula in 1991; and in October 1995, it issued proposed regulations for conducting the reasonable rent studies. However, according to HUD, the proposed regulations were superseded by the Fiscal Year 1995 Appropriations Act, which required HUD to implement the reasonable rent studies provision regardless of whether it had issued regulations on how to conduct these studies. HUD issued a series of policy notices to implement this requirement; these notices instruct public housing agencies on conducting annual rent adjustments and comparability studies.

Agency Comments

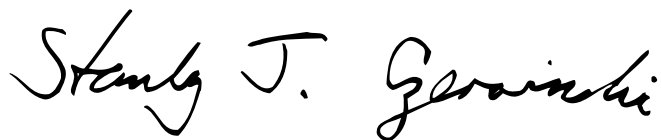
We provided a copy of this report to HUD for its review and comment. In its letter commenting on the report, the Department indicated that the report fairly represents its activities to comply with the Reform Act. HUD’s letter is reproduced in appendix I.

Scope and Methodology

To determine the actions that HUD has taken to comply with the Reform Act, we reviewed all of the titles of the act and 34 provisions that were pertinent to HUD. We asked HUD to provide documentation on its implementation of each provision during fiscal years 1997 and 1998. However, we did not independently verify or assess the accuracy of this documentation. We also did not ask HUD to provide documentation on provisions that had clearly been implemented, such as the title I provision that requires HUD to establish a Chief Financial Officer. We performed our work from September 1999 through February 2000 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Honorable Pete Domenici, Chairman, and the Honorable Frank R. Lautenberg, Ranking Minority Member, Senate Committee on the Budget; the Honorable Fred Thompson, Chairman, and the Honorable Carl Levin, Ranking Minority Member, Senate Committee on Governmental Affairs; Honorable John R. Kasich, Chairman, and the Honorable John M. Spratt, Jr., Ranking Minority Member, House Committee on the Budget; and the Honorable Dan Burton, Chairman, and the Honorable Henry A. Waxman, Ranking Minority Member, House Committee on Government Reform; and other interested parties. We will also make copies available upon request.

If you or your staff have any questions about this report, please contact me at (202) 512-7631. Key contributors to this report were John McGrail, Frank J. Minore, Robert Procaccini, and Carol Herrnsstadt Shulman.

A handwritten signature in black ink that reads "Stanley J. Czerwinski". The signature is written in a cursive, flowing style.

Stanley J. Czerwinski
Associate Director,
Housing, Community Development, and
Telecommunications Issues

Comments From the Department of Housing and Urban Development



U. S. Department of Housing and Urban Development
Washington, D.C. 20410-0003

OFFICE OF DEPARTMENTAL OPERATIONS
AND COORDINATION

March 7, 2000

Stanley J. Czerwinski
Associate Director, Housing and Community
Development Issues
General Accounting Office
Washington, DC 20548

Dear Mr. Czerwinski:

At the request of Deputy Secretary Ramirez, HUD staff reviewed the General Accounting Office (GAO) draft report on the Department's Compliance with the HUD Reform Act of 1989. It is the Department's position that the report fairly represents our HUD Reform Act compliance activities, as documented. Therefore, there will be no additional comments.

Thank you for the opportunity to review and comment on the draft report.

Sincerely,

Frank L. Davis
Director, Office of Departmental
Operations and Coordination

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