United States Government Accountability Office
Washington, DC 20548

May 25, 2007

The Honorable Maxine Waters
Chairwoman
Subcommittee on Housing and Community Opportunity
Committee on Financial Services
House of Representatives

Subject: *Leveraging Federal Funds for Housing, Community, and Economic Development*

Dear Madam Chairwoman:

Each year the federal government funds numerous affordable housing and community and economic development initiatives through an array of programs, such as the Department of Housing and Urban Development's (HUD) Section 108 Loan Guarantee (Section 108) program.[1] Yet, the need for federal money to fund these initiatives has continued to grow, while the federal budget increasingly has been strained by other competing funding priorities. To help finance their initiatives and achieve program goals, recipients of funding under these federal programs often have combined or "leveraged" their funds with other federal, state, local, and private sector resources. While leveraging is generally recognized favorably by public and private sector officials, its use in federal programs has not been widely analyzed.

This report responds, in part, to your request that we examine leveraging as it relates to federal housing, community, and economic development programs. Specifically, this interim report (1) examines the perspectives of stakeholders—government and industry officials, academics, and others with knowledge of or experience with leveraging—on the use, implications, and measurement of leveraging in housing and community and economic development programs and (2) describes the type of data HUD collects that could be used to determine the extent of leveraging in the Section 108 program. Additionally, enclosure II describes how federal funds may have been or could be leveraged in the Section 108 program.[2]

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[1]As described in further detail in this report, the Section 108 program allows communities to borrow against their current and future Community Development Block Grant allocations to fund larger-scale housing and community and economic development projects.

[2]Also as will be discussed in this report, the Section 108 data derive from information on proposed sources and amounts of funding at the time of application for program funding. Because the data do not represent actual funding, we describe the funding conditionally—for example, "may have been leveraged."

To examine the perspectives of stakeholders on the use, implications, and measurement of leveraging in housing and community and economic development programs, we reviewed academic, industry, and other literature and interviewed stakeholders. To describe the type of data HUD collects that could be used to determine the extent of leveraging in the Section 108 program, we interviewed HUD officials, reviewed relevant program regulations and guidance, and reviewed our prior reports in this area and reports of others. To describe how funds may have been leveraged in the Section 108 program, we collected information on the proposed sources and amounts of funds used to finance a random sample of 50 proposed Section 108 projects. For a detailed description of our scope and methodology, see enclosure I. Enclosure III describes how we categorized some of the types of funding sources that can be leveraged with Section 108 funds and selected programs under those categories. We conducted our work in Washington, D.C. and Chicago from November 2006 to May 2007 in accordance with generally accepted government auditing standards.

As agreed with your office, we will provide a final report in the fall of 2007, which will address any further information we have gathered relating to the objectives listed above. For example, we plan to assess how generally accepted measurements of leveraging can be used in combination with other indicators to measure the performance of housing and community and economic development programs. In addition, we plan to review how or the extent to which leveraging occurs in the following additional programs: the Department of the Treasury's Community Development Financial Institutions (CDFI), Low-Income Housing Tax Credit, and New Markets Tax Credits programs; and HUD's Community Development Block Grant (CDBG), HOME Investment Partnerships (HOME), and HOPE VI programs.

Results in Brief

Leveraging can be a useful tool for financing affordable housing and community and economic development and generally is regarded favorably by public and private sector officials; however, its use may have unintended consequences, and commonly used measures of leveraging have certain limitations. Leveraging can occur at an institutional level (to fund multiple initiatives) and at a project level (to fund a discrete activity or development). Leveraging also may occur because programs require that program dollars be matched with other funds or because program dollars are limited and participating communities or other recipients need to seek additional funds for their initiatives. Although stakeholders we interviewed and the literature we reviewed generally regarded leveraging as useful, they also noted that it may have implications such as inefficiencies resulting from differing application and reporting deadlines in public programs and the potential substitution of federal for private funding, which could direct scarce federal funds from the neediest communities. Finally, stakeholders and the literature agreed that the most common way to describe the extent of leveraging for programs or projects is through a ratio, which expresses the proportion of dollars that other sources contributed against dollars that the program contributed. However, most of our interviewees said that what a ratio can reveal about the success or efficiency of funding a program or project depends partly on the circumstances of the development, such as its location and the availability of potential investors.

HUD collects data on the other sources and amounts of funds communities plan to leverage with Section 108 loan funds to finance various housing and community and economic development projects. HUD maintains these data in Section 108 memorandums, which the agency prepares as a record of actions taken with respect to a Section 108 loan guarantee application. However, because these data represent projected sources and amounts of funding, they cannot be used to determine the actual amount of leveraging in the Section 108 program. Nonetheless, available data on projected funding can provide insight into the extent to which communities planned to leverage Section 108 loan funds with other federal, state or local, and private sources. See enclosure II for information about the Section 108 projects we reviewed.

Background

Traditionally, a range of governmental and financial entities and academics have defined or conceptualized leveraging as using one source of funds to attract additional sources of funds.[3] Thus, for example, a low-income housing development in which the federal government's initial investment attracted, or was the impetus for, additional private or other investment could be seen as a project that involved leveraging. However, some have said that leveraging also can be thought of broadly to mean the combining of multiple sources of funds.[4] Under this broader conceptualization, the investment of federal funds does not necessarily have to be the impetus for the investment of other funds.[5] Thus, for example, a low-income housing development for which the federal government provided "gap" financing also could be seen as a project that involved leveraging.[6] For purposes of this report, we refer to leveraging in this broader sense—the combination of multiple sources of funds, including other federal, state, local, and private funds, to finance development projects, among other things.

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[3]The traditional conceptualization of leveraging includes financial leveraging—the degree to which a business or an investor utilizes borrowed funds. For example, a company that uses borrowed funds to invest in a real estate development project is considered to be using leverage to carry out its investment strategy.

[4]For example, see R. Quercia, W. Rohe, and D. Levy, "A New Look at Creative Finance," *Housing Policy Debate*, 11, issue 4 (2000): 943-972.

[5]We have referred to leveraging in both the traditional and the broader sense in several reports. See GAO, *Empowerment Zone and Enterprise Community Program: Improvements Occurred in Communities, but the Effect on the Program Is Unclear*, GAO-06-727 (Washington, D.C.: Sept. 22, 2006); *Public Housing: HOPE VI Leveraging Has Increased, but HUD Has Not Met Annual Reporting Requirements*, GAO-03-91 (Washington, D.C.: Nov. 15, 2002); and *Urban Action Grants: An Analysis of Eligibility and Selection Criteria, and Program Results*, GAO/RCED-89-143 (Washington, D.C.: July 7, 1989).

[6]Gap financing is a source of funds that is used to complete a project's funding needs when all other available sources of funds have been exhausted.

Congress established the Section 108 program in 1974 as a part of the CDBG program.[7] As amended in 1977, the law permitted entitlement communities—generally cities designated as central cities of metropolitan statistical areas, other cities with populations of at least 50,000, and qualified urban counties—to borrow up to three times their current year's CDBG allocation to obtain additional resources for financing larger-scale housing and community and economic development projects that otherwise could not be accomplished with a single year's CDBG allocation.[8] In 1990, the Cranston-Gonzales National Affordable Housing Act extended participation in the program to nonentitlement communities—smaller communities, including many rural communities whose CDBG programs are administered by the state—and raised the amount communities could borrow to five times their current year's CDBG allocation (or in the case of nonentitlement communities, five times the state's allocation).[9]

Eligible communities must apply to HUD to obtain approval for a Section 108 loan guarantee. Both HUD field offices and headquarters play a role in managing the loan program. Generally, field offices assist communities and states in preparing their applications, make recommendations to headquarters to approve or deny loans, and monitor funded activities. Headquarters provides final approval for all loan guarantees, negotiates loan terms with applicants, and arranges for the sale of loans. The maximum amount HUD can commit to guarantee to a community is fives times the community's annual CDBG allocation, and HUD guarantees repayment of 100 percent of the community's Section 108 indebtedness.

Under the Section 108 program, a community's current and future CDBG allocations serve as the principal collateral for the loan (that is, a community or state's CDBG funds are used to make payments due on the guaranteed loan if other funds, such as project-related income, are insufficient for that purpose). To date, HUD has not been required to make a payment to the holder of a note guaranteed under Section 108 as a result of a default.

The Section 108 program does not require communities to leverage program funds as a condition of receiving a loan guarantee. However, Congress created two sources of funds for use specifically in conjunction with Section 108 loan proceeds—Economic Development Initiative (EDI) and Brownfields Economic Development Initiative

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[7] 42 U.S.C. § 5308.

[8] Communities can use Section 108 loan funds to carry out these activities themselves or can reloan the funds to a third-party borrower.

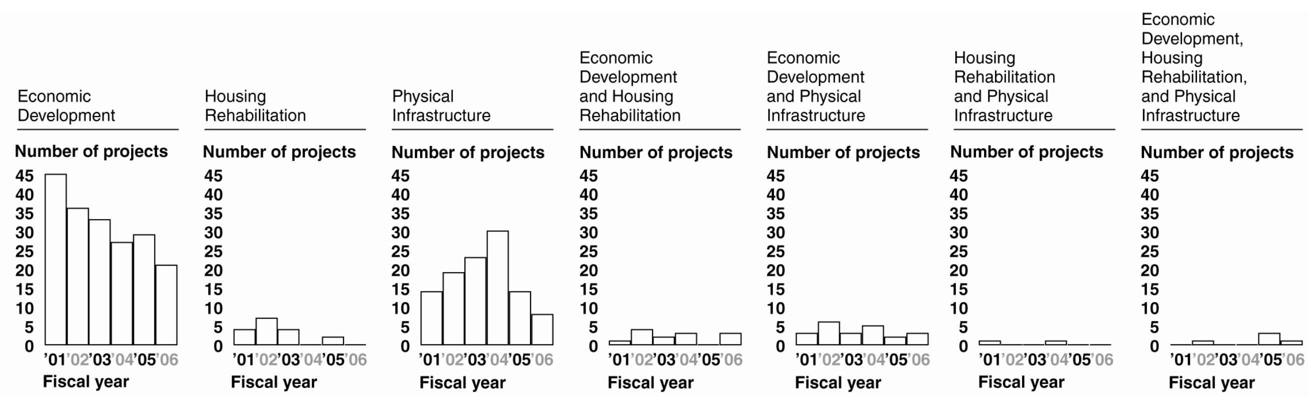
[9] P.L. 101-625, § 910.

(BEDI) grants.[10] HUD awards grant funds under both programs to states and communities undertaking initiatives funded in whole or in part with Section 108 loan funds.[11] As discussed later in this report, communities often leverage (combine) Section 108 loan funds with other federal, state or local, and private sources of funds.

From 2001 through 2006, federal commitments to proposed Section 108 projects—that is, reservations of funds to guarantee loans—averaged approximately $290 million annually. Commitments declined sharply between 2005 and 2006, from approximately $337 million to $220 million. During the same period, advances—Section 108 loan funds provided to a community—averaged $325 million annually.[12]

From 2001 through 2006, HUD approved 358 applications for loan guarantees. The number of applications HUD approved ranged from 36 (2006) to 73 (2002) and averaged approximately 60 per year. Most of the communities HUD approved for loan guarantees during this period proposed using their Section 108 loan funds for economic development and physical infrastructure projects (see fig. 1).

Figure 1: Proposed Section 108 Projects by Type, Fiscal Years 2001 through 2006



Source: GAO analysis of HUD data.

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[10]The EDI program was established in 1994 to encourage communities to make greater use of Section 108 loan guarantees by providing additional financing for projects and paying for some costs of borrowing under Section 108. BEDI was established in 1998 to support state and local efforts to start or continue redevelopment on brownfields sites—abandoned, idled, or underused real property where actual or potential environmental contamination complicates redevelopment—and enhance the viability of projects financed with Section 108 loan guarantees. By statute, HUD must make BEDI grant awards contingent on applicants getting a Section 108 loan guarantee (42 U.S.C. § 5308(q)). Communities have 5 years from the date grants are committed to use them.

[11]HUD stopped making competitive grants under EDI in 2001. However, HUD still may make special-purpose or targeted EDI grants to qualifying communities pursuant to Congressional directives. HUD still makes competitive BEDI grants.

[12]This average excludes advances made in 2005. Advances made in this year were artificially low (approximately $168 million) because no public offering was held that year. HUD obtains funding for Section 108 loans though public offerings of pooled loans on the private sector capital market. The average for advances can exceed the average for commitments because communities have up to 5 years from the date of commitment to use their loan funds.

Leveraging Can Occur in Different Ways and for Different Reasons, but Its Relationship to Success or Efficiency in Funding Is Not Well Understood

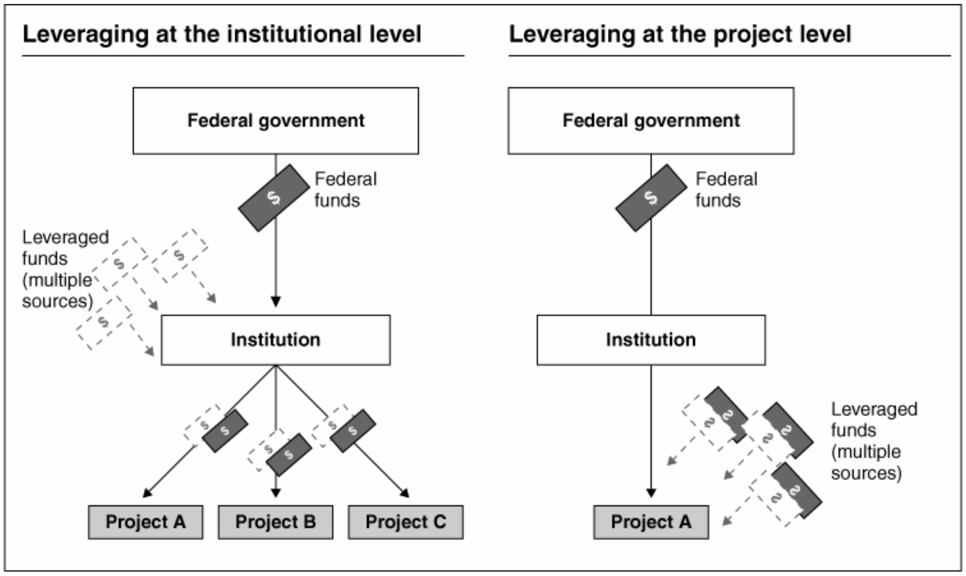
Based on our conversations with stakeholders and a review of the literature, we found that leveraging occurs in different ways and for different reasons, depending on the program. Further, the stakeholders with whom we spoke discussed several unintended implications of leveraging that were echoed in some of the literature. Finally, while the most common way to express the extent of leveraging is through a leverage ratio, stakeholders agreed that what a ratio can reveal about the success or efficiency of an institution in funding a program or project has certain limitations.

<u>According to Stakeholders and Literature, Leveraging Can Occur at Different Levels and for Different Reasons</u>

Leveraging can occur at the institutional or at the project level (see fig. 2). At the institutional level, an institution or organization pools funds from multiple sources, which later are used to finance individual projects. For example, under the CDFI program, the federal government makes investments in certified institutions, which the institutions use to leverage (in this case match) additional sources of funds.[13] The certified institutions then determine how they will use these pooled resources to finance a range of housing and community and economic development activities. In comparison, at the project level, a community or other development authority leverages funds as necessary for discrete projects. For example, under the Section 108 program, communities may use Section 108 loan funds to finance a variety of projects, and each individual project may contain a different mix of funding sources, depending on its size and type. As previously described, at either level, leveraging may occur in the traditional sense—federal program funds are used to attract other sources of funds—or in the broader sense—sources of funds are combined for development, but no one source of funds is specifically intended to attract the other sources of funds.

[13]Congress created the CDFI Fund under the Riegle Community Development and Regulatory Improvement Act of 1994 (P.L. 103-325) to promote economic revitalization and community development through investment in certified institutions. The CDFI Fund makes financial assistance awards in the form of equity investments, loans, deposits, or grants to certified institutions. Before receiving any financial assistance through the CDFI program, a CDFI must be certified by the CDFI Fund—which does so after determining that a program has a primary mission of promoting development, its predominant business activity is lending or investing in development, and it serves (an) economically distressed investment area(s) or targeted population(s). Institutions must match these investments dollar for dollar with funds of the same type from nonfederal sources. For purposes of this report, we considered matched funds to be leveraged funds.

Figure 2: Leveraging at the Institutional and Project Levels



Source: GAO.

Leveraging also may occur as a result of statutory or regulatory requirements, program design, or for other reasons. For example, the HOME program statute generally requires states and communities to match 25 percent of their HOME allocations on an annual basis.[14] According to HUD officials, Congress thought it was important for states and communities to make permanent contributions to the development of affordable housing in their areas, so it included a matching (leveraging) requirement in the HOME statute. Under the New Markets Tax Credit program, leveraging is not legally required, but applicants that propose projects that leverage additional funds are rewarded with additional points in the competitive application process for issuance of tax credits.[15] Finally, some programs, such as the Section 108 program, do not require or provide incentives for recipients of program funds to leverage, but leveraging often occurs anyway in these programs—for example, to stretch limited federal dollars or promote partnerships among public and private investors.

Finally, many with whom we spoke said that while leveraging is often a useful tool for improving communities, it may be harder to do in highly distressed urban areas or in rural areas than it is in more developed urban areas. They explained that the risk of investment in highly distressed urban areas is often too high to attract significant private investment.[16] For example, in our 2002 report on the HOPE VI program—a

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[14]42 U.S.C. § 12750. Under HOME, HUD provides formula grants to states and localities to fund activities that build, buy, or rehabilitate affordable housing for rent or home ownership or provide direct rental assistance to low-income households.

[15]See "Notice of Allocation Availability Inviting Applicants for the 2007 Allocation Round of the New Markets Tax Credit Program," 71 *Federal Register* 70835, 70841 (Dec. 6, 2006).

[16]Investment risk is the potential for fluctuation in the value of an investment, which could result in loss of principal.

program designed to improve severely distressed public housing, which is often located in distressed urban communities—we found that 79 percent of the funds contributed to HOPE VI projects were from federal sources while 12 percent were from private sources.[17] Our 1989 report on the Urban Development Action Grants (UDAG) program similarly found that more-distressed cities expected to need more UDAG funding to complete projects and had lower amounts of leveraging than less-distressed cities that received UDAG funds.[18] Similarly, some stakeholders said that the number of investors in rural areas may be limited. An Office of Thrift Supervision report on rural development noted that it is not uncommon for only one or two financial institutions to serve a rural community, and some communities lack access to such institutions.[19]

Although Generally Regarded Favorably, Leveraging Also Has Implications Such as Potentially Substituting Federal for Private Funding

Many with whom we spoke and much of the literature we reviewed indicated that leveraging can help facilitate housing and community and economic development.[20] For example, as discussed previously, leveraging is often used as a way to stretch scarce federal funds and promote partnerships between the public and private sectors to improve conditions in communities. However, leveraging at the project level can be challenging and inefficient, partly because federal, state, and local funding sources often have different application and other requirements and deadlines. For example, the Low-Income Housing Tax Credit program requires developers to complete housing projects within 2 years of receiving a tax credit

[17]GAO-03-91. HOPE VI provides demolition and revitalization grants to public housing authorities. Demolition grants fund the demolition of distressed public housing, the relocation of affected residents, and provision of supportive services for permanently relocated residents. Revitalization grants fund the capital costs of major rehabilitation, new construction, and other physical improvements; demolition of severely distressed housing; and community and supportive service programs for residents, including relocated residents. To increase the number of affordable housing units developed at HOPE VI sites, HUD encouraged housing authorities to use their grants to leverage funding from other sources.

[18]GAO/RCED-89-143. Under the terminated UDAG program, HUD granted funds to distressed cities to combine with private funds for investment in industrial, commercial, and neighborhood projects. HUD defined "distressed" cities as those that ranked among the needier half of all U.S. cities under measures such as the communities' percentage of pre-1940 housing, poverty, and unemployment.

[19]Office of Thrift Supervision, "Best Practices in Rural Communities" (Washington, D.C.: 1998).

[20]For example, see L. Riggin, P. Grasso, and M. Westcott, "A Framework for Evaluating Housing and Community Development Partnership Projects," *Public Administration Review*, 52, no. 1 (1992): 40-46; M. Nenno, "State and Local Governments: New Initiatives in Low-Income Housing Preservation," *Housing Policy Debate*, 2, issue 2 (1991): 467-497; and R. Quercia, W. Rohe, and D. Levy, "A New Look at Creative Finance," *Housing Policy Debate*, 11, issue 4 (2000): 943-972.

allocation from a state.[21] However, according to some stakeholders with whom we spoke, this 2-year deadline can make it difficult to leverage the tax credits with certain other federal financing sources, such as HOPE VI grants because such large-scale developments can take more than 2 years to complete.

The inclusion of federal funds in housing and community and economic development project finance also helps to spread the investment risk between potential private sector investors and the federal government, thereby encouraging private sector participation in development. However, some of the literature we reviewed noted the potential in public-private partnerships for the uneven distribution of investment risks among investors, with the federal government often bearing greater risks and costs relative to the partnership benefits.[22]

According to some stakeholders, at the institutional level, communities and investors generally are not encumbered by differing application and other requirements, and investors generally are isolated from the investment risks associated with particular projects, and thus may be more willing to invest in housing and community and economic development initiatives. However, when federal funding is provided at the institutional level, the market could play a greater role in influencing what development is completed because the federal government plays a more limited role in determining how funds are used at this level than it does at the project level. Moreover, when funding is provided at the institutional level, it may be difficult to trace federal funding down to specific projects because of its more limited role.

Finally, some of the literature we reviewed suggested that a proportion of projects that involve leveraging also likely involve some level of substitution—that is, the replacement of private dollars that otherwise would have been invested in a project (if lower-cost public funding were not available) with public dollars.[23] One suggested means of limiting the level of substitution and appropriately sizing public subsidies is the inclusion of a "but for" test—a test designed to determine whether a project would have been completed but for, or in the absence of, the investment of public

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[21]Under the Low-Income Housing Tax Credit program, states are authorized to issue federal tax credits for the acquisition, rehabilitation, or new construction of affordable rental housing. The credits generally are sold to investors, including individuals, financial institutions, and corporations to raise development funds for a project. These outside investors use the tax credit to offset taxes otherwise owed on their tax returns. See also M. Stegman, "The Excessive Costs of Creative Finance: Growing Inefficiencies in the Production of Low-Income Housing," *Housing Policy Debate*, 2, issue 2 (1991): 357-373.

[22]For example, see S. Mullin, *Econsult Corporation for the U.S. Economic Development Administration*, "Public-Private Partnerships and State and Local Economic Development: Leveraging Private Investment," (Philadelphia, Pennsylvania: 2002).

[23]See GAO, *Federal Grants: Design Improvements Could Help Federal Resources Go Further*, GAO/AIMD-97-7 (Washington, D.C.: Dec. 18. 1996) and C. Walker and others, *The Urban Institute for the U.S. Department of Housing and Urban Development*, "Public-Sector Loans to Private-Sector Businesses: An Assessment of HUD-Sponsored Local Economic Development Lending Activities," (Washington, D.C.: 2002). For the replacement of state funds with federal funds see GAO/AIMD-97-7 and J. Gerenrot, D. Cashin, and A. Paulson, "Community Development Spending, 1981-2004," *Chicago Fed Letter*, no. 232 (Chicago, Illinois: 2006).

funds.[24] However, such tests may not be good at predicting, for example, the private sector's willingness to absorb risk and thus the appropriate proportion of private investment and public subsidy for a project.[25] Some stakeholders said that the amount of substitution in federal programs can be minimized through the inclusion of matching requirements. However, others said that requirements to leverage might preclude certain communities (for example rural and severely distressed urban communities) from receiving federal funds because they would be unable to attract sufficient additional funding. Further, such requirements may provide incentives for more developed communities to apply for federal funds because they can easily match them with private sources, substituting private funding with public funding and potentially diverting scarce federal resources from the projects where they were most needed.

Leverage Ratios Are Commonly Used to Measure the Extent of Leveraging, but They Have Certain Limitations

Based on our conversations with stakeholders and our review of the literature and housing and community and economic development program guidance, a common way of expressing the extent or amount of leveraging that occurs at either the institutional or the project level is with a leverage ratio. A leverage ratio relates the dollars other sources provide to the dollars a program provides to an institution or a project. For example, the leverage ratio for a particular project may be 1:1, meaning that the other federal, state, local, and private sources collectively contributed a dollar for every program dollar contributed to the project. In general, an institution or project with a high leverage ratio is one in which the investment of all other funds is large relative to the investment of program funds (for example, 10:1 or 25:1). Similarly, an institution or project with a low leverage ratio is one in which the investment of all other funds is reasonably small relative to the investment of program funds (for example, 2:1 or 0.5:1).

However, stakeholders identified some limitations in the usefulness of leverage ratios for conveying detailed information on a program or project. According to stakeholders, at the institutional level, leverage ratios are a useful expression of the success or efficiency of the institution in attracting or combining resources for future development initiatives—at this level, a higher ratio generally would indicate more success or efficiency than a lower ratio. But, at the project level, factors such as the local economy and the availability of investors could have a positive or negative impact on a project's ability to leverage additional funds, and thus its leverage ratio. In addition, ratios used alone cannot convey information on the level of substitution in a project.

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[24]The UDAG program included such a test. The UDAG statute specified that grants could be made under the program only when HUD determined that there was a strong probability that (1) the nonfederal investment in the project would not be made without the UDAG grant and (2) the grant would not substitute for nonfederal funds that were otherwise available to the project. 42 U.S.C. 5318 (j). Cities and private investors were required to certify that projects that received UDAG funds were in compliance with the statutory requirements.

[25]For example, see C. Walker and others, "Public-Sector Loans to Private-Sector Businesses: An Assessment of HUD-Sponsored Local Economic Development Lending Activities."

As part of our ongoing work in this area, we plan to interview additional stakeholders to obtain a broader understanding of the perspectives that exist on the use, implications, and measurement of leveraging for housing and community and economic development programs. We also plan to further review how leverage ratios, in combination with other indicators, can be used to measure the performance of housing and community and economic development programs.

HUD Data Could Be Used to Estimate the Extent of Leveraging in the Section 108 Program

Although HUD does not calculate a leverage ratio for the Section 108 program, the agency collects and maintains some information that may be used to estimate the extent to which projects supported by Section 108 loan guarantees plan to leverage other federal, state or local, and private funds.[26] Specifically, HUD collects information on sources and amounts of funds that communities plan to use in conjunction with Section 108 loan funds and documents this information in a Section 108 memorandum. In most cases, these memorandums list the type—for example, EDI and BEDI grants, tax-exempt bond and tax credit proceeds, and developer equity—and amount of proposed funding sources for projects that will be supported by Section 108 loan guarantees. See enclosure III for more information on how we categorized some of the types of funding sources that can be leveraged with Section 108 funds and selected programs included under those categories.

However, agency officials acknowledged a limitation to the data that affects the extent to which it can be used to accurately measure leveraging in the Section 108 program. In particular, HUD only has data on what sources and amounts of funds a community proposes to use (at the time of its application to HUD for a Section 108 guarantee) to complete a project. According to HUD, proposed sources and amounts may differ from the actual sources and amounts used to complete a project, and do not represent firm commitments. Some HUD data provided limited support for this statement: in fiscal year 2006, HUD reported $1.8 million in unplanned uses of CDBG funds to make payments on Section 108 loans, indicating that the sources—in particular CDBG funds—communities used in conjunction with Section 108 loan funds can change over time.[27]

Nonetheless, information from these memorandums provides some insight into the extent to which communities planned to leverage Section 108 loan funds with other

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[26]Because Section 108 does not have a leveraging requirement, HUD is not required to and does not collect data that could be used to calculate an actual (as opposed to an estimated) leverage ratio, as discussed in this report. According to HUD, the agency is considering changing its Integrated Disbursement and Information System (IDIS) to include information on sources and amounts of funds for Section 108 projects. HUD said that such changes would be subject to the results of the Office of Management and Budget's ongoing Program Assessment Rating Tool (PART) evaluation of Section 108 and that any changes would not take effect prior to 2009.

[27]Communities make unplanned uses of CDBG funds when an intended source of funds, such as project-related income, is not used to make a payment on the loan. Communities are expected, but not required to report unplanned uses to HUD. As a result unplanned uses may exceed $1.8 million.

sources of funds to finance development projects. For example, the total number of proposed sources of funds for each of the 50 projects we reviewed ranged from 1 (Section 108 loan funds only) through 15.[28] The number of other sources used to finance a project could be related to, among other things, its size and type. For example, projects that used Section 108 loan proceeds as the only source of funding generally were for small physical infrastructure improvements in a community, such as the construction of a youth sports center or the repair of sidewalks and gutters. On the other hand, those projects that used multiple sources of funds often were larger-scale, such as the renovation of a brownfields site into a mixed-use commercial and residential complex. Enclosure II provides more detailed information on proposed sources and amounts of funds for the 50 projects we reviewed.

In 2002, the Urban Institute found that each Section 108 dollar leveraged an additional $1.54 in private funding and $0.68 in other public funding, for a total of $2.22 in other funds leveraged.[29] In other words, the program had a 2.22:1 leverage ratio. Because of the small sample of Section 108 memorandums we reviewed, for purposes of this report we were not able to calculate a similar ratio.[30]

As part of our ongoing work for you in this area, we plan to assess what data are available to measure the extent of leveraging in several other federal programs including the Department of the Treasury's CDFI, Low-Income Housing Tax Credit, and New Markets Tax Credits programs; and HUD's CDBG, HOME, and HOPE VI programs and provide information on how these programs leverage federal funds for housing and community and economic development.

Agency Comments

We provided HUD with a draft of this report for review and comment. The agency provided technical comments, which we incorporated in the report as appropriate.

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[28]One loan guarantee in our sample (Monessen, Pennsylvania) supported 38 different projects proposed by multiple nonentitlement communities that formed a consortium. For each individual project described, the community did not list more than 15 sources of funds, although the aggregated number of sources for all 38 projects was 95.

[29]The Urban Institute collected leveraging data by reviewing loan files for a sample of 201 Section 108 loans made to third parties from 1994 through 1999 in 51 communities determined to be the greatest utilizers of such third-party loans (in terms of dollar-volume). However, the researchers acknowledged a limitation—missing leveraging data—and noted that leveraging results for Section 108 loans were from data collected on 149 economic development projects. Although the 51 communities accounted for 96 percent of Section 108 third-party lending during that period, Section 108 loans are often used by communities themselves in order to undertake various local projects. For purposes of calculating the leveraging ratio, the study defined "public" funds to include Section 108, EDI/BEDI, other federal loans, state and local, and other CDBG funds, and "private" dollars to include private lending, equity, stock, personal borrowing, and other funding.

[30]Due to the small sample size (50 proposed projects), our results cannot be projected with enough precision to provide accurate generalizations to all projects with Section 108 loan guarantees.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies of this report to the Ranking Minority Member, Subcommittee on Housing and Community Opportunity and the Secretary of Housing and Urban Development. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions concerning this report, please contact me at (202) 512-8678 or at shearw@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in enclosure IV.

Sincerely yours,

William B. Shear
Director, Financial Markets and Community Investment

Enclosures – 4

Objectives, Scope, and Methodology

The objectives of this interim report were to (1) examine the perspectives of stakeholders on the use, implications, and measurement of leveraging in housing and community and economic development programs and (2) describe the type of data the Department of Housing and Urban Development (HUD) collects that could be used to determine the extent of leveraging in the Section 108 Loan Guarantee (Section 108) program. Enclosure II contains the results of our review of the potential extent of leveraging in 50 selected Section 108 projects. See enclosure III for a description of how we categorized some of the types of funding sources that could be leveraged (combined) with Section 108 funds and selected programs included under those categories.

To examine the perspectives of stakeholders on the use, implications, and measurement of leveraging in housing and community and economic development programs, we reviewed academic, government, and industry literature related to leveraging in the housing and community and economic development fields. To identify this literature, we conducted a literature search on research databases and agency Web sites using each of the terms "leveraging," "leverage," "private investment," and "public-private partnership" in combination with each of the terms "housing," "community development," and "economic development." For example, we searched using the phrase "leveraging and housing." We also interviewed representatives of several federal agencies, including the Department of Agriculture, the Department of Commerce, the Department of the Treasury, HUD, and the Office of Management and Budget, as well as representatives of industry groups and other organizations involved in housing and community and economic development initiatives, including the Coalition of Community Development Financial Institutions, the Council of State Community and Economic Development Agencies, Enterprise Community Partners, the International Economic Development Council, Harvard University's Center for Housing Studies, the John D. and Catherine T. MacArthur Foundation, Living Cities: The National Community Development Initiative, the Local Initiatives Support Corporation, the National Association of Affordable Housing Lenders, the National Association of Development Organizations, the National Community Development Association, the National Council of State Housing Agencies, NeighborWorks America, and the New Markets Tax Credit Coalition.

To describe the type of data HUD collects that could be used to determine the extent of leveraging in the Section 108 program, we interviewed HUD officials to identify what data the agency collects for the Section 108 program. HUD officials explained that the agency maintains information on the sources and amounts of funds communities proposed using to finance development projects in Section 108 memorandums. HUD officials provided us with several examples of these memorandums, which we reviewed prior to submitting a request for further documentation, as described below. We also reviewed relevant program regulations and guidance, budget documents, GAO reports, HUD Inspector General reports, and other literature to determine what other information was available on the extent of leveraging in the program.

To describe how federal funds may have been leveraged in the Section 108 program, we randomly selected a sample of 50 loan guarantees using a summary spreadsheet containing high-level project information on the 358 loan guarantees committed from fiscal years 2001 through 2006, and requested copies of the Section 108 memorandums for each of the 50 projects.[31] We chose this period for review because HUD officials said that those were the only years for which the agency maintained electronic copies of Section 108 memorandums. In addition to interviewing a HUD official knowledgeable in the procedures used to collect and maintain the data contained in the Section 108 memorandums, we reviewed the sample of 50 memorandums for their accuracy and completeness and summarized project information in them, including sources and amounts of funds. We found that the data contained in these memorandums were sufficiently reliable for describing how communities planned to leverage Section 108 loan funds with other sources of funds. To simplify the presentation of funding source information for each project (please refer to enclosure II), we classified sources into three broad categories:

- other federal funding sources,
- state or local funding sources, or
- private funding sources.

Enclosure III describes how we defined these categories and some of the funding sources we included under each of the three categories. However, due to the small sample size, our results cannot be projected with enough precision to provide accurate generalizations to all projects with Section 108 loan guarantees.

We conducted our work in Washington, D.C., and Chicago from November 2006 to May 2007 in accordance with generally accepted government auditing standards.

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[31]To determine the accuracy and completeness of the information provided in the summary spreadsheet, we performed basic checks on the data and interviewed a HUD official who is responsible for maintaining the spreadsheet. Based on these checks and HUD's responses to our questions about the completeness and accuracy of the data in the spreadsheet, we determined that the data were sufficiently reliable for the purposes of selecting the sample of Section 108 memorandums for our further review, as well as reporting the total number of applications for Section 108 loan guarantees HUD approved from 2001 through 2006 and the amounts of Section 108 loan funds committed and advanced from 2001 through 2006.

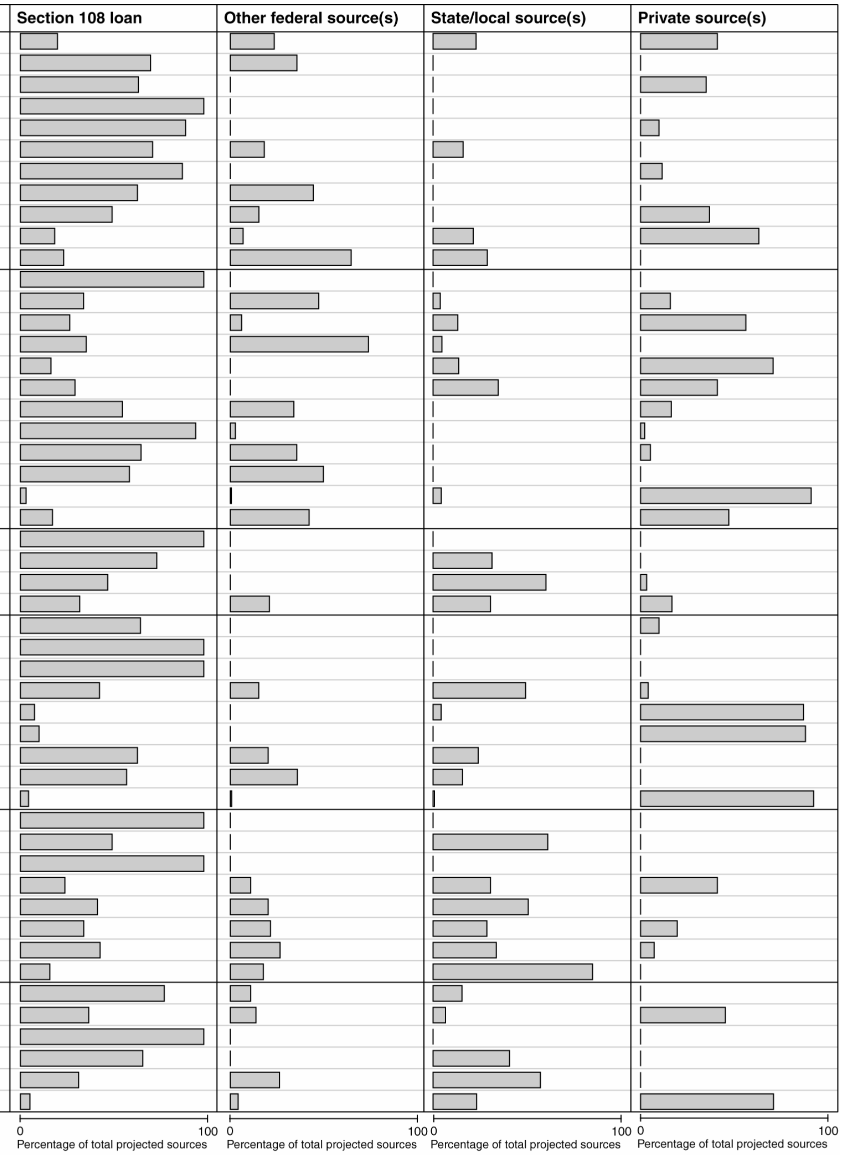
Descriptions of Proposed Sources and Amounts of Funds Used to Finance 50 Section 108 Projects

To determine how funds may have been leveraged in the Section 108 program, we examined a random sample of 50 proposed Section 108 projects to determine the types and amounts of funding sources communities planned to use to finance these projects. In varying amounts of detail, the figures below illustrate how communities planned to leverage Section 108 loan funds with other sources of funds for development. Due to the small sample size, our results cannot be projected with enough precision to provide accurate generalizations to all projects with Section 108 loan guarantees.

Figure 3 provides information, by fiscal year, on the projected sources for each of the 50 Section 108 projects we reviewed. Sources are categorized by Section 108 loan funds, other federal funding sources, state or local funding sources, and private funding sources.

Figure 3: Summary of Projected Sources for the Sample of 50 Section 108 Projects, Fiscal Years 2001 through 2006

Year	City/County, State	ED	HSG	PI
2001	Akron, Ohio	●		
	Dade County, Fla.	●		
	Daly City, Calif.			●
	Guaynabo, P.R.			●
	Hudson, N.Y.	●		
	New Haven, Conn.	●		
	North Tonawanda, N.Y.	●		
	Reading, Penn.	●		
	Rochester, N.Y.	●		
	Rochester, N.Y.	●		
	Scranton, Penn.			●
2002	Burlington, Vt.	●	●	●
	Denver, Colo.		●	
	Hammond, Ind.	●		
	Huntington, W. Va.			●
	Kansas City, Mo.	●		
	New Orleans, La.	●		
	Newburgh, N.Y.	●		
	Palm Beach County, Fla.	●		
	Rialto, Calif.			●
	San Bernardino Cty, Calif.	●	●	
	San Jose, Calif.	●		●
	West Valley, Utah		●	
2003	El Cajon, Calif.			●
	Key West, Fla.		●	
	Lancaster, Calif.			●
	North Adams, Mass.	●		
2004	Casper, Wyo.	●		
	Fort Pierce, Fla.			●
	Gloucester Cty, N.J.	●		
	Irving, Tex.			●
	Los Angeles, Calif.	●		
	Montgomery County, Penn.	●		
	Pasco County, Fla.			●
	Pittsburgh, Penn.	●		
	Tempe, Ariz.	●		
2005	Akron, Ohio			●
	Berks County, Penn.	●		
	Chattanooga, Tenn.	●	●	●
	Harrisburg, Penn.	●		
	Milwaukee, Wis.	●		
	Monessen, Penn.	●	●	●
	Montgomery County, Penn.	●		
	San Diego, Calif.			●
2006	Alameda, Calif.	●		●
	Flint, Mich.	●		
	Isabela, P.R.			●
	Manuabo, P.R.			●
	Oklahoma City, Okla.	●		
	Reading, Penn.	●		

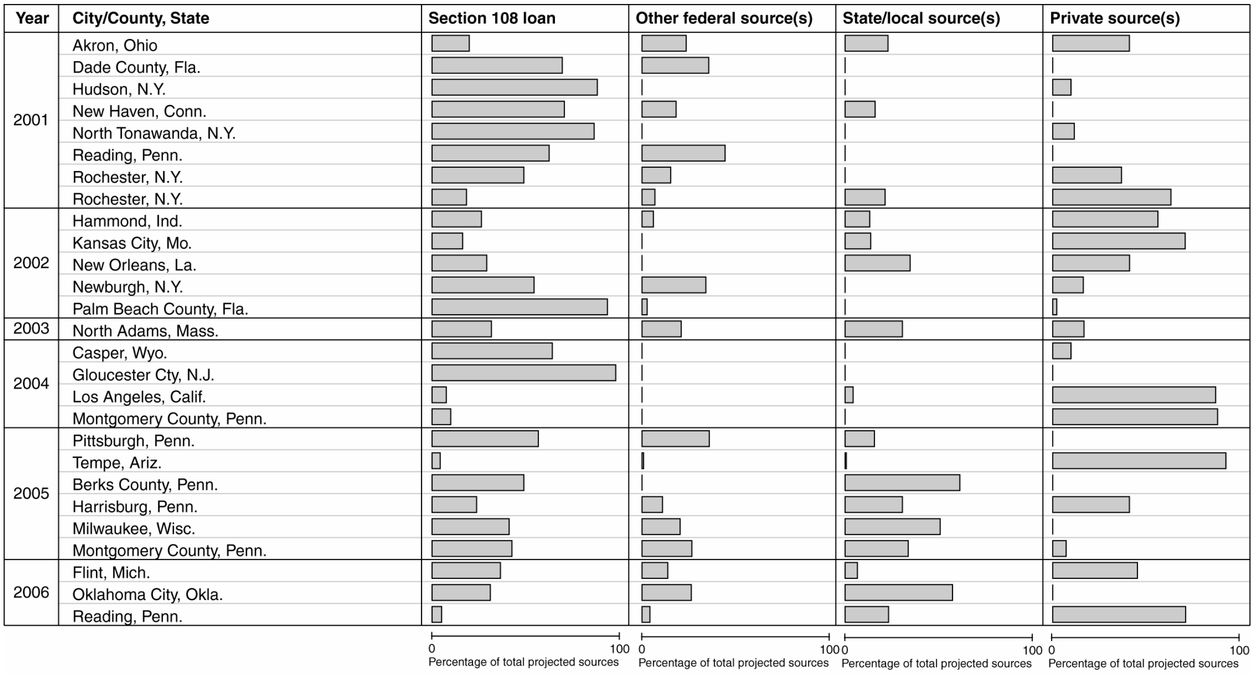


Source: GAO analysis of HUD data.

Note: ED (economic development), HSG (housing), PI (physical infrastructure)

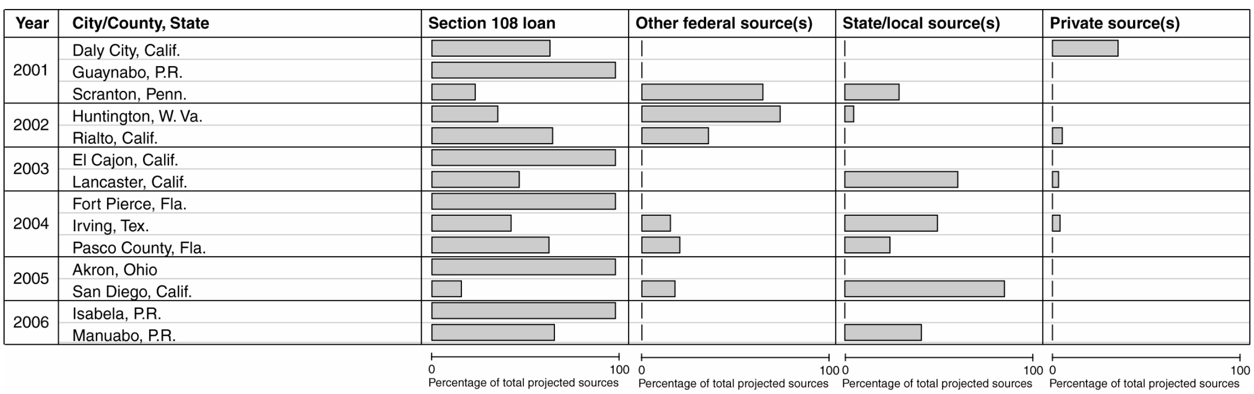
Figures 4 through 7 provide information on the proposed funding sources for the 50 projects in our sample by project type—economic development, physical infrastructure, housing, and multiple-type projects.

Figure 4: Proposed Funding Sources for Section 108 Economic Development Projects, Fiscal Years 2001 through 2006



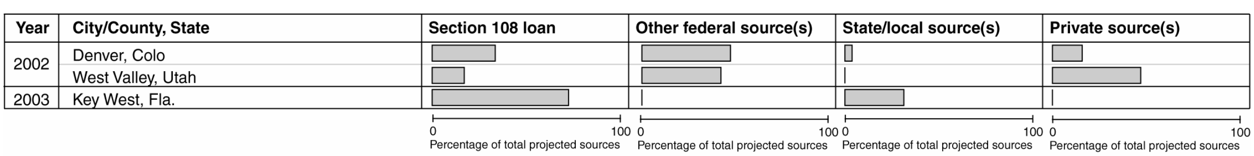
Source: GAO analysis of HUD data.

Figure 5: Proposed Funding Sources for Section 108 Physical Infrastructure Projects, Fiscal Years 2001 through 2006



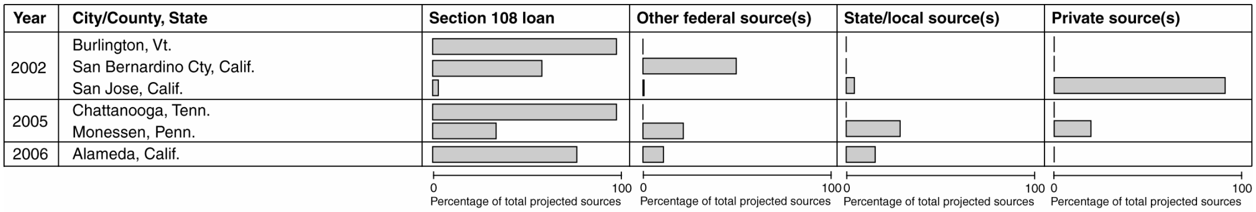
Source: GAO analysis of HUD data.

Figure 6: Proposed Funding Sources for Section 108 Housing Projects, Fiscal Years 2001 through 2006



Source: GAO analysis of HUD data.

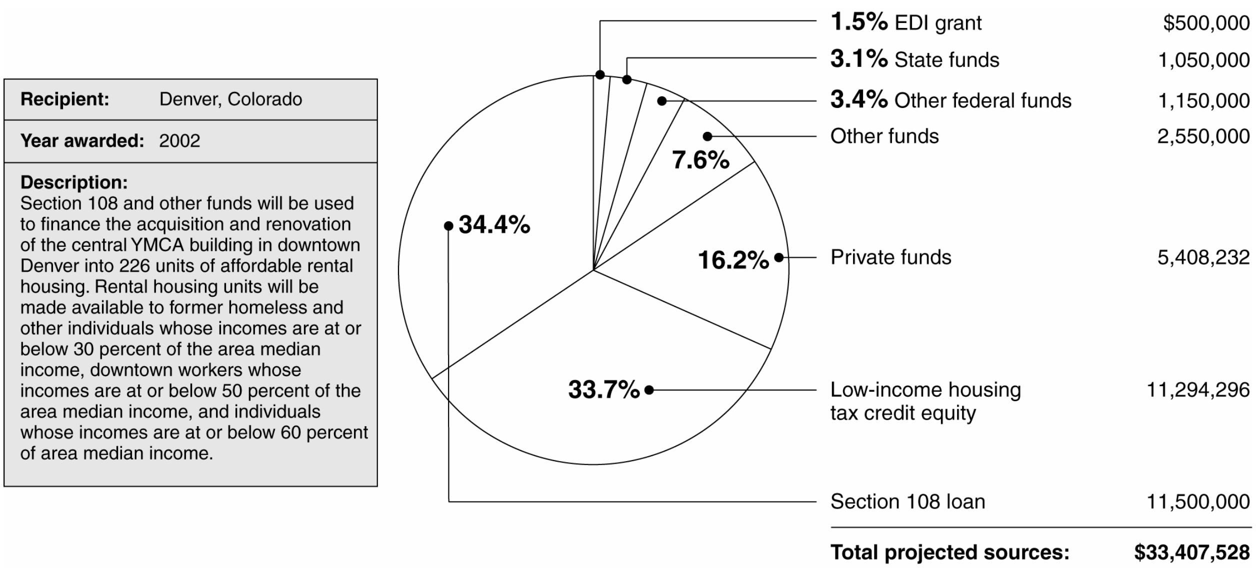
Figure 7: Proposed Funding Sources for Section 108 Multi-Type Projects, Fiscal Years 2001 through 2006



Source: GAO analysis of HUD data.

Figures 8 through 13 provide more detailed information on several of the Section 108 projects we reviewed.

Figure 8: Proposed Funding Sources—Denver, Colorado



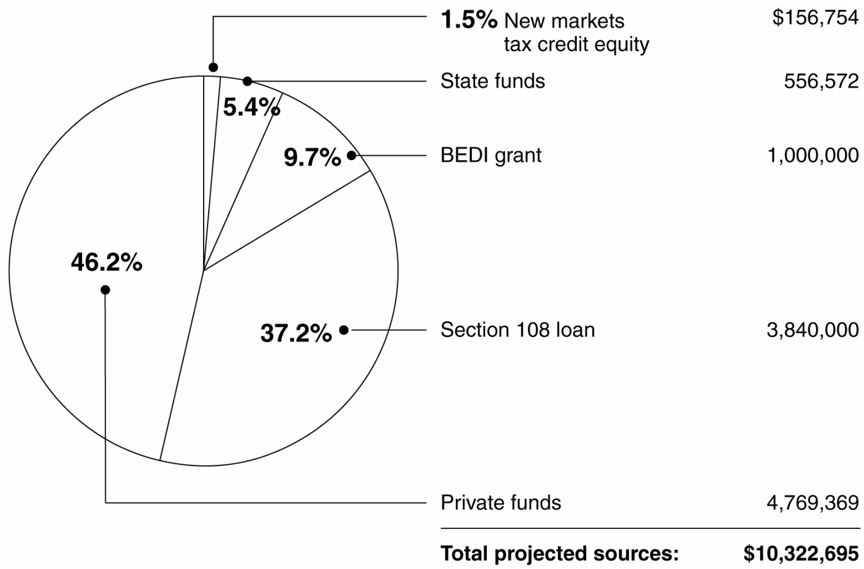
Source: GAO analysis of HUD data.

Figure 9: Proposed Funding Sources—Flint, Michigan

Recipient: Flint, Michigan

Year awarded: 2006

Description:
Section 108 and other funds will be used to finance the renovation of three downtown buildings to eliminate blight. The project will create a mixed-use center that will include 30,000 square feet of office space, 20,000 square feet of restaurant and entertainment space, and 30,000 square feet of residential space. The residential space will be financed entirely with private funding sources. The project is one phase of the ongoing revitalization of downtown Flint.



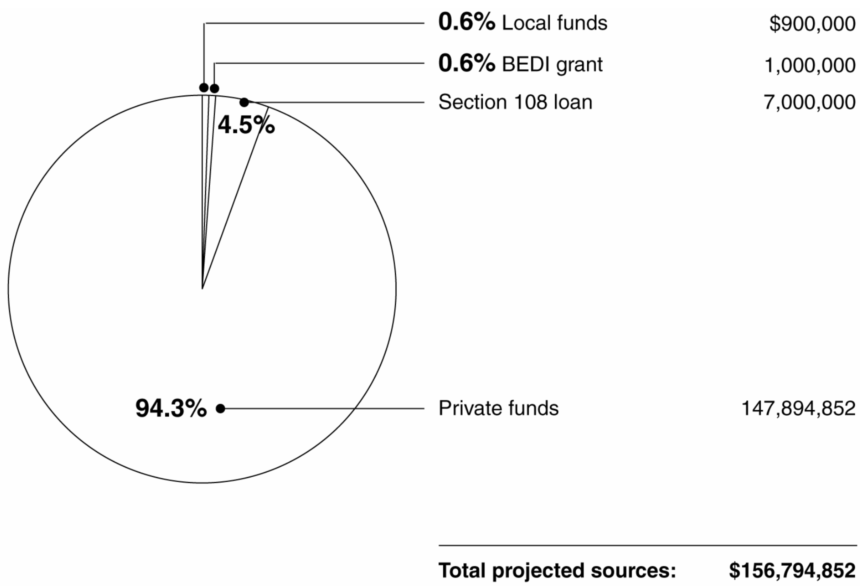
Source: GAO analysis of HUD data.

Figure 10: Proposed Funding Sources—Tempe, Arizona

Recipient: Tempe, Arizona

Year awarded: 2004

Description:
Section 108 and other funds will be used to finance the development of the Tempe Marketplace project, consisting of a retail facility anchored by six nationally known retailers. A portion of the Section 108 funds will be used to clean up (remediate) the development site. The city estimates that the project will create approximately 2,000 new jobs in a high-poverty area.

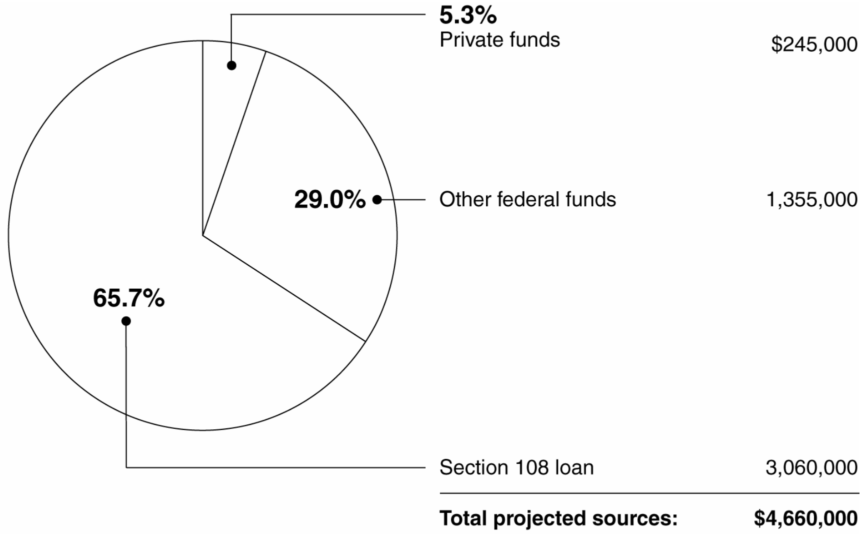


Source: GAO analysis of HUD data.

Figure 11: Proposed Funding Sources—Rialto, California

Recipient:	Rialto, California
Year awarded:	2002

Description:
Section 108 and other funds will be used to finance the construction of a senior citizens center. The center will provide services and facilities including banking, postal, conference and multipurpose rooms, a stage, a billiard room, a beauty salon, a computer classroom, a television and audio library, a kitchen, and an exterior courtyard.

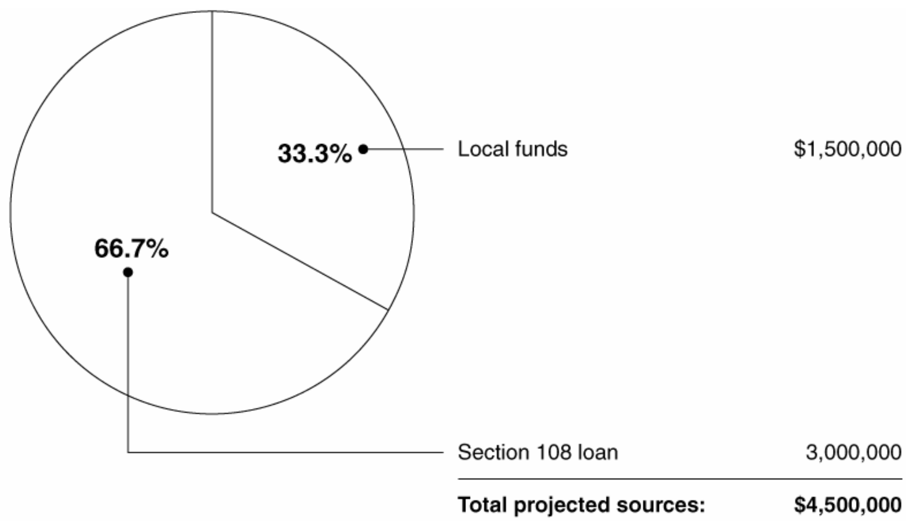


Source: GAO analysis of HUD data.

Figure 12: Proposed Funding Sources—Maunabo, Puerto Rico

Recipient:	Maunabo, Puerto Rico
Year awarded:	2006

Description:
Section 108 and other funds will be used to finance the construction of a sports court and entertainment center within the city's existing sports complex. The city plans to demolish an existing sports field and in its place construct conference areas, restrooms, dressing rooms, bleachers, a maintenance room, an outdoor recreational space, and additional parking spaces. According to the city's application, low- and moderate-income individuals will be charged nominal admission fees for events and schools, civic organizations, and nonprofit organizations will be able to use the facility free of charge.



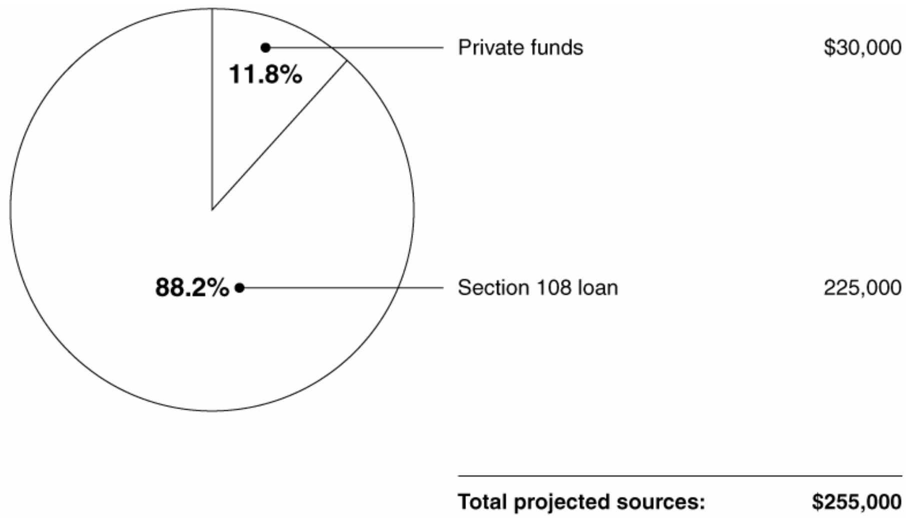
Source: GAO analysis of HUD data.

Figure 13: Proposed Funding Sources—North Tonawanda, New York

Recipient: North Tonawanda, New York

Year awarded: 2001

Description:
Section 108 and other funds will be used to finance the Canal Corridor Initiative Tonawanda Island Marine Development Corporation project. The purpose of the project is to redevelop and expand the Placid Harbor Marina and Restaurant and ancillary facilities including boat slips, a gas service dock, a boat storage and repair shop, and parking areas. The redevelopment and expansion effort is considered to be a key component of North Tonawanda's effort to revitalize the canal area.



Source: GAO analysis of HUD data.

Descriptions of Programs or Entities We Included Under Categories for Federal, State or Local, and Private Funding Sources

As described in our report and in enclosure II, communities often leverage Section 108 funds with other sources of funds to finance development projects. We classified each of the sources of funds listed in our sample of 50 HUD Section 108 memorandums into three general categories: "other federal funding sources," "state or local funding sources," and "private funding sources." Generally, we considered federal funding to be that which is appropriated or otherwise authorized by the U.S. Congress. We considered state or local funding to be that which is appropriated or otherwise authorized by state or local governmental entities. Finally we considered private funding to be that which is contributed by a private source, such as a bank or a foundation. This enclosure describes more fully some of the funding sources we placed into these categories.

Other Federal Funding Sources

Brownfields Economic Development Initiative (BEDI) Grant Program

Established in 1998 and administered by the U.S. Department of Housing and Urban Development (HUD), the BEDI grant program supports state and local efforts to commence redevelopment or continue phased redevelopment efforts on brownfields sites.[32] The BEDI grant program serves a purpose similar to that of the Economic Development Initiative grant program when it was first established—to enhance the viability of a project financed with a Section 108 loan guarantee. Currently, HUD makes BEDI grant awards contingent upon applicants also obtaining a Section 108 loan guarantee.

Community Development Block Grant (CDBG) Program

Through CDBG, HUD provides annual formula grants to states and local jurisdictions called "entitlement communities." States distribute the funds to localities that do not qualify as entitlement communities. CDBG funds can be used to implement a wide variety of community and economic development activities directed toward neighborhood revitalization, economic development, and improvement of community facilities and services. We consider CDBG to be a federal source because the grants are originally funded at the federal level through Congressional appropriations.

Economic Development Administration (EDA) Public Works and Economic Development Grant Program

The Department of Commerce's EDA Public Works and Economic Development Grant Program provides funds to help distressed communities attract new industry and business growth, diversify local economies, and create jobs. These grants

[32]HUD defines brownfields as abandoned, idled, or under-used real property where actual or potential environmental contamination complicates expansion or redevelopment.

support various types of projects such as water and sewer system improvements; access roads to industrial parks or sites; business incubator facilities; and other infrastructure improvements needed for business retention and expansion. Generally, the grants are targeted to communities demonstrating the greatest need for such improvements. Grant recipients are required to match up to 50 percent of the amount of the award with local matching funds. The amount of matching funds required is based on the level of economic distress in the recipient community. Recognized Indian tribes may be eligible for up to 100 percent assistance, and may not have to provide matching funds.

Economic Development Initiative (EDI) Grants Program

HUD's EDI program was established in 1994 to encourage communities to make greater use of the Section 108 loan guarantee program, by providing an additional source of financing for projects and reducing or paying for some of the costs of borrowing under the loan program. HUD stopped making competitive grants under the EDI program in 2001; however, HUD may still make special purpose or targeted EDI grants to qualifying communities pursuant to Congressional directives.

Historic Rehabilitation Tax Credit Program

Historic Rehabilitation Tax Credits are available for work on certified historic structures that will need substantial rehabilitation. Eligible applicants receive a tax credit equal to 20 percent of the amount of qualified rehabilitation expenditures.

HOME Investment Partnerships (HOME) Program

Through HOME, HUD provides annual formula grants to states and localities to fund a wide range of activities designed to build, buy, or rehabilitate affordable housing or provide direct rental assistance to low-income people. Specifically, states and localities use HOME funds for grants, direct loans, loan guarantees or other forms of credit enhancement, rental assistance, and security deposits. We consider HOME funds to be a federal source because the grants are originally funded at the federal level through Congressional appropriations.

Low-Income Housing Tax Credit Program

Under the Low-Income Housing Tax Credit program, states are authorized to issue federal tax credits for the acquisition, rehabilitation, or new construction of affordable rental housing. The credits generally are sold to investors, including individuals, financial institutions, and corporations to raise development funds for a project. These outside investors use the tax credit to offset taxes otherwise owed on their tax returns. To qualify for credits, a project must have a specific proportion of its units set aside for lower-income households, and the rents on these units must be limited to 30 percent of qualifying income.[33] Investors may claim these credits on their tax returns annually for 10 years. Each state receives an annual allocation of $1.75 per capita, adjusted each year by a cost of living adjustment factor. States must reserve a minimum of 10 percent of the credit for nonprofit developers. Although some consider these tax credits to be either a state or private source of funds, we consider them to be a federal source because they represent foregone federal income and, therefore, are a direct cost to the federal government.

New Markets Tax Credit Program

The New Markets Tax Credit program was established by Congress in 2000 to help revitalize impoverished, low-income communities. Tax credits are allocated to Community Development Entities, who sell the tax credits to investors—including individuals, financial institutions, and corporations—who in turn use the proceeds to make investments in low-income communities and eligible businesses. The tax credit allows the investors to reduce their tax liability by 39 percent of the amount of the investment over a 7-year period. The New Markets Tax Credit is nonrefundable, meaning that taxpayers do not receive payments for tax credits that exceed their total tax liability. Although some consider these tax credits to a private source of funds, we consider them to be a federal source because they represent foregone federal income and, therefore, are a direct cost to the federal government.

State or Local Funding Sources

Housing Trust Funds

Housing trust funds are funds established by cities, counties, and states that permanently dedicate a source of public revenue to support the production and preservation of affordable housing. There are at least 257 housing trust funds in the United States.

Tax Increment Financing (TIF)

TIFs allow a municipality to provide financial incentives to stimulate private investment in a designated area (a TIF district) where blight has made it difficult to attract new development. The TIF program can be used to support new development or the rehabilitation of existing buildings in industrial, commercial, or residential projects. Funding for TIF eligible activities is derived from the increase in incremental tax revenues generated by new construction or rehabilitation projects within the boundaries of the TIF district. States determine what activities are eligible with TIF funds, and these activities may include land acquisition, site preparation, building rehabilitation, public improvements, and interest subsidy.

[33] Projects must meet one of two low-income occupancy requirements: (1) 20 percent of the units must be reserved for households with initial, qualifying incomes at or below 50 percent of area median income or (2) 40 percent of units must go to households with initial, qualifying incomes at or below 60 percent of area median income.

State Tax Credit Programs

States may also administer tax credit programs to support activities such as historic preservation and economic development. For example, Michigan sponsors a historic preservation tax credit program where a state income tax credit of up to 25 percent is available for preservation of certain historic properties; however, if combined with a federal historic preservation tax credit of 20 percent, a project only will be eligible for an additional 5 percent state tax credit. The State of Michigan also administers the Brownfield Single Business Tax Credit program, which provides an incentive in the form of a tax credit for eligible redevelopment investments on a brownfield property. The credit is applied against the Single Business Tax liability of the developer.

Private Funding Sources

Nonprofit organizations, developers, private banks and lending institutions, businesses, and individuals provide an array of financial support—such as developer fees, private loans, grants, land donations, and individual financial contributions—to Section 108 and other federal housing and community and economic development projects.

Enclosure IV

GAO Contact and Staff Acknowledgements

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