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Testimony

USE OF HOUSING SUBSIDIES

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Statement of
John M. Ols, Jr., Director
Housing and Community Development Issues
Resources, Community and Economic
Development Division

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Investigations
Committee on Banking, Housing, and Urban Affairs
United States Senate

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Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to assist the Subcommittee in analyzing HUD's Section 8 Moderate Rehabilitation Program. As you know, we testified before the Senate Committee on Banking, Housing, and Urban Affairs on August 2 and September 29, 1989, regarding our analysis of cash flows to developers of eight Moderate Rehabilitation projects and of ways to improve the efficiency of federal housing subsidies. Today, we will discuss the results of our analyses of one of these projects, Sierra Pointe, located in Clark County, Nevada. I will also discuss the financial ramifications and the associated impact on low-income families of using the Moderate Rehabilitation Program and tax credits.

In summary, there is a real danger of providing too much financial assistance to a developer when multiple subsidies are awarded to individual projects without a review of the total amount of assistance. For Sierra Pointe, a 160-unit project, we estimate that the developer realized cash flows of about $1.8 million, or about 22 percent, above the cost to acquire and rehabilitate the project. This cash flow was generated from the proceeds of tax credits combined with loan proceeds secured by rental subsidies for 15 years provided under the Moderate Rehabilitation Program.

Aside from the issue of awarding substantial subsidies, there is also the real danger of using subsidies inefficiently. It is inefficient to use the Moderate Rehabilitation Program and tax credits in housing markets that already have an adequate supply of existing rental housing. At the time Sierra Pointe was approved and during its development, estimates of the vacancy rate for rental units in Clark County ranged from 4-8 percent. These estimates, given the approximately 80,000 rental units in Clark County, suggest that there may have been upwards of several thousand vacant units. While we cannot go back in time to determine the condition of these units, we believe that it is reasonable to conclude that at least 160 suitable units would have been available to house low-income families. Moreover, the Director of the Clark County Public Housing Authority told us that when the Sierra Pointe project was approved, low-income families were not experiencing any difficulty finding housing using HUD's Section 8 certificate program. Under this program, a family pays 30 percent of its monthly adjusted income for rent, and HUD pays the private landlord the difference between the tenant's payment and an approved monthly rent. Our analysis shows that if certificates had been used instead of the Moderate Rehabilitation Program and tax credits, about 419 households could have been assisted rather than the 160 households assisted in the Sierra Pointe project. In essence, Mr. Chairman, another 259 households could have been assisted with the same level of subsidies.

On the basis of our preliminary work on the other seven projects we are reviewing, we are finding that it would have been more economical to have relied on existing rental housing using Section 8 certificates rather than producing additional units through the combination of moderate rehabilitation and tax credit subsidies. For these projects, approximately 850 additional households could have been assisted if certificates had been available to local public housing agencies for housing low income families.

Mr. Chairman, I have brought two charts (Attachments I and II) that provide specifics on the Sierra Pointe project. However, before discussing the charts, I would like to highlight key provisions of the Moderate Rehabilitation and Tax Credit programs.

MODERATE REHABILITATION AND TAX CREDIT PROGRAMS

The Moderate Rehabilitation and Tax Credit programs were intended to increase the supply of rental units for low-income families. Under the Moderate Rehabilitation Program, owners agreed to upgrade substandard rental housing in exchange for 15 years of guaranteed, project-based Section 8 rental subsidies. For low-income housing, where the prospects for profit from operations and gain on the sale of the property are limited, tax benefits have historically been very important in inducing developers to build or rehabilitate such housing. Under the Low-Income Housing Tax Credit Program, owners are encouraged to develop low-income housing through reductions in their overall tax liability.

DEVELOPER CASH FLOWS GREATLY EXCEEDED PROJECT COSTS

The developer of the Sierra Pointe project, like the developers of the other seven projects we are reviewing, used subsidies offered under the Moderate Rehabilitation Program along with tax credits to generate substantial cash flows. The Sierra Pointe project consists primarily of 2- and 3-bedroom units and was placed in service in 1987.

Our first chart, which is also attachment I to my statement, presents our cash flow analysis of the Sierra Pointe project. The principal sources of funds were a mortgage loan in the amount of $7.4 million and tax credit proceeds, which we have estimated, after syndication, to be about $2.3 million. Actual tax credits awarded to the project will result in $5,788,360 over a ten-year period.

Our chart shows that $3.7 million of these funds were used to acquire the project and another $4.5 million to rehabilitate it. In addition, we estimated that the developer received a fee of about $900,000. This estimate is based on what the state of Nevada typically allows developers to claim for reimbursement for this kind of project. When these principle uses of funds are combined with other adjustments, the estimated proceeds to the developer amounted to about $1.8 million or 22 percent above the costs to acquire and rehabilitate the project. On a per-unit basis, this is approximately $11,400.

There are no standards or guidelines governing the amount of proceeds a developer can realize above the cost to acquire and rehabilitate these types of properties. However, we believe the Sierra Pointe developer, as well as most developers of the other projects we reviewed, realized cash flows that were greater than what would have been required to ensure project feasibility. The developers realized sizeable cash flows while assuming less risk than is usually encountered in typical development activities. They assumed less risk because the rents were guaranteed by HUD and the mortgage loan was co-insured by HUD.

HOUSING SUBSIDIES WERE USED INEFFICIENTLY

The inefficient use of federal housing subsidies has serious repercussions on low-income families. As shown in our second chart, and in attachment II to this statement, rents at Sierra Pointe for a 2-bedroom unit were established at $596 per month. Section 8 certificate subsidies at this rent level, when adjusted for inflation and combined with awarded tax credits, will total about $23 million over the next 15 years. By contrast, other rental rates in Clark County for 2-bedroom units were about $425 per month. Subsidizing rents with certificates and adjusting for inflation would require about $9 million in federal financial assistance for 160 families over the next 15 years.

Looking at the situation another way, our analysis shows that based on the average annual voucher/certificate subsidy of about $3,300 per household for the area, about 419 families could have been assisted for the same amount of federal subsidy ($23 million) required to assist 160 families at Sierra Pointe. This represents an increase of about 162 percent or 259 additional households.

Using housing vouchers/certificates is generally a more efficient and prudent method than producing additional units when there are sufficient vacancies in the market. As I mentioned earlier, we estimate that Clark County had upwards of several thousand vacant rental units during the periods before, during, and after Sierra Pointe was developed. We believe that the 160 families housed at Sierra Pointe could have been absorbed in suitable rental housing already available in Clark County.

CONTROLLING THE AMOUNT OF PROJECT SUBSIDY

We have demonstrated the result of awarding financial assistance to projects without consideration of the actual need for assistance. Until recently, moderate rehabilitation and tax credit subsidies were awarded with little regard for the total amount of combined subsidies or the actual amount of project subsidy required to ensure project feasibility. In many instances, rental subsidies were awarded up to the maximum amount permitted by regulation, and tax credits were awarded on a "first-come, first-served" basis up to the maximum amount allowable.

Recent changes to both programs have limited the amount of subsidies allowable and the way the subsidies can be used. Section 127 of Public Law 101-235 changed elements of the Moderate Rehabilitation Program concerning minimum rehabilitation costs, the number of units (100) in a rehabilitation project that can be assisted, the amount of rental subsidies that can be awarded to a project when tax credits are also used, and the way the program awards are made. Moreover, Section 7108 of the Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239), which extended the Tax Credit Program through calendar year 1990, placed greater responsibility on state credit-allocation agencies for administering the program and prohibited using the Tax Credit

Program in combination with the Moderate Rehabilitation Program. Aside from these legislative changes, we believe as HUD revises its procedures for awarding moderate rehabilitation subsidies that it will need to ensure that these subsidies are targeted to market areas where there is a demonstrated need to increase the supply of rental housing.

We believe these actions will help to prevent the kinds of problems we have outlined here today and allow limited federal funds to assist the greatest number of households possible.

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Mr. Chairman, this concludes my statement. I would be pleased to respond to any questions that you or members of the Subcommittee may have.

ESTIMATED CASH FLOW - SOURCES AND APPLICATIONS OF FUNDS

SIERRA POINTE

	SOURCES OF FUNDS:		
(A)	Mortgage Loan (from HUD Form 2580)	$7,401,300	
(B)	Tax Credit Proceeds (1)	2,344,286	
(C)	Other	0	
(D)	Owners Cash Investment (2)	54	
(E)	Total Sources of Funds		$9,745,640
	APPLICATION OF FUNDS:		
(F)	Acquisition Costs (from HUD Form 2264)	$3,700,000	
(G)	Development Costs (from HUD 2331A)	4,497,415	
(H)	Developers Fee (3)	899,483	
(I)	Estimated Escrows and Prepaid expenses (1.5% of Mortgage Loan) (4)	111,020	
(J)	Gross Total Applications	9,207,918	
(K)	Less: BSPRA (from HUD Form 2331A) (5)	(383,855)	
(L)	Net Total Applications of Funds		$8,824,063
	PROCEEDS TO DEVELOPER AT COMPLETION OF DEVELOPMENT		
(M)	Estimated Proceeds To Developer (E-L+H-D)		$1,821,006
(N)	Estimated Proceeds To Developer Per Unit (160 Units)		11,381

(1) Cash value of tax credit proceeds result from developer sale of ownership interest in project. Tax credit data is not subject to 26 U.S.C. 6103. Assumptions regarding value of tax credits as follows:
   (A) Syndication proceeds equal 45% of awarded credits
   (B) Credit proceeds disbursed to project owner over three years, discounted at 10% per year.
   Actual tax credits awarded were $5,788,360

(2) Estimated cash requirements at initial endorsement exclusive of letters of credit required for mortgage closing. For this project, owner also provided $445,182 in letters of credit.

(3) Developers fee was estimated at 20 percent of development cost.

(4) Estimated amount on the basis of standard industry practice.

(5) BSPRA = Builders and Sponsors Profit and Risk Allowance.

ATTACHMENT II

GAO Subsidy Comparison Estimates for Clark County, Nevada — 1987

	Sierra Pointe Project (Using Tax Credits)	Other Section 8 Certificate Projects	Differences
Rent (2 Bedroom)	$596	$425	$171
Subsidy Over 15 Years (160 Assisted Units)	$23,000,000	$9,000,000	$14,000,000
Number of Assisted Families	160	419	259