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SECTION 8 PROJECT-BASED RENTAL ASSISTANCE

HUD's Processes for Evaluating and Using Unexpended Balances Are Ineffective

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GAO

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**Resources, Community, and
Economic Development Division**

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Congressional Committees

This report was prepared to comply with the requirements of the 1997 Emergency Supplemental Appropriations Act (P.L. 105-18, June 12, 1997), which requested that GAO study the Department of Housing and Urban Development's (HUD) systems for budgeting and accounting for Section 8 rental assistance funds. HUD administers its Section 8 program in two parts: tenant-based assistance and project-based assistance. This report focuses on the project-based assistance program. As requested, we determined whether HUD's systems ensure that unexpended Section 8 project-based funds do not reach unreasonable levels and that obligations are spent in a timely manner.

We are sending copies of this report to congressional committees and subcommittees interested in housing, the Secretary of Housing and Urban Development, the Director of the Office of Management and Budget, and other interested parties. We will also make copies available to others upon request.

If you or your staff have any questions about this report, please call me at (202) 512-7631. Major contributors to this report are listed in appendix III.

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Development Issues

List of Committees

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Executive Summary

Purpose

The Department of Housing and Urban Development's (HUD) Section 8 program provided more than $16 billion in rental assistance payments to low-income households in fiscal year 1997. Because of concerns about HUD's budgeting and accounting practices for Section 8 funds, the 1997 Emergency Supplemental Appropriations Act (P.L.105-18, June 12, 1997) mandated that GAO determine whether HUD's systems ensure that unexpended Section 8 funds do not reach unreasonable levels and that obligations are spent in a timely manner. HUD administers its Section 8 program in two parts. In general, HUD's Office of Public and Indian Housing manages the tenant-based portion of the program, while HUD's Office of Housing manages the project-based portion. GAO reported on the tenant-based program in February 1998.[1]

This report examines the Section 8 project-based rental assistance program, particularly (1) the categories and amounts of unexpended rental assistance funds and (2) the effectiveness of HUD's processes to evaluate unexpended Section 8 project-based balances, ensure they do not reach unreasonable levels and are spent in a timely manner, and take unexpended balances into account when determining funding needs as part of HUD's budget process.

Background

HUD's Section 8 project-based program provides rental assistance to low-income tenants. In contrast to tenant-based assistance, which is linked to specific individuals, the project-based assistance is linked to housing units. Residents in subsidized units generally pay 30 percent of their income for rent, and HUD pays the balance. The project-based contracts—generally between HUD and the owners of private rental housing—were entered into beginning in the 1970s and 1980s, typically for 15, 20, or 40 years. For some of these long-term contracts, actual expenditures have proven to be lower than anticipated when the funds were provided. In such cases, HUD can recapture the unneeded funds and use them to help fund other Section 8 contracts. However, other contracts have insufficient funding to make rental assistance payments through the life of the contracts. For such contracts, the Department requests additional funding (budget authority) to amend the contracts.[2] In addition, the long-term contracts that were entered into in the 1970s and 1980s

[1]Section 8 Tenant-Based Housing Assistance: Opportunities to Improve HUD's Financial Management (GAO/RCED-98-47, Feb. 20, 1998).

[2]Budget authority is the authority provided by law to enter into financial obligations that will result in immediate or future outlays involving federal government funds.

began expiring in the early 1990s. Initially, contracts were renewed for 5 years. Currently, expiring contracts are being renewed for 1 year.

Results in Brief

As of September 30, 1997, HUD's Section 8 project-based rental assistance program had about $59.1 billion in unexpended balances in three major categories: (1) undisbursed obligations—funds obligated to Section 8 contracts but not yet disbursed; (2) unobligated but reserved funds—balances reserved for specific rental assistance contracts but not yet obligated; and (3) unobligated and unreserved funds—funds that are neither obligated nor reserved for any specific contracts. Most of the unexpended balances—$55.4 billion—represent undisbursed obligations associated with approximately 31,000 rental assistance contracts. In addition, at the end of fiscal year 1997, HUD had about $3 billion in unobligated funds that were reserved for but not yet obligated to specific contracts and about $.7 billion in unobligated and unreserved funds that were carried over for use in 1998. While most of the unexpended balances are needed for HUD to fulfill its commitments to the Section 8 contracts for which the funds have been obligated or reserved, GAO found at least $517 million in unexpended balances that are no longer needed for such purposes and thus could be recaptured by HUD and used to help fund other Section 8 contracts.

HUD's procedures for identifying and deobligating funds that are no longer needed to meet its Section 8 contractual obligations are not effective. Specifically, the procedures do not ensure that all Section 8 project-based balances are evaluated each year and that any excess balances are identified and deobligated in a timely manner. While HUD's program offices are responsible for reviewing unexpended balances each year to determine whether they are still needed or can be deobligated, GAO found that some offices did not perform annual reviews in 1997 and that some funds identified as being available for deobligation in earlier reviews were not deobligated. In addition, GAO found errors in the process HUD used to identify and take into account unexpended balances when formulating its budget request for fiscal year 1999. As a result, HUD's fiscal year 1999 request for $1.3 billion in amendment funding to cover shortfalls in existing Section 8 contracts was significantly overstated. More recent analyses that correct most of these errors and update the economic assumptions used indicate that HUD already has sufficient funding available to meet its amendment needs for fiscal year 1999.

Principal Findings

Section 8 Unexpended Balances Are Large and Stem From Long-Term Contracts

HUD's unexpended balances for Section 8 project-based rental assistance included $55.4 billion in outstanding undisbursed obligations, primarily for HUD's existing contractual obligations under approximately 31,000 rental assistance contracts. About $32.7 billion (59 percent) of these funds are associated with long-term Section 8 contracts supporting rents at properties that were developed for families under HUD's new construction and substantial rehabilitation program in the 1970s and early 1980s. Another $15 billion (27 percent) is associated with contracts for properties that provide housing for elderly and disabled persons, while the rest is associated with various other HUD programs.

Most of the unobligated funds—about $3 billion—represent funds reserved for, but not yet obligated to, specific assistance contracts. About $1.3 billion of this amount was reserved for properties being developed for elderly and disabled persons, and another $1 billion was reserved for renewals and amendments of existing Section 8 contracts.

While most of the undisbursed obligations and obligated but reserved funds will be needed during the remaining terms of the contracts to which the funds have been assigned, GAO found at least $517 million that was not needed and could be used for other purposes. For example, about $405 million ($345 million in undisbursed obligations and $60 million in reservations) was associated with expired contracts—many of which expired 3 or more years ago. GAO also identified (1) at least $77 million still in the accounting records associated with contracts with future expirations that HUD had terminated for various reasons, such as noncompliance with HUD's housing quality standards, and (2) about $35 million associated with contracts that were never executed for various reasons. In addition, GAO identified other balances for which the continued need is questionable, such as $79 million that HUD has assigned to the property disposition program, even though the Department discontinued the use of project-based assistance for the program in 1995 and instead uses tenant-based assistance for that program.

HUD's Process for Evaluating Unexpended Balances Is Not Effective

Each year, the status of HUD's unexpended balances are to be examined under a review process the Department refers to as the annual review of unliquidated obligations. This review is to determine whether recorded obligations should be continued, reduced, or canceled. According to HUD's Acting Assistant Chief Financial Officer for Accounting, the annual review of Section 8 project-based balances focuses on identifying those balances associated with contracts that are no longer active, such as balances remaining on expired or terminated contracts. GAO identified a number of weaknesses with the review process, including reviews not being done and funds identified as no longer needed for specific contracts not being deobligated. These weaknesses stem from a number of factors, including limited oversight of the process by HUD's Office of the Chief Financial Officer.

The Department has also not ensured that all available Section 8 project-based unexpended balances are identified and taken into account as part of its budget process. While HUD has developed a model for estimating the funding needed to amend Section 8 contracts with insufficient funding, it did not ensure that the data used in the analyses supporting its fiscal year 1999 request for such amendment funding were complete, accurate, and current. HUD also did not sufficiently review the analyses performed by a contractor to ensure that the analyses were reliable. GAO found errors in the analyses. For example, the funds appropriated in fiscal year 1997 were omitted from an analysis because the computer program was not revised to receive data from new appropriation accounts, and about 1,800 active contracts were excluded from an analysis because of a computer programming error.

In an April 1998 analysis, HUD corrected most of these errors and revised the assumptions used in the model to reflect the Office of Management and Budget's economic assumptions for the fiscal year 1999 budget and legislatively mandated limits on rent increases for certain contracts. The revised analysis indicated that shortfalls would be much lower and that HUD could recapture amounts much higher than indicated in the analysis it used to support its fiscal year 1999 budget request for funding to amend existing contracts. HUD's estimate of long-term funding needs to amend Section 8 project-based contracts shifted from an overall net shortfall (taking into account both contracts with estimated shortfalls and those with funding that is estimated to be available for recapture) of $19 billion to a shortfall of less than $2 billion. The analysis also indicated that the recaptured funds that could be applied to meet HUD's fiscal year 1999 amendment needs were substantially higher than the amount identified in the Department's budget request for fiscal year 1999.

While the April 1998 analysis is a substantial improvement over previous HUD analyses, it does not reflect about $1.5 billion in additional funding that could be used to meet the Department's needs for funding to amend the Section 8 project-based contracts, and it still contains some errors. Specifically, the analysis does not include $833 million in amendment funding provided to HUD for fiscal year 1998, $133 million in amendment funding that was not used in fiscal year 1997 and continued to be available in 1998, and the balances totaling $517 million that GAO found were no longer needed. In addition, the analysis does not accurately estimate future expenditure rates for some contracts and omits about 1,800 contracts that should have been included.[3] Finally, long-term amendment needs could increase substantially if inflation rates prove to be higher than those used in the analysis. In connection with this concern about inflation, HUD provided two sensitivity analyses that reflect net funding needs of $7.5 billion and $14.2 billion, which it views as providing a range of future funding needs. However, neither of these analyses incorporates the legislatively mandated limits on future increases in contract rents, which would reduce the future funding needs identified in the sensitivity analyses.

Recommendations

To improve the Department's oversight of Section 8 project-based balances, GAO recommends that the Secretary of Housing and Urban Development require the Chief Financial Officer to revise the procedures used in the Department's annual review of unexpended balances to ensure that reviews are completed and that balances that are not needed are identified and deobligated in a timely manner. This process should include a requirement that those officials responsible for reviewing the balances actually certify the continued need for the unexpended balances associated with Section 8 project-based contracts and that the Office of the Chief Financial Officer provide sufficient oversight to determine the adequacy of the reviews conducted.

GAO also recommends that the Secretary require the Chief Financial Officer and the Office of Housing to ensure that HUD's future funding requests for the Section 8 project-based program fully take into account the availability of unexpended balances that may be used to offset funding needs. To accomplish this goal, the Department would need to establish controls to ensure that the data used in any supporting analyses are complete, current, and accurate; that available funding is fully reflected in

[3]These contracts are not the same 1,800 contracts that had been erroneously excluded from an earlier analysis.

these analyses; and that sufficient checks are performed to ensure that the analyses produced are reliable. In addition, the Department should improve the methodology used to estimate future expenditure rates for Section 8 project-based contracts.

Agency Comments and GAO's Evaluation

GAO provided a draft copy of this report to HUD for its review and comment. In commenting on the draft, HUD agreed with the data presented in the report and with the recommendations. However, HUD disagreed with the way in which GAO presented the results of the three analyses of Section 8 project-based funding needs. More specifically, HUD believed that the report's presentation would be strengthened if instead of emphasizing one of the analyses, GAO presented the results of the three analyses dated April 1998 in a consolidated table and did more to explain the risks associated with each analysis. HUD also emphasized that it believes that estimates of Section 8 project-based amendment needs are very sensitive to inflation rates and that estimates of amendment shortfalls and recaptures should be expressed as a range of estimates that reflects alternative assumptions about inflation.

GAO agrees with HUD that estimates of long-term amendment needs are sensitive to assumptions about inflation. In fact, the report clearly states that HUD's long-term amendment needs could increase substantially if inflation rates prove to be higher than currently estimated. However, GAO believes that its presentation of the three analyses of Section 8 project-based funding needs is appropriate. The report gives more emphasis to one analysis because it is based on legislatively mandated limits on rent increases for certain properties and the Office of Management and Budget's economic assumptions for the fiscal year 1999 budget. In contrast, the other two analyses of long-term amendment needs that HUD prepared do not reflect the legislatively mandated limits and thus tend to overstate the increases in Section 8 assistance that many properties would receive under current law. The report does recognize, however, that HUD views the three analyses as a potential range of needs for amendment funding. HUD's comments and GAO's evaluation of them are discussed in more detail in chapter 3 and appendix II.

Contents

Abbreviations

BFS	Budget Forecast System
CFO	Chief Financial Officer
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
OIG	Office of Inspector General
OMB	Office of Management and Budget
PAS	Program Accounting System
TRACS	Tenant Rental Assistance Certification System VA

Introduction

Section 8 rental housing assistance, managed by the Department of Housing and Urban Development (HUD), is the main form of federal housing assistance for low-income tenants. In fiscal year 1997, it had expenditures totaling $16.4 billion. Under the Section 8 program, residents in subsidized units generally pay 30 percent of their income for rent and HUD pays the balance. The Section 8 program provides rental assistance tied to specific property units (project-based assistance) and to families and individuals who live in affordable rental housing of their choice, as long as the units meet HUD's rent and quality standards (tenant-based assistance). According to HUD data, in fiscal year 1997, the tenant-based and project-based programs each served approximately 1.4 million households. This report focuses on issues concerning the project-based rental assistance program, including the project-based assistance associated with housing for the elderly and disabled.[1]

HUD has estimated a growing need for Section 8 project-based funding over the next 5 years to cover the costs of renewing expiring Section 8 rental assistance contracts and of providing additional funding to existing Section 8 contracts that lack sufficient funds to cover payments for the full term of the contracts. As a result, the Congress has become increasingly concerned that HUD have effective systems in place to identify unexpended Section 8 funds that can be used to offset future funding needs.

History of the Section 8 Program

The Section 8 housing assistance program, named for the revised section 8 of the U.S. Housing Act of 1937, was originally established by the Housing and Community Development Act of 1974 (P.L. 93-383). Section 8 rental assistance is generally limited to families whose incomes are at or below 50 percent of the area's median income and to rental units that meet HUD or local standards for decent, safe, and sanitary housing. In the project-based program, assistance is tied to specific housing units under an assistance contract, rather than to the families themselves, and is therefore referred to as "project based." HUD generally contracts directly with, and provides rental subsidies to, the owners of private rental housing; in some cases, HUD contracts with state finance agencies that are responsible for administering the rental assistance program for low-income residents. Typically, the initial contracts were for 15, 20, or 40 years.

[1]For information on the tenant-based program, see our report entitled Section 8 Tenant-Based Housing Assistance: Opportunities to Improve HUD's Financial Management (GAO/RCED-98-47, Feb. 20, 1998). A third report will address the Section 8 moderate rehabilitation program.

In recent years, the Congress has generally preferred to provide new Section 8 rental assistance in the form of tenant-based assistance. However, the Congress continues to provide funding to renew existing Section 8 project-based contracts as they expire and to amend contracts with insufficient funding to meet their contract terms. The Congress also continues to provide new project-based assistance for properties funded under the Section 202 housing for the elderly program and the Section 811 housing for the disabled capital advance program. According to HUD, about 24,000 active Section 8 project-based contracts covered about 1.4 million property units as of September 30, 1997. These contracts are associated with four main programs and several smaller programs.

Four Main Section 8 Project-Based Programs

The four principal project-based programs are the (1) New Construction/Substantial Rehabilitation Program, (2) Elderly/Disabled Program, (3) Loan Management Set Aside Program, and (4) Property Disposition Program. These programs are described below.

- New Construction/Substantial Rehabilitation Program. The purpose of this program was to encourage developers to build or rehabilitate projects for lower-income families by providing rental assistance contracts for a negotiated number of units in a project for periods ranging from 15 to 40 years. The program was established in 1974 and repealed by the Congress in 1983 because of its high cost. Thus, funding for new project-based rental assistance contracts associated with newly constructed or rehabilitated properties was discontinued in 1983, except for new contracts associated with housing for the elderly and disabled.
- Elderly/Disabled Program. Since fiscal year 1992, HUD's programs for the elderly and disabled have provided property development funding to sponsors of low-income housing through capital advances and project-based rental assistance contracts. The sponsors do not have to repay the advances as long as they continue to meet HUD's requirements for keeping rents affordable. Thus, the rental assistance contracts need to subsidize only operating costs because no mortgages are associated with the properties. The contracts under the current program are not funded under the same appropriations account as the Section 8 rental assistance program, but the project-based assistance under these programs is substantially the same as Section 8 project-based assistance, except that the subsidy is limited to operating costs. HUD includes these contracts in its inventory of Section 8 project-based contracts. New contracts currently being issued for project-based assistance for properties for the elderly and

disabled are generally issued for 5- or 20-year terms, depending upon when the project was initially approved.

- Loan Management Set Aside Program. This program was developed to provide Section 8 rental assistance to financially troubled projects. Section 8 contracts under this program were initially for 15-year terms. These contracts began expiring during the 1990s and required renewal funding. No new loan management set aside Section 8 contracts have been issued since fiscal year 1994.
- Multifamily Property Disposition Program. The purpose of this program is to facilitate the sale or transfer to new owners those properties acquired through foreclosures on defaulted loans insured by the Federal Housing Administration. Legislation enacted in 1988 required HUD to preserve some of the units in these properties as affordable housing for low- to moderate-income households. HUD satisfied this requirement by providing project-based rental assistance under 15-year Section 8 contracts with the new owners. In 1995, HUD stopped entering into new project-based contracts for property disposition and began using Section 8 vouchers and certificates under the tenant-based program instead. However, some new project-based contracts with 15-year terms will be executed in the future as a result of a demonstration program that HUD implemented in 1994 to test the feasibility of tenant ownership options at foreclosed properties.

Smaller Section 8 Project-Based Programs

Other Section 8 programs include the (1) housing preservation program, (2) project-based tenant protection program, and (3) community investment demonstration program, also referred to as the pension program. These programs are described below.

- Housing Preservation Program. From 1987 to 1996, HUD issued project-based rental assistance contracts under the housing preservation program. The Congress established the program to avoid displacing lower-income households and losing affordable housing stock. These consequences were anticipated as the owners of federally insured properties, developed during the 1960s and 1970s, were approaching eligibility to pay off their mortgages. Once they have paid off the mortgages, owners do not have to meet existing operating restrictions, such as limits on residents' income levels and the rents that could be charged. HUD provided project-based rental assistance as one of the incentives for owners to continue low-income restrictions. The Congress discontinued the use of this incentive to reduce excessive program costs by 1997 and terminated the preservation program in its entirety in fiscal year 1998.

- Project-Based Tenant Protection Program. This program provides vouchers or certificates to eligible households who face displacement or rent increases for various reasons, such as the owners' opting out of the Section 8 project-based program or HUD's terminating the project-based assistance because owners failed to comply with housing quality standards. Under this program, HUD's Office of Housing receives appropriations but transfers the funding over to HUD's Office of Public and Indian Housing, which provides the tenant-based assistance.
- Community Investment Demonstration Program. This program, referred to as the pension fund program, was created by the Congress in 1993 to demonstrate how the leveraging of HUD's resources can encourage pension funds to invest in the production and preservation of affordable housing. Six participating pension funds make or purchase uninsured loans to finance the construction or rehabilitation of multifamily rental housing for lower-income families. To reduce the risks incurred by the pension funds, HUD uses Section 8 project-based funds, limited to 120 percent of the local fair market rent under contracts of up to 15 years.

HUD's Funding Requests for Section 8 Project-Based Contracts

HUD receives funding (budget authority) for the project-based program primarily to pay for contract renewals as well as for contract amendments to fund contracts that do not have sufficient funds to make payments for the full term of the contract.[2] The original long-term contracts that were entered into in the 1970s and 1980s began expiring in the early 1990s. The Congress and HUD have worked together to fund renewals for all of these contracts. Renewals are now funded for 1 year.

While some contracts have more funding than is needed because expenditures have been less than anticipated, other contracts are underfunded and need contract amendments to provide funding for the full term. This need arises when the initial funding was not sufficient to provide adequate rental assistance over the life of the contract. In 1996, the Congress revised the Section 8 program to permit HUD to transfer any remaining budget authority from expired or terminated Section 8 project-based assistance contracts to other housing assistance contracts. Prior to this change, HUD's authority to use recaptured budget authority from expired or terminated contracts had to be treated in accordance with the terms of the annual appropriations acts.

[2]Budget authority is the authority provided by law to enter into financial obligations that will result in immediate or future outlays involving federal government funds. In this report, we use the term "funding" to mean budget authority.

Because an increasing number of Section 8 project-based contracts are coming due for renewal and because of the need to provide amendment funding to existing contracts, HUD has estimated a growing need for budget authority. Specifically, as shown in table 1.1, HUD received $2.4 billion for Section 8 project-based funding in fiscal year 1997 and estimates this need will grow to $6.8 billion in fiscal year 2003.[3] The future outlays associated with the program are estimated to remain relatively constant, ranging from $8.6 billion in fiscal year 1999 to $8.8 billion in 2003.[4]

Table 1.1: Estimated Budget Authority and Total Outlays for the Section 8 Project-Based Rental Assistance Program Contract Renewals and Amendments, Fiscal Years 1997 Through 2003

Dollars in billions

Fiscal year	Budget authority	Outlays
1997 (actual)	$2.4	$8.4
1998 (actual)	3.8	8.5
1999	4.1	8.6
2000	4.7	9.0
2001	5.4	8.9
2002	6.1	8.8
2003	6.8	8.8

Note: Amounts include the project-based funding associated with properties for the elderly and disabled that is included in HUD's fiscal year 1999 budget request under the HOME Investment Partnerships Program.

HUD's Budget Office was unable to provide the funding and outlay data associated with the Section 8 project-based rental assistance program prior to fiscal year 1997. According to an official in that office, such information could not be provided because the appropriations for the tenant-based and project-based programs are provided in one lump sum, and the Department has not tracked the two programs separately. Furthermore, until fiscal year 1998, HUD did not separately track new appropriations and carryover balances from prior years.

[3]These estimates include the project-based assistance for properties for the elderly and disabled. In the fiscal year 1999 budget request, this funding is requested under the HOME Investment Partnerships Program.

[4]Outlays are federal expenditures (payments to liquidate obligations).

HUD Is Centralizing Its Section 8 Financial Management

The Section 8 tenant-based program and the moderate rehabilitation program are managed by the Office of Public and Indian Housing, and the project-based program is managed by the Office of Housing. However, as part of the implementation of the Department's 2020 Plan,[5] HUD is currently in the process of establishing a Section 8 Financial Management Center that will centralize the management of the Section 8 programs under the Office of Public and Indian Housing. The center, located in Kansas City, Missouri, will serve as the focal point for the administrative services necessary to support all Section 8 contracts, including both tenant-based and project-based contracts.

Under the plan, contract management responsibilities for most Section 8 project-based contracts would be handled in the same manner as they currently are for the tenant-based program—that is, contract management responsibilities would be delegated to state and local public housing or housing finance agencies that will administer the contracts on behalf of HUD. Currently, most project-based contracts are in the form of housing assistance payment contracts that are administered by HUD personnel. These contracts are to be converted into annual contributions contracts administered by a public housing agency or a housing finance agency. HUD says that state housing agencies currently administering Section 8 tenant-based programs would be offered an opportunity to administer an annual contributions contract for all the remaining project-based contracts in the state if they have the administrative capacity to do so. While the plan initially estimated converting 95 percent of the project-based contracts to annual contributions contracts by the end of fiscal year 1998, HUD officials now expect to complete the conversion by the end of fiscal year 1999.

Objectives, Scope, and Methodology

This report was prepared to comply with the requirements of the 1997 Emergency Supplemental Appropriations Act (P.L. 105-18, June 12, 1997), which requested that GAO study HUD's systems for budgeting and accounting for Section 8 rental assistance funds to determine whether HUD's systems ensure that unexpended Section 8 funds do not reach unreasonable levels and that obligations are spent in a timely manner. This report examines the Section 8 project-based assistance program, particularly (1) the categories and amounts of unexpended rental

[5]In June 1997, HUD issued the "HUD 2020 Management Reform Plan" to address its management weaknesses, including those that contributed to GAO's designation of HUD as a high-risk area because of long-standing departmentwide management deficiencies—weak internal controls, inadequate information and financial management systems, an ineffective organizational structure, and an insufficient mix of staff with the proper skills.

assistance funds and (2) the effectiveness of HUD's processes to evaluate unexpended Section 8 project-based balances, ensure they do not reach unreasonable levels and are spent in a timely manner, and take unexpended balances into account when determining funding needs as part of HUD's budget process. In addition, chapter 1 of the report provides HUD's estimate of future funding trends for the Section 8 project-based program for fiscal years 1999 through 2003.

To identify unexpended Section 8 project-based balances, we obtained information on the balances as of September 30, 1997, from HUD's Program Accounting System (PAS), which HUD reported as being in compliance with the Federal Manager's Financial Integrity Act. We reviewed the PAS documentation to confirm that we were provided with complete information. We did not perform a reliability assessment of these data. However, HUD's Office of the Inspector General has examined funding and expenditure data as part of its financial statement audit for fiscal years 1996 and 1997 and has not identified data errors that were material to HUD's financial statements. In addition, HUD's Office of the Chief Financial Officer has retained a contractor to evaluate the documentation supporting the PAS data (as well as the Tenant Rental Assistance Certification System (TRACS) data discussed below) to determine its reliability. The contractor's review is based on a random sample of 100 Section 8 project-based contracts. As of June 1998, the review was still under way. We also reviewed budget allotment and apportionment data as of September 30, 1997, and data for the first quarter of fiscal year 1998 to ensure that we had included all relevant unexpended balances. The balances include those for project-based rental assistance contracts for housing for the elderly and disabled, which are included in HUD's inventory of Section 8 contracts.

To evaluate the unexpended Section 8 project-based balances and to ensure they do not reach unreasonable levels, we analyzed HUD's data to identify the balances associated with contracts that had expired on or before September 30, 1996, and with those contracts with future expiration dates but no expenditures from March through September 1997. The latter category will include contracts that have been terminated. In addition, we obtained information from Office of Housing officials at headquarters and field office locations concerning the status of unexpended balances associated with the elderly/disabled, property disposition, and pension fund programs because of issues associated with these programs, such as program changes that affect the need for existing funds. Additionally, we examined HUD's reports on the status of funds on inactive projects (also referred to as aging reports) and other documentation provided by the Office of the Chief Financial Officer to analyze selected inactive, expired, and pending contracts. However, we did not conduct a systematic analysis of all of HUD's Section 8 project-based unexpended balances to identify funds that were no longer needed.

To examine the effectiveness of HUD's procedures to evaluate unexpended Section 8 project-based balances to ensure they do not reach unreasonable levels and are spent in a timely manner, we reviewed and analyzed HUD's annual certification process for Section 8 project-based balances and reviewed HUD's Budget Forecast System (BFS) model, which the Department uses to estimate Section 8 amendment needs for budgeting purposes, as well as various analyses produced by the model. For the certification process, we reviewed HUD's handbook and other relevant documents, including memorandums and various accounting reports. We interviewed HUD officials at headquarters and six field offices (located in Chicago, Illinois; Dallas and Fort Worth, Texas; Denver, Colorado; New York, New York; and Seattle, Washington). In addition, we reviewed reports by HUD's Office of the Inspector General, as well as the supporting workpapers, on the 1997 year-end certification process and discussed the report's findings with officials in the Office of the Inspector General.

To examine the effectiveness of HUD's processes to take unexpended balances into account when determining funding needs as part of its budget process, we evaluated HUD's BFS model. We met with HUD and contractor officials to obtain information on the purpose of the model, its methodology, and the analyses produced. We obtained the supporting data files and examined the model's input and output to determine if the model was working as intended. The funding estimates produced by the model are in nominal dollars, not adjusted for inflation. We reviewed five different analyses and worked with HUD throughout the review to correct the errors in data and methodology that we identified. We also reviewed HUD's fiscal year 1999 budget request for amendment funding for the Section 8 project-based program. This request was supported by an April 1997 BFS analysis. Because our review focused on the unexpended balances for the existing portfolio of project-based rental assistance contracts, we did not examine HUD's budget request for Section 8 contract renewals. We also did not assess how HUD's Section 8 Financial Management Center would oversee unexpended balances for Section 8 project-based contracts, such as how the annual reviews of unexpended balances will be conducted, because this aspect of the Center's operations was in the early planning stage at the time of our review.

To provide information on funding trends in the Section 8 project-based rental assistance program, we requested historical data from HUD on the budget authority and outlays associated with the program. However, HUD could provide this information only for fiscal years 1997 and 1998, along with the amounts in the fiscal year 1999 budget for fiscal years 1999 through 2003.

We provided a draft copy of this report to HUD for its review and comment. HUD provided written comments on the draft, and these comments are presented and evaluated in chapter 3 and appendix II. We conducted our work from August 1997 through June 1998 in accordance with generally accepted government auditing standards.

Unexpended Section 8 Balances Totaled More Than $59 Billion

As of September 30, 1997, HUD had available about $59.1 billion in unexpended Section 8 project-based funds.[1] About $55.4 billion of the unexpended balances was obligated to about 31,000 Section 8 contracts. HUD also had about $3.7 billion in unobligated Section 8 project-based balances. These balances consisted of about $3 billion reserved for specific contracts but not yet obligated and about $.7 billion in unreserved funds that carried over into fiscal year 1998.

While we did not conduct a comprehensive analysis of all of HUD's unexpended balances for Section 8 project-based rental assistance, we identified about $517 million that is no longer needed because the contracts expired, were terminated, or were never executed. In addition, we identified other balances for which the continued need is questionable, such as $79 million that HUD has assigned to the property disposition program, even though the Department discontinued the use of project-based assistance for the program in 1995 and instead uses tenant-based assistance.

Unexpended Funds Fall Into Three Categories

We identified three categories of Section 8 unexpended balances, which we used to analyze the status of existing funding balances as of September 30, 1997. Broadly stated, the funds are (1) obligated to specific Section 8 contracts, (2) reserved for specific Section 8 contracts, or (3) totally unobligated.[2]

The first category, called "undisbursed obligations," is the amount of funds obligated to the Section 8 contracts but not yet disbursed. This category includes balances for both active and inactive Section 8 contracts. HUD's Office of the Chief Financial Officer also uses the term "undisbursed contracts" to describe this category of funds.

In the second category, referred to as "unobligated but reserved," HUD has funding that has been reserved for specific Section 8 contracts but has not yet been obligated to them. This category includes Section 8 funding for properties for which Section 8 contracts have not yet been executed, such as properties that are still being planned or are under development or

[1]The unexpended balances for the Section 8 project-based program were provided by (1) contract authority with permanent indefinite appropriations for contracts executed before fiscal year 1988 and (2) annually appropriated funds that remain available for obligation for an indefinite period of time (no-year funds) covering the full cost over the term of the contract for contracts executed after fiscal year 1987.

[2]HUD's practice is to reserve funds when the property associated with the contract is approved for development and to obligate the funds to the contract when the property is ready for occupancy.

construction. It also includes reservations associated with active and inactive contracts that have already had funds obligated to them. HUD uses the terms "uncontracted reservations" and "unobligated reservations" to describe this category of funding.

The third category, "unobligated and unreserved" funds, is the amount of budget authority that HUD has received for Section 8 project-based programs but has not yet reserved or obligated for specific contracts. HUD refers to this funding as "unassigned allotments" and "unreserved assignments." These amounts are also referred to as carryover funds at the end of the year because they become available for reservations and obligations in the next fiscal year.

Fund Balances as of September 30, 1997, Were Over $59 Billion

As of September 30, 1997, HUD had available about $59.1 billion in unexpended Section 8 project-based funds. Table 2.1 presents the $59.1 billion in the three funding categories and associates the funds with the Section 8 project-based programs. About $55.4 billion of the funding represents undisbursed obligations; about $3 billion represents funds that are unobligated but reserved; and about $.7 billion represents unobligated and unreserved funds.

Table 2.1: Section 8 Project-Based Unexpended Balances by Program and Fund Category, as of September 30, 1997

Dollars in billions

	Fund balance categories			
Section 8 program	**Undisbursed obligations**	**Unobligated but reserved**	**Unobligated and unreserved**	**Total**
New construction/ substantial rehabilitation loans				
Family	$32.7	$.7	$.1	$33.6
Elderly and disabled	12.5	.1	0	12.6
Subtotal	**$45.2**	**$.8**	**$.1**	**$46.2**
Loan management set aside (LMSA)	**4.1**	**.5**	**.1**	**$4.7**
Elderly and disabled capital advances	**2.5**	**1.3**	**0**	**$3.9**
Property disposition	**2.5**	**.2**	**.1**	**$2.8**
Other	**1.0**	**.2**	**.3**	**$1.5**
Total	**$55.4**	**$3.0**	**$.7**	**$59.1**

Notes: Some totals do not add due to rounding.

HUD includes Section 8 housing assistance payment contracts for properties serving the elderly and the disabled under two programs: the Section 202 direct loan program, which is under the new construction/substantial rehabilitation program, and a newer program, the Sections 202/811 elderly and disabled capital advance program, which provides capital advances in lieu of loans. The contracts for the newer program are substantially the same as Section 8 rental assistance and are provided under a project rental assistance contract. These contracts are included in HUD's analysis of its long-term Section 8 project-based funding needs for contract amendments, discussed in ch. 3.

Undisbursed Obligations Accounted for Most Unexpended Funds

As shown in table 2.1, undisbursed obligations constituted the largest segment of unexpended Section 8 project-based balances as of September 30, 1997. About $55.4 billion, or 94 percent of the total unexpended fund balance of $59.1 billion, is associated with about 31,000 Section 8 contracts.[3] About $32.7 billion (59 percent) of the $55.4 billion was allocated to contracts supporting rents at family properties developed under the new construction/substantial rehabilitation program. HUD programs serving the elderly and disabled under the new construction/substantial rehabilitation loan program ($12.5 billion) and the elderly and disabled capital advance program ($2.5 billion) command the second largest portion of HUD funds, about $15 billion in total. The loan management set aside program accounted for about $4.1 billion (7

[3]The balances are associated with active as well as expired contracts that remain in HUD's accounting records. According to HUD, about 24,000 of the contracts are active.

percent) in unexpended balances, while about $2.5 billion (5 percent) in funds were associated with properties covered through property disposition programs. The remaining $1 billion (2 percent) was for other programs, such as the housing preservation, pension fund, and tenant protection programs.

While most of the undisbursed obligations are needed to fulfill HUD's Section 8 funding commitments over the remaining life of each contract, funding in excess of contractual needs has accumulated in some cases. Specifically, for 1,085 contracts that expired on or before September 30, 1996, we identified about $345 million in undisbursed obligations as of September 30, 1997. About 900 of these contracts, with balances totaling about $218 million, expired during 1994 or earlier. These balances generally remained because rental assistance payments were lower than HUD anticipated when the contracts were funded. As discussed in the next section, unobligated but reserved balances of $60 million are also associated with expired contracts, bringing the total balance of funding remaining on contracts that expired on or before September 30, 1996, to $405 million.

Additionally, we identified 440 contracts, with $503 million in undisbursed obligations, that had future expiration dates but no disbursements during the last 6 months of fiscal year 1997. While the lack of expenditures may occur in active contracts that do not bill regularly or do not currently require a subsidy, it can also occur in contracts that have been terminated for various reasons. According to our examination of a 1997 HUD field review of existing contracts, at least $77 million was associated with contracts that were no longer in effect. Specifically, for 304 of the 440 contracts without recent expenditures,[4] HUD field offices indicated that 77 of these contracts had been terminated for various reasons. The other 227 contracts were designated as either active, pending, or suspended. Included in the active category were 104 contracts with property owners serving the elderly or disabled, with about $100 million in Section 8 balances, that were not disbursing funds at all because the owners had not requested rental assistance payments. According to Office of Housing officials, in some cases a project's costs are low enough to be supported by residents' incomes without the need for the HUD subsidy. They also noted that contracts may go through periods when owners either do not file for reimbursement or submit claims that are lower than the projected annual requirements for rental assistance.

[4]HUD did not have recent information on the remaining 136 contracts without recent expenditures.

Finally, a substantial number of other contracts are likely to have unexpended balances remaining when the contracts expire. For these contracts, the actual subsidies required are less than those HUD anticipated as being needed when funds were obligated to the contract. In chapter 3, we discuss HUD's efforts to identify such balances and to compare them with the amounts needed to fund current contracts that lack sufficient funding to cover payments for the full term of the contracts.

Unobligated but Reserved Balances Totaled About $3 Billion

Approximately $3 billion of the $59.1 billion in unexpended balances fell into the category of unobligated but reserved funds. HUD has reserved most of these funds for future contracts associated with (1) the elderly and disabled capital advance programs, (2) renewals and amendments of existing Section 8 contracts, (3) property disposition programs, and (4) other programs such as the pension fund program. While we did not analyze all of these balances in detail, we did identify some cases in which unneeded funds have accumulated, such as $60 million associated with expired contracts and about $35 million associated with contracts that HUD never executed for various reasons, such as the property's not being constructed.[5]

The elderly and disabled capital advance programs accounted for about $1.3 billion of the $3 billion in unobligated but reserved funding as of September 30, 1997. In all, about 1,100 Section 8 contracts, which will be for 5 or 20 years, depending upon when HUD reserved the funds, had not yet been executed. According to Office of Housing officials, considerable time usually elapses between the date funds are reserved for an approved project and the date that property is ready for occupancy. HUD officials said that in some cases it has taken 7 or more years to complete planning, development, and construction—at which point the Section 8 contract is executed.

In addition, about $1 billion for renewing and amending existing Section 8 contracts was included in the unobligated but reserved balances as of September 30, 1997. Approximately $753 million of the total was from HUD's 1997 appropriations, while the remainder, about $248 million, was appropriated for fiscal year 1996 or prior years. The $1 billion was reserved for contracts under the new construction/substantial rehabilitation ($417 million), loan management set aside ($408 million), elderly and disabled capital advances ($131 million), and property

[5]The balances associated with contracts that were not executed represent $6.4 million under the property disposition program and $29 million under other programs.

disposition ($37 million) programs. (These funding amounts are not shown separately in table 2.1 but are included in the overall fund totals for each of the Section 8 programs.)

In addition to the $37 million for the renewals and amendments of existing property disposition contracts, HUD's property disposition programs had another $163 million in reserved funds available on September 30, 1997—for a total of approximately $200 million. About $77 million of this total was reserved for a 1994 HUD demonstration program in which a state housing finance agency agreed to administer the disposition of 11 foreclosed properties. The program requires that tenant groups receive preference in purchasing the properties. HUD expects to execute the 15-year contracts under this program within 2 years.

Another $53 million in unobligated but reserved funds in the property disposition program was for 16 unexecuted contracts having funding reservation dates as far back as 1984. In the three cases we examined, totaling $6.4 million, HUD either could not identify the property or told us that the new owners decided not to participate in the Section 8 program. For example, HUD records showed that a field office had reserved about $4.6 million for a Section 8 contract in 1985 but never executed the contract because of a change in disposition plans. At another office, property disposition staff reserved about $1.4 million in August 1994 for a HUD-owned property it planned to transfer to a unit of city government. However, by August 1996, the purchaser had decided to demolish the property instead of accepting the Section 8 contract. In another case, HUD officials informed us that they could not identify a specific property associated with a 1991 reservation of $423,000 that we questioned. In all of these situations, HUD officials stated that the funds should have been released.

In the category of "other" programs, HUD had about $170 million in unobligated but reserved funds. The largest portion of this amount, about $123 million, was for the pension fund program, which the Congress authorized in 1993 to test the feasibility of becoming partners with large pension funds in the purchase, rehabilitation, and construction of affordable housing. HUD agreed to subsidize these properties through 15-year Section 8 contracts, with rents limited to 120 percent of an area's fair market rent.[6] As of April 1998, six participating pension funds had submitted applications for the renovation of 42 properties. HUD has

[6]HUD establishes fair market rents annually for geographic areas and uses them as limits for the rents that it can subsidize under its Section 8 rental assistance programs.

approved 24 of the proposals, and work had been completed on 15. By the end of fiscal year 1998, HUD expects that as many as 30 properties, consisting of about 3,300 units, will be financed by participating pension funds. HUD has developed a preliminary proposal for the repeal of this program; however, we were told that such action would not affect the completion of projects currently in the pipeline.

In addition to the unobligated but reserved fund balances for future Section 8 contracts, many existing contracts that have already been executed have unobligated but reserved balances remaining. Our analysis of these balances showed that some are not needed. For instance, 271 Section 8 contracts that had expired on or before September 30, 1996, had about $60 million in unobligated but reserved balances remaining. We also found cases in which HUD continued to record Section 8 reservations as valid in its accounting records even though the Section 8 contracts were never executed. For example, we examined two reservations, made in 1980 and 1990, that totaled $29 million. The $20 million reservation recorded in 1980 had no further activity reflected in HUD's accounting records. The cognizant field office confirmed that this reservation should have been removed from the accounting records. The reservation had been associated with a property that was planned under the new construction/substantial rehabilitation program, but the commitment for the property was never made. Similarly, we found a $9 million reservation, recorded in 1990, that was associated with a property for the elderly and disabled that the cognizant field office reported it could not identify. Funds for both of these properties remained reserved as of September 30, 1997.

In addition, we found that HUD had reserved approximately $25 million of Section 8 project-based funding during the last week of fiscal year 1997 for 82 contracts previously executed under the housing preservation program. However, on the basis of HUD's own projections of contract expenditure rates through contract expiration, it is questionable whether most of these contracts need the additional funds.

Unobligated and Unreserved Balances Are Available in Fiscal Year 1998

As of September 30, 1997, HUD's Section 8 project-based balances included about $.7 billion in unobligated and unreserved funds that it carried into fiscal year 1998. Most of the funds were associated with the renewals of expiring contracts, amendments for underfunded contracts, and funds for the disposition of foreclosed multifamily properties.

Approximately $510 million of the unobligated and unreserved fund balance included funds for renewing and amending Section 8 project-based contracts. About $246 million of this total was from funds appropriated in fiscal year 1996 or earlier. An Office of Housing official informed us that the carryover funds are needed to fund expirations and amendments that occur during the first quarter of the fiscal year because the Office of Housing does not usually receive its fiscal year apportionments until December—or about 2 months into the fiscal year.

Also included in the unobligated and unreserved balance was about $79 million for the disposition of failed HUD properties. An Office of Housing official informed us that it did not have an immediate need for these project-based disposition funds and had carried them over into fiscal year 1998. As discussed previously, since 1995, HUD has discontinued the use of project-based assistance for property disposition and uses tenant-based assistance instead. An official overseeing HUD's property disposition programs said these unobligated balances had stayed with the program in case HUD ever goes back to using Section 8 project-based assistance for its disposition efforts.

We also found that the Office of Housing had unobligated and unreserved funds of about $52 million carried into fiscal year 1998 for the project-based tenant protection program.[7] According to HUD's budget director for the Office of Housing, fiscal year 1997 program activity, such as Section 8 contract terminations resulting from HUD's enforcement actions or owners opting out of the Section 8 program, was slower than anticipated. The director indicated that the funding that was unobligated and unreserved at the end of fiscal year 1997 remains available to meet increasing tenant displacement needs that may materialize.

In chapter 3, we discuss HUD's efforts to identify unexpended balances that can be recaptured and used to help meet its future needs for Section 8 project-based funding. We also compare HUD's estimates of Section 8 project-based amendment needs with the amount of existing Section 8 project-based funding that may be used to meet those needs.

[7]About $38 million in tenant protection funding transferred to the Office of Public and Indian Housing in fiscal year 1997 was also unobligated and unreserved at the end of the fiscal year, bringing the total carryover for this program to about $90 million.

HUD's Processes for Evaluating and Using Unexpended Balances Are Not Effective

HUD uses two processes to evaluate unexpended Section 8 project-based balances to ensure that the balances do not reach unreasonable levels, are spent in a timely manner, and are taken into account in HUD's budget process. These processes are its annual review of unexpended balances (unliquidated obligations) and the HUD Budget Forecast System (BFS) model, which is used to estimate Section 8 amendment needs for budgeting purposes. We identified weaknesses in both of these processes. For example, some HUD offices did not conduct the annual reviews of unexpended balances, and some funds that were identified as being no longer needed were not deobligated. We also found that errors in the analyses derived from the BFS model resulted in HUD's substantially underestimating the amount of unexpended balances that are available for recapture. More recent HUD analyses, which correct most of the problems we found in the BFS model and update information to reflect more current economic assumptions, indicate that at the end of fiscal year 1998, the Department will have about $1.5 billion in funding that could be used to meet fiscal year 1999 needs. Furthermore, these analyses do not reflect an additional $1.5 billion in funding that could be used by HUD to meet its fiscal year 1999 needs for contract amendments.

Annual Review of Unexpended Balances Is Limited by Weaknesses

HUD's procedures for identifying and deobligating funds that are no longer needed to meet its contractual obligations do not ensure that all Section 8 project-based balances are evaluated each year and that excess balances are identified and deobligated in a timely manner. For example, we found that some offices did not perform annual reviews of unexpended balances, and some funds that were identified as no longer needed were not deobligated. These weaknesses stem from a number of factors, including limited oversight of the process by HUD's Office of the Chief Financial Officer.

HUD's Annual Process to Review Unexpended Balances

Each year, the status of HUD's unexpended balances are to be examined under a review process the Department refers to as the annual review of unliquidated obligations.[1] According to HUD's handbook on incurring, recording, and adjusting obligations, the purpose of the review is to determine whether the recorded obligations should be continued, reduced, or canceled. According to HUD's Acting Assistant Chief Financial Officer for Accounting, the annual review covering Section 8 project-based balances focuses on identifying those balances associated with contracts

[1]HUD's annual review process is carried out pursuant to 31 U.S.C. 1554. The law requires all federal agencies to certify annually to the Department of the Treasury as to the accuracy of the amount of its obligated balances outstanding as of Sept. 30.

that are no longer active, such as balances remaining on expired or terminated contracts.

The review process is based on balances as of June 30 and is to be completed by August 31. For decentralized programs such as the Section 8 project-based rental assistance program, the reviews are conducted by HUD's program offices. The program office for the Section 8 project-based program is the Office of Housing. The reviews are coordinated by HUD's field accounting divisions and conducted by Office of Housing staff at the various field office locations. The annual review process is to occur in four major steps.[2]

First, HUD's field accounting divisions provide a listing of all Section 8 project-based contracts with unexpended balances that have had no financial activity for 6 or more months to the responsible Office of Housing directors at the various field office locations.

Second, Office of Housing officials are to have the balances examined and report the results of their reviews to the field accounting division. These reports should specify whether each contract is (1) active, (2) completed and cancellation action has been initiated, or (3) completed and cancellation action will be initiated. For contracts for which funds are to be canceled, the Office of Housing is to provide the appropriate documentation to the field accounting division so that the remaining balances may be deobligated.

Third, the field accounting divisions are to compile the results of all of the reviews and send a certification statement to HUD's Office of the Chief Financial Officer (CFO). The certifications are to state that the program offices were notified, in writing, of the obligations that had no financial activity for 6 months or more, and that responses were obtained from the program offices indicating whether the obligations were valid—that is, whether the balances were still needed or should be deobligated. We note that HUD's guidance on performing the review of unliquidated obligations does not specifically define a valid obligation. However, the guidance for this review implies that a valid obligation represents one associated with an active contract. Thus, invalid obligations are those obligations

[2]As discussed in ch. 1, HUD is in the process of consolidating its management of the Section 8 tenant-based and project-based programs in a Section 8 Financial Management Center. It is not clear how the annual review of unexpended balances associated with Section 8 project-based balances will be conducted for fiscal year 1998. The center's annual review process is directed at annual contributions contracts. As discussed in ch. 1, HUD estimates that most of the project-based contracts will be converted to this type of contract by the end of fiscal year 1999.

associated with expired or terminated contracts. While the guidance states that the review should determine whether to continue, reduce, or cancel obligations, it does not directly address whether active contracts should be reduced if the unexpended balances are greater than projected needs. HUD's Acting Assistant Chief Financial Officer for Accounting indicated that this type of analysis is optional.

The certification is also to indicate, as appropriate, that efforts were made to obtain responses from program offices when no response was received within the requested time frame and attempts were made to obtain the documentation needed to deobligate unneeded obligations. The certification is also to state that the documentation of the review is available for future internal control review and audits.[3]

Finally, primarily on the basis of these and other certifications covering HUD's other programs and activities, the Office of the CFO is to certify to the Department of the Treasury that the obligation balances in each of the agency's appropriation accounts reflect proper existing obligations.

The Annual Review Process Has Weaknesses

We found a number of weaknesses in HUD's annual process for identifying and deobligating Section 8 project-based funds that are no longer needed, including (1) some offices not completing the reviews and (2) funds identified for deobligation not being deobligated. These weaknesses stem from a number of factors, including limited oversight of the reviews conducted by the program offices. As a result of the weaknesses in the review process, the balances associated with expired or terminated contracts have remained in the accounting records for years after contracts have expired or been terminated.

In Some Cases, the Annual Review Is Not Conducted or Is Incomplete

In examining the annual process for field offices under the jurisdiction of HUD's Midwest, Southwest, and Northwest/Alaska locations, we found that in some cases the required annual reviews were not conducted by the field offices responsible for reviewing Section 8 project-based balances.[4] In other cases, the reviews were incomplete. For example, the Southwest

[3]HUD's handbook on incurring, recording, and adjusting obligations includes an additional statement that the assistance of the Assistant Secretary for Administration or the Director, Office of the Regional Administrator, as appropriate, was requested in cases where responses and/or documentation could not be obtained from the field or program office. A certification of this nature was not used in fiscal year 1997.

[4]At the time of the annual review for fiscal year 1997, these offices were responsible for 26 of HUD's 79 field offices. Of the 26 offices, 22 had project-based contracts to oversee. HUD has subsequently reorganized its headquarters and field office structure.

location, which included 10 field offices with responsibility for Section 8 project-based assistance, did not complete the reviews at all in 1997. The director of the New York field accounting division, who is responsible for the Section 8 project-based balances managed by the Southwest offices, did not disseminate the unexpended balances report because of his heavy workload.

Similarly, 3 weeks after the certification statements were due to the Office of the CFO, we found that the unexpended balances reports had not been distributed to the Northwest/Alaska field offices for review because of an oversight. As a result of our September 1997 request for documentation of the reviews, however, the field accounting director had the reports distributed to the location's three field offices with responsibility for Section 8 project-based contracts. As a result, the Seattle field office identified $3 million in Section 8 project-based funds that were no longer needed.[5] We noted that while the certification letter by the director of the field accounting division for the Northwest/Alaska offices indicates that, as of September 16, 1997, some of the reviews were not yet completed, the letter from the director of the New York field accounting division does not indicate that the reports were not distributed and thus the reviews not performed. This certification letter only states—incorrectly—that appropriate HUD officials and employees had been notified of unliquidated obligations that needed to be liquidated or deobligated.

HUD's Office of the Inspector General (OIG) also found shortcomings in the review process at the two field accounting divisions it examined in 1997 as part of its annual financial statement audit of the Department. In that audit, the OIG reviewed the Department's year-end certification process for the Denver and Chicago field accounting divisions. The OIG was to determine whether the various program office directors at these locations responded to the field accounting directors with the results of their reviews of unexpended balances. The OIG found that two multifamily housing directors did not respond at all and that one multifamily housing director provided an incomplete response.

Funds Identified as No Longer Needed Are Not Always Deobligated

The review process does not always result in the deobligation of funds identified as no longer needed for specific Section 8 project-based contracts. For example, in 1993, the Dallas field office identified about $17 million in balances associated with expired or terminated contracts and prepared the necessary documentation to deobligate the funds.

[5]We did not examine the subsequent reviews conducted by the other two Northwest/Alaska field offices with responsibility for Section 8 project-based contracts.

However, according to the housing management specialist responsible for the review, the balances were never deobligated because HUD staff in headquarters instructed the field office to wait until it determined whether the funds could be reprogrammed for future Section 8 program needs. In April 1996, the Congress provided HUD with authority to reuse these funds. As of September 30, 1997, however, these balances were still in HUD's accounting records. For example, for properties in Texas alone, we found that as of September 30, 1997, there were 132 expired Section 8 project-based contracts with about $45 million in balances.[6] Many of these contracts expired in the early 1990s. The New York field accounting division director also told us that Office of Housing staff have not been deobligating funds for expired contracts for a number of years because HUD headquarters has had plans to recapture these funds centrally. According to the budget director of the Office of Housing, these plans will be initiated beginning in June 1998.

During its fiscal year 1997 financial statement audit, the OIG also found that funds identified for deobligation had not been processed. Specifically, the OIG found that during the annual review process for fiscal year 1997, HUD's Chicago Housing Office identified nearly $34 million in Section 8 project-based funds associated with expired or closed contracts that were no longer needed. However, according to the OIG's audit summary of this review, the Housing Office provided the field accounting division director with a listing of the balances that needed to be deobligated but not with the required documentation to deobligate the funds. The field accounting division's deputy director informed the OIG that the program person responsible for completing the task had been reassigned to another area in HUD, and the deobligation documents were not prepared before the reassignment. Without the documents, the field accounting division could not deobligate the $34 million in HUD's accounting systems. The OIG reported this deficiency to HUD in its May 21, 1998, management letter for the fiscal year 1997 financial statement audit. The OIG recommended, among other things, that the field accounting divisions ensure that all funds to be deobligated at year end are in fact deobligated.

Adequacy of Program Offices' Reviews Is Not Examined

Weaknesses in the annual certification processes are also due in part to the fact that the Office of the CFO and the field accounting divisions provide limited oversight of the annual review process. The Office of the CFO relies upon the certifications received from the directors of the field accounting divisions in order to certify to the Department of the Treasury

[6]These balances are included in the balances of $405 million associated with expired contracts that we identified in ch. 2.

that all obligations at the end of the fiscal year are proper existing obligations. However, we found that the certifications relied upon do not express an opinion on the continued need for the balances and that HUD does not require the program officials who actually perform the annual reviews to certify that the balances are needed.

The directors only certify that program offices were asked to perform the reviews and that they received responses from the program offices indicating that the obligations were still valid or should be deobligated. According to HUD's Acting Assistant Chief Financial Officer for Accounting, who provided HUD's certification to the Department of the Treasury for fiscal year 1997, the responsibility for certifying the balances actually rests with the program offices, such as the Office of Housing, and not the field accounting divisions. However, HUD's handbook does not require that the program officials performing the reviews provide certifications on the continued need for the unexpended balances.

Nevertheless, we found that some program officials were asked by the director of their respective field accounting division to provide certifications on the continued need for the balances. For example, the Midwest field accounting director requests such certifications from Housing Office officials, although some of the respondents did not provide them. However, not all accounting division directors require certifications. For example, the memorandum from the director of the Rocky Mountain field accounting division to program directors initiating the review for fiscal year 1997 did not request a certification from the program offices. The field accounting director acknowledged that he did not specifically ask program offices for the certification, although in his view the memorandum did imply that program directors should certify that the balances are accurate. According to the director, some offices did provide a written certification even though his memorandum did not directly ask them do so.

We also found that the certifications provided to the CFO by the directors of field accounting divisions generally used the standard certification letter provided in HUD's review guidance. As such, the certifications did not identify which offices were covered by the certification and, most importantly, which of these offices had not completed the reviews. Thus, under this system, the Office of the CFO is unaware of deficiencies in the review process at the field accounting division and/or the program office level. For example, the Office of the CFO was not aware of the offices that had not completed the review. Specifically, the Office was not aware of the

New York field accounting division's failure to request the Southwest location—which covered 10 offices with Section 8 project-based responsibilities—to perform the fiscal year 1997 review. Nor was it aware of existing balances, such as the $20 million reservation made in 1980 for a project that was subsequently canceled but was still in HUD's accounts as of September 30, 1997.

While the primary responsibility for the reviews appropriately rests with the program offices, some oversight over the manner in which the field accounting divisions and the program offices conduct their reviews is appropriate given the reliance on their work by the Office of the CFO. According to the Director, Office of Financial Policy and Procedures, Office of the Assistant Chief Financial Officer for Systems, the Office of the CFO does not review any documentation supporting the reviews and certifications. Furthermore, the Acting Assistant Chief Financial Officer for Accounting said it would not be appropriate to have accounting staff (field accounting divisions) evaluate programmatic decisions, such as whether to deobligate funds for specific contracts, because accounting staff do not have the necessary background to make such determinations.

At a minimum, the CFO's confirmation that the reviews have been completed and that the funds identified for deobligation have been deobligated would improve accountability. HUD also does not identify certain balances—such as those associated with expired contracts—and require the program offices to justify keeping the funds. For example, as discussed in chapter 2, we found about $517 million that is no longer needed because the contracts had expired, were terminated, or were never executed.

HUD Does Not Effectively Identify and Use Unexpended Balances in Its Budget Process

HUD does not have effective processes in place to take unexpended balances into account when determining its needs for Section 8 project-based funding as part of its budget process. Specifically, HUD's Budget Forecast System (BFS) model, used to estimate Section 8 amendment needs for budgeting purposes, has not provided reliable information, in part because basic quality checks on the data used in the analyses were not performed. As a result, the Department requested substantially more funding than is needed for contract amendments in its fiscal year 1999 budget request. More specifically, HUD requested $1.3 billion for contract amendments in fiscal year 1999, whereas more recent HUD analyses, which correct most of the problems we found in the BFS model and update information to reflect more current economic assumptions, indicate that at the end of fiscal year 1998, the Department will have about $1.5 billion in funding that could be used to meet fiscal year 1999 needs. Furthermore, these analyses do not reflect an additional $1.5 billion in funding that could be used by HUD to meet its contract amendment needs for fiscal year 1999.

Amendment Funding Needs and Overview of the BFS Model

Each year, the Department receives funding to amend Section 8 project-based contracts that have insufficient funding. However, while some contracts do not have sufficient funding, others have more funding than is needed. HUD refers to the amount of funds remaining in such contracts at expiration as recaptures—that is, HUD can recapture and use these funds for other Section 8 contracts.[7] Until the fiscal year 1999 budget, HUD had not factored the use of recaptures into its budget requests to offset the estimated needs for amendment funding. According to the budget director for the Office of Housing, recaptures were not factored into earlier budget requests because of data limitations that existed before HUD was able to use computerized data from the Section 8 Tenant Rental Assistance Certification System (TRACS).

To estimate its amendment funding needs for fiscal year 1999, HUD added a new analysis to its BFS model. HUD contractor staff maintain and operate the BFS model. For each active Section 8 project-based contract, the BFS model compares projected expenditures over the life of the contract, adjusted for inflation, with funding that is currently available and estimates whether each contract has a funding shortfall or excess funding that can be recaptured. The model includes two categories of funding: undisbursed obligations and unobligated but reserved funds. The BFS model provides estimates, by year, of the projected shortfall amounts and of the recaptures associated with expiring contracts. The current analysis is carried through 2035, at which point HUD data indicate that all contracts in the portfolio as of September 30, 1997, will have expired.[8]

HUD incorporates a methodology referred to as "leveling" into the analysis. In this methodology, HUD spreads estimated funding shortfalls over the remaining term of the contract rather than beginning in the year the contract is projected to run out of funds. For example, for a contract costing $1 million a year with 10 years remaining and $9 million available,

[7]As noted in ch. 1, in 1996, the Congress gave HUD the authority to use recapture balances from expiring or terminated project-based contracts to meet its Section 8 funding needs.

[8]According to HUD data, most Section 8 project-based contracts expire by 2023. HUD's database includes only eight contracts in effect after 2023.

the $1 million shortfall would be spread out in $100,000 increments over the next 10 years, rather than being identified as a shortfall of $1 million in the tenth year. According to HUD officials, this approach enables HUD to request a consistent annual amount to fund amendments and to avoid requesting large amounts in later years. Thus, the amounts identified as shortfalls each year will include shortfalls that will actually occur in future years.

HUD's Fiscal Year 1999 Budget Request to Amend Section 8 Project-Based Contracts Is Based on Inaccurate Analyses

According to HUD's fiscal year 1999 budget request, the total amount of funding needed to amend Section 8 project-based contracts for fiscal year 1999 is $1.7 billion. HUD's request also shows that this amount can be reduced by over $463 million from recaptures from expiring contracts, to a net funding need of $1.3 billion. According to HUD, the budget request was supported by an April 1997 BFS analysis. As shown in table 3.1, the funding need (shortfall amount) for fiscal year 1999 was projected to be about $1,162.8 million; this shortfall could be reduced by $540.1 million in recaptures.[9] HUD and the Office of Management and Budget (OMB) added $500 million more to the fiscal year 1999 budget request above the funding shortfall identified in the analysis for 1999. According to HUD officials, this funding was added because of the long-term funding need for amendments. The April 1997 analysis showed a long-term net funding shortfall for amendments through the year 2023 of $18.9 billion, based on funding shortfalls of $24 billion and recaptures of $5.3 billion. Table 3.1 provides excerpts from the April 1997 BFS analysis covering fiscal years 1998 through 2003 and for 2023 when all contracts were projected to be expired.[10]

[9]HUD did not offset its fiscal year 1999 budget request by the full amount of recaptures identified ($540.1 million). As stated above, the 1999 budget reflected $463 million in recaptures.

[10]As discussed earlier, later analyses indicate that some active contracts will not expire until 2035.

Table 3.1: April 1997 BFS Report on Section 8 Project-Based Shortfalls and Recaptures, Fiscal Years 1998-2003, and 2023.

Dollars in millions

Fiscal year	Shortfall amount	Recapture amount	Net funding need[a]
1998	$1,165.7	$0	$1,165.7
1999	1,162.8	(540.1)	$622.7
2000	1,160.4	(621.6)	$538.8
2001	1,150.9	(580.2)	$570.8
2002	1,131.1	(453.8)	$677.2
2003	1,115.9	(591.5)	$524.4
Total through 2023	**$24,192.5**	**($5,331.7)**	**$18,861.0**

[a]Net funding need equals shortfalls minus recaptures.

We found a number of errors in the analyses produced by the BFS model that resulted in the shortfall estimates being overstated and the recapture amounts understated. We could not review the April 1997 analysis, which was based on fiscal year 1996 data and was used to support the fiscal year 1999 budget request, because HUD could not provide us with the supporting data files. However, we reviewed five different analyses from September 1997 through May 1998. These analyses were based on data through fiscal year 1997, whereas the April 1997 analysis was based on fiscal year 1996 data. We reviewed the data supporting these analyses, identified errors and methodological issues with each one, and worked with Office of Housing officials to have the errors and methodology issues corrected.[11] The budget director for the Office of Housing said that the errors we found in the updated analyses would also occur in the April 1997 analysis. Among the errors we found with the analyses we reviewed were the following:

- A total of about $1.4 billion in Section 8 project-based funding provided to the contracts in fiscal year 1997 was not included in the analyses because the contractor was not told to update the BFS model to pick up funding data from new appropriation accounts for the program. HUD corrected this error after we informed officials of the problem in January 1998.
- Active contracts were excluded from several of the analyses because of either inaccurate expiration dates in HUD's database of Section 8 contracts

[11]As discussed in ch. 1, we did not conduct a reliability assessment of the Section 8 funding data used in the analysis. However, HUD's OIG has examined funding and expenditure data as part of its financial statement audit for fiscal years 1996 and 1997 and has not identified data errors that were material to HUD's financial statements. In addition, HUD's CFO has retained a contractor to evaluate the financial and contract data used by the BFS model. This review was ongoing as of June 1998.

or computer programming errors.[12] For example, about 1,000 active contracts were excluded from an analysis on the basis of incorrect expiration dates, and 1,800 active contracts were excluded because of a programming error.

- HUD applied an inflation factor to 1997 data in error. HUD made this error because updating the data to fiscal year 1997 required eliminating the inflation factor that was applicable to the earlier analysis, dated April 1997, which was based on fiscal year 1996 data. However, the 1997 inflation factor was not eliminated from the analyses based on 1997 data until we identified the error.
- The methodology used to project future contract expenditures, referred to as the burn rate, does not accurately estimate expenditures for some contracts. The BFS model treats contract expenditures as a monthly expenditure, whereas the payments for a number of the contracts (generally those contracts managed by public housing entities, referred to as annual contributions contracts) actually reflect expenditures for either 3, 6, or 12 months, depending on the terms of the contracts. In addition, the methodology excludes some active contracts that did not receive any payments during the 6 months included in the analysis. HUD officials emphasized to us that the methodology would overstate some needs and understate others. However, the Department has not examined the overall impact of this methodology on the estimates. Our analysis of the expenditure rates indicates this problem tends to overstate expenditures to some degree. HUD officials have agreed that the methodology should be corrected. The Office of the CFO has developed a methodology for estimating Section 8 contract expenditures that links expenditure data with the time period covered by the expenditure, which appears to provide a more accurate estimate for the contracts that do not bill monthly. However, this methodology is not used in the BFS model.

In addition, in response to our questions about the basis for the inflation factors and about the legislatively mandated limits on Section 8 project-based rent increases, HUD updated the analyses to include more current economic assumptions and to reflect the legislatively mandated

[12]HUD uses the expiration dates in its TRACS Section 8 database for its BFS Section 8 project-based analyses. However, the expiration dates for many contracts that expired in fiscal year 1997—but which were renewed by 1-year contract extensions—were incorrect. To work around this data problem, HUD revised its BFS model to treat contracts with fiscal year 1997 expirations that were making rental assistance payments as active for 1 additional year.

limits.[13] Specifically, the analyses provided to us through February 1998 reflected OMB's economic assumptions (inflation factors) for the fiscal year 1998 budget. The subsequent analyses, provided in April 1998, reflect OMB's economic assumptions for the fiscal year 1999 budget, and included an analysis that used assumptions reflecting the legislatively mandated limits on rent increases.

While the errors we identified had various causes, most of them resulted from HUD's not having adequate controls in place to ensure that the data and assumptions used in the BFS model were complete, accurate, and current, and that the data were fully reflected in the analyses produced by the model. For example, we identified a number of errors by performing basic data quality checks. Specifically, we examined the contracts excluded from the analyses to determine if any active contracts were being excluded incorrectly; we matched input to output to determine if all relevant shortfalls and recaptures were included in output; and we matched Section 8 project-based funding data from HUD's Program Accounting System (PAS) with the funding included in the BFS analysis to determine if all funding was included in the analyses. These quality checks were not performed by the HUD contractor nor requested by HUD officials when the contractor provided them with various analyses. In addition, Office of Housing officials did not always ensure that the contractor had all the information it needed to perform the analysis, such as information on all relevant appropriation accounts that include Section 8 project-based funding.

Revised Analysis Shows Lower Shortfalls and Higher Recaptures

In April 1998, HUD provided a revised analysis that reflected the lower inflation factors OMB established for the fiscal year 1999 budget as well as the legislatively mandated limits on rent increases for certain contracts. As shown in table 3.2, this analysis estimates significantly lower shortfalls, higher recaptures, and lower net funding needs in the short term as well as the long term compared with the prior analyses—including the April 1997 analysis presented in table 3.1. Specifically, the current analysis estimates total shortfalls of $13 billion, recaptures of $11.5 billion, and a net funding need of $1.5 billion, compared with the shortfalls of $24 billion, recaptures

[13]The Balanced Budget Act of 1997 (P.L. 105-33, Aug. 1997) made permanent the limits on rent increases for the categories of Section 8 project-based contracts that were required by recent annual appropriations laws. The limits pertain to contracts that receive rent increases in the form of annual adjustment factors. Specifically, new construction and substantial rehabilitation Section 8 contracts generally may not receive rent increases if the Section 8 contract rents are higher than HUD's fair market rents. In addition, the annual adjustment factor is to be reduced by 1 percent for all Section 8 project-based units in which there has been no change in occupancy (except that the factor is not to be reduced to less than 1 percent).

of $5.3 billion, and net funding needs of $18.8 billion reflected in the April 1997 analysis used to support the fiscal year 1999 budget request.[14]

Table 3.2: April 1998 Budget Forecast System Report on Section 8 Project-Based Shortfalls and Recaptures Using OMB's Fiscal Year 1999 Economic Assumptions and Incorporating Limits on Future Rent Increases.

Dollars in millions

Fiscal year	Shortfall amount	Recapture amount	Net funding need[a]
1998	$1,130.2	($2,705.4)	($1,575.2)
1999	978.4	(971.7)	$6.6
2000	861.5	(899.8)	($38.3)
2001	768.4	(903.0)	($134.7)
2002	712.4	(710.0)	$2.4
2003	678.7	(928.0)	($249.3)
Total through 2035	**$13,021.5**	**($11,474.3)**	**$1,547.2**

Notes: OMB's inflation factors are 1.9 percent for fiscal year 1998; 2 percent for fiscal years 1999 and 2000; 2.1 percent for fiscal year 2001; and 2.2 percent for fiscal years 2002-35. The inflation factors increase future expenditures, reflecting Section 8 increases at the inflation level. The legislatively mandated limits on rent increases reduce these inflation factors for most contracts.

HUD uses different assumptions regarding future rent increases covering six categories of contracts, depending on how the contracts receive rent increases and the ratio between the contract rents and HUD's Fair Market Rents. (HUD's assumptions are summarized in app. I.)

[a]Net funding need equals shortfalls minus recaptures. Numbers in parenthesis indicate that recaptures exceed shortfalls. As discussed below, this analysis excludes about 1,800 contracts with recaptures in excess of shortfalls. If these active contracts were included, net funding needs would be reduced from about $1.5 billion to about $1.3 billion.

Furthermore, regarding the short-term funding needs, the April 1998 analysis indicates that the amount of recaptured funds that could be applied toward HUD's fiscal year 1999 amendment needs is substantially higher than HUD estimated in its budget request. As shown in table 3.2, the analysis indicates that contracts expiring in fiscal year 1998 are estimated to have over $2.7 billion in recaptures and that contracts expiring in fiscal year 1999 will have close to $1 billion in recaptures. As discussed earlier, HUD's budget request indicated that $463 million in recaptures were available to help offset fiscal year 1999 amendment needs.

[14]Because HUD could not provide the data supporting the April 1997 analysis, we could not determine the relative impact of the various factors that resulted in the significantly lower estimates in April 1998. In addition to the types of data errors discussed above, other factors that affect the results include assumptions on inflation rates and rent increases and older (1996) data. We discuss the importance of inflation factors and the legislatively mandated limits on rent increases on HUD's analyses in the next sections.

Testifying in March 1998,[15] we pointed out that updated HUD analyses indicated that recaptures were likely to be much higher than HUD had indicated in its budget request. Accordingly, we stated that the Congress may wish to consider reducing HUD's fiscal year 1999 request for funding to amend Section 8 project-based contracts.

While HUD's April 1998 analysis reflects a substantial improvement over earlier estimates, it does not present a complete and accurate picture of Section 8 project-based needs because it (1) does not reflect all of the Section 8 project-based funding the Department has available for funding shortfalls and (2) still contains some errors. Specifically, the analysis does not reflect about $1.5 billion that could be used to offset HUD's fiscal year 1999 request for amendment funding. This total includes the following amounts:

- $833 million in project-based amendment funding that, according to the budget director for the Office of Housing, was appropriated to the Department for fiscal year 1998, including amounts associated with properties funded under the capital advance program for the elderly and disabled;
- $133 million of Section 8 project-based amendment funds that were unobligated and unreserved at the end of fiscal year 1997 and were carried over for use in 1998;
- $517 million in project-based funding that we identified in chapter 2 as being no longer needed.

These funds would nearly offset the net funding needs through 2035, as shown in table 3.2.[16]

In terms of errors, this analysis again excludes about 1,800 active contracts, which would further reduce funding shortfalls.[17] Our analysis indicates that if these contracts were included, the total long-term funding need would be reduced by approximately $200 million.[18] These contracts were excluded because (1) the contractor made an error by accidently

[15]Housing and Urban Development: Comments on HUD's Fiscal Year 1999 Budget Request (GAO/T-RCED-98-137, Mar. 25, 1998).

[16]The analyses will also not reflect any requested new funding. For example, the net funding needs would be reduced to the extent that the fiscal year 1999 budget request of $1.3 billion for amendments is provided.

[17]These contracts are not the same 1,800 that had been erroneously excluded from an earlier analysis.

[18]This estimate does not take into account the effect of the rent limitations mandated in the Balanced Budget Act of 1997 (P.L. 105-33, Aug. 1997).

excluding 400 of the contracts and (2) the Office of Housing provided a file of contracts to be used in the analysis that excluded 1,400 active contracts. In addition, this analysis continues to use the methodology for estimating expenditures that tends to overstate expenditures.

HUD's Sensitivity Analyses Illustrate the Effects of Different Assumptions

According to HUD's Chief Financial Officer, Budget Director, and other HUD staff, the April 1998 estimate of $1.5 billion in net funding needs for Section 8 contract amendments (in table 3.2) could understate actual needs because the inflation rate is low (about 2 percent) and the analysis assumes limits on rent increases for many properties. That is, the net funding needs produced by BFS analyses vary depending upon the assumptions about future inflation rates and the limits on future rent increases. To illustrate how changes in these assumptions can affect estimates of amendment needs, HUD prepared two sensitivity analyses.

The first sensitivity analysis is based on the same inflation factors as the analysis presented in table 3.2 (ranging from 1.9 to 2.2 percent), but this analysis does not include assumptions incorporating legislatively mandated limits on rent increases. This analysis projects amendment funding shortfalls for Section 8 project-based assistance of about $18 billion, recaptures of about $10.6 billion, and net funding needs of about $7.5 billion through 2035. Table 3.3 presents the results of this analysis.

Table 3.3: April 1998 BFS Report on Section 8 Project-Based Shortfalls and Recaptures Using OMB's Fiscal Year 1999 Economic Assumptions and Excluding Limits on Future Rent Increases.

Dollars in millions

Fiscal year	Shortfall amount	Recapture amount	Net funding need[a]
1998	$1,172.9	($2,714.4)	($1,541.5)
1999	1,073.2	(980.3)	$98.2
2000	1,008.7	(962.3)	$46.4
2001	967.0	(871.1)	$95.9
2002	938.4	(675.9)	$262.5
2003	924.4	(840.1)	$84.2
Total through 2035	**$18,071.7**	**($10,619.4)**	**$7,452.3**

[a]Net funding need equals shortfalls minus recaptures. Numbers in parenthesis indicate that recaptures exceed shortfalls.

The second sensitivity analysis assumed that the inflation rate for each year was 3.2 percent and also excluded the impact of limits on rent increases.[19] As shown in table 3.4, this analysis projects shortfalls of $24 billion, recaptures of $9.7 billion, and net funding needs of $14.2 billion through 2035.

Table 3.4: April 1998 BFS Report on Section 8 Project-Based Shortfalls and Recaptures Using a 3.2-Percent Inflation Factor and Excluding Limits on Future Rent Increases.

Dollars in millions

Fiscal year	Shortfall amount	Recapture amount	Net funding need[a]
1998	$1,218.9	($2,702.0)	($1,483.1)
1999	1,156.5	(969.1)	$187.4
2000	1,122.8	(942.9)	$179.9
2001	1,105.6	(837.8)	$267.8
2002	1,095.6	(638.3)	$457.3
2003	1,099.1	(768.0)	$331.1
Total through 2035	**$23,936.9**	**($9,705.2)**	**$14,231.7**

[a]Net funding need equals shortfalls minus recaptures. Numbers in parenthesis indicate that recaptures exceed shortfalls.

HUD officials view the estimates shown in table 3.2 and the sensitivity analyses shown in tables 3.3 and 3.4 as a range of potential amendment funding needs. However, it is important to note that both sensitivity analyses exclude the effect of the legislatively mandated limits on future rent increases—that is, they assume that the limits are repealed and that the inflation estimates apply to all Section 8 contracts. At this time, we are not aware of any major legislative efforts to repeal the limits on rent increases. As shown in table 3.2, the legislatively mandated limits substantially lower the estimate of long-term amendment needs.

Conclusions

HUD's policies and procedures for identifying and deobligating funds that are no longer needed do not ensure that all Section 8 project-based balances are evaluated each year and that balances that are no longer needed for specific Section 8 project-based contracts are identified and deobligated in a timely manner. The current review process does not provide HUD with adequate assurance that the reviews are being conducted properly and that identified funds are being deobligated. Assurance is inadequate because HUD does not adequately oversee the review process conducted by program offices and because the program officials who are responsible for reviewing the balances are not required to certify that the unexpended balances associated with the Section 8 project-based

[19]HUD did not provide an analysis using an inflation factor of 3.2 percent that includes the legislatively mandated limits on future rent increases.

contracts continue to be needed. As we discussed in chapter 2, we identified about $517 million in funding that was still reflected in HUD's accounting system as of September 30, 1997, and that was no longer needed because the contracts expired, were terminated, or were never executed. If such funding had been identified by HUD, it could have been used to help offset the Department's need for Section 8 amendment funding.

In addition, the Department has requested more funding for Section 8 contract amendments than needed because it does not have effective processes in place to take unexpended balances into account when determining funding needs as part of its budget process. While HUD uses a model to perform such analysis, we found a number of errors in the analysis it used for formulating its fiscal year 1999 budget request. These errors included active contracts being excluded, all available funding not being fully reflected, and weaknesses in the methodology used to estimate expenditure rates. These errors stemmed from the Department's not ensuring that the data used in the model were complete, accurate, and current and that sufficient quality checks were performed either by HUD or contractor staff to ensure that the analyses were reliable. While HUD and contractor staff took actions to correct most of the problems that we identified during our review, it is important that HUD have effective controls in place to ensure that these problems do not recur in future analyses. In addition, HUD has yet to correct problems with the methodology used by the BFS model to estimate future expenditure rates.

Recommendations

To improve the Department's oversight of Section 8 project-based balances, we recommend that the Secretary of Housing and Urban Development require the Chief Financial Officer to revise the procedures used in the Department's annual review of unexpended balances to ensure that reviews are completed and that balances that are not needed are identified and deobligated in a timely manner. This process should include a requirement that those officials responsible for reviewing the balances actually certify the continued need for the unexpended balances associated with Section 8 project-based contracts and that the Office of the Chief Financial Officer provide sufficient oversight to determine the adequacy of the reviews conducted.

We also recommend that the Secretary require the Chief Financial Officer and the Office of Housing to ensure that HUD's future funding requests for the Section 8 project-based program fully take into account the availability of unexpended balances that may be used to offset funding needs. To accomplish this goal, the Department would need to establish controls to ensure that the data used in any supporting analyses are complete, accurate, and current; that available funding is fully reflected; and that sufficient checks are performed to ensure that the analyses produced are reliable. In addition, the Department should improve the methodology used to estimate future expenditure rates for Section 8 project-based contracts.

Agency Comments and Our Evaluation

We provided a draft copy of this report to HUD for its review and comment. In commenting on the draft, HUD agreed with the data presented in the report and with the recommendations. However, HUD disagreed with the way in which we presented the results of three analyses of Section 8 project-based funding needs. HUD believed that the report's presentation would have been strengthened if instead of emphasizing one of the analyses, we presented the results of the three analyses dated April 1998 in a consolidated table and did more to explain the risks associated with each analysis. In this regard, HUD stated that our report highlights a HUD-prepared analysis that uses the low inflation assumptions for the 1999 budget and essentially "freezes" much of the expenditures on Section 8 contracts at current rates for long periods. HUD stated that a more realistic assumption is that rents and incomes will increase in the future (notwithstanding current law limiting certain rent increases) and these increases will result in a growing drain on the obligated balances on those contracts. HUD also emphasized that it believes that estimates of Section 8 project-based amendment needs are very sensitive to inflation rates and that estimates of amendment shortfalls and recaptures should be expressed as a range, based on alternative inflation assumptions.

We agree with HUD that estimates of long-term amendment needs are sensitive to assumptions regarding inflation. In fact, the report clearly states that HUD's long-term amendment needs could increase substantially if inflation rates prove to be higher than currently estimated. However, we believe that our presentation of the three analyses of Section 8 project-based funding needs is appropriate. The report gives more emphasis to one analysis because that analysis is based on legislatively mandated limits on rent increases for certain properties and OMB's economic assumptions for the fiscal year 1999 budget. In contrast, the other two analyses of long-term amendment needs that HUD prepared do not reflect the legislatively mandated limits on rent increases and thus tend to overstate the increases in Section 8 assistance that many properties would receive under current law. Accordingly, we do not agree with HUD's assertion that these analyses reflect more realistic assumptions concerning Section 8 project-based amendment needs. Our report does recognize, however, that HUD views the three analyses as a potential range of amendment funding needs.

HUD also stated that the report leads to a conclusion that remaining balances can be diverted out of the project-based inventory with no long-range consequences. Instead, HUD states that each dollar taken from the inventory will have to be replaced with budget authority at some point in the future. Our report does not conclude that remaining balances can be diverted from the program. However, we do not agree that HUD is in a position to conclude that each dollar taken from Section 8 project-based amendment funding would necessarily have to be replaced at some point in the future. Before a reliable conclusion on the long-term funding needs of the Section 8 project-based program can be made, HUD needs to implement our recommendation to improve the methodology used to estimate future expenditure rates for the Section 8 project-based contracts because the methodology currently used may substantially overstate expenditure rates. In addition, HUD needs to establish controls to ensure that the data used in its analyses are complete, current, and accurate. Once these actions are completed, we believe the Department will be in a better position to reach reliable conclusions concerning its short- and long-term funding needs. (The complete text of HUD's comments are provided in app. II.)

HUD's Methodology for Incorporating Limits on Rent Increases Into Its Budget Forecast System Model

In the Balanced Budget Act of 1997 (P.L. 105-33, Aug. 1997), the Congress made permanent the limits on rent increases for those categories of Section 8 project-based contracts that had been included in recent annual appropriations laws. The limits pertain to contracts that process rent increases through the Department of Housing and Urban Development's (HUD) annual adjustment factors—that is, the contract rents are increased each year by these factors. The limits generally do not permit rent increases for new construction and substantial rehabilitation Section 8 contracts if the contract rents are higher than HUD's fair market rents. In addition, the annual adjustment factor is to be reduced by 1 percent for all Section 8 project-based units in which there has been no change in occupancy (except that the factor is not to be reduced to less than 1 percent).

HUD's April 8, 1998, analysis of Section 8 project-based amendment needs discussed in chapter 3 incorporates assumptions to reflect the legislatively mandated limits into the Budget Forecast System (BFS) model. To accomplish this, HUD divided the Section 8 contracts into six categories, depending on the type of amendment funding received and the ratio of contract rents to fair market rents. HUD developed inflation rates for each of the categories to use in the BFS model to project contract expenditures until expiration. The inflation rates for the Section 8 contracts that have budget-based rents are not reduced because the limits are not applicable to these contracts. The inflation factors used for such contracts reflect the economic assumptions the Office of Management and Budget used in the fiscal year 1999 budget. However, for contracts that receive increases with annual adjustment factors, the inflation rates are reduced as shown in table I.1.

Table I.1: HUD's Methodology Incorporating Contract Rent Limits Into Its BFS Model

Amendment type	Ratio of contract rent to fair market rent	Inflation rates
Budget-based contracts	Not applicable	1.9 percent for 1998 2.0 percent for 1999 2.1 percent for 2000 2.2 percent for 2001 and thereafter
Annual adjustment factor	Contract rents are below fair market rents (allowed to have rent increases, but increases are reduced when occupancy does not change)	1.0 percent for 1998 1.1 percent for 1999 1.2 percent for 2000 1.3 percent for 2001 and thereafter
Annual adjustment factor	100 percent to 120 percent of fair market rents	0 percent for first 5 years, 1.3 percent thereafter
Annual adjustment factor	121 percent to 140 percent of fair market rents	0 percent for first10 years, 1.3 percent thereafter
Annual adjustment factor	141 percent to 160 percent of fair market rents	0 percent for first 15 years, 1.3 percent thereafter
Annual adjustment factor	Above 160 percent of fair market rents	0 percent for all years

Comments From the Department of Housing and Urban Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

U. S. Department of Housing and Urban Development
Washington, D.C. 20410–0100

JUL 1 1998

OFFICE OF THE CHIEF FINANCIAL OFFICER

Ms. Judy England-Joseph
Director
Housing and Community
Development Issues
General Accounting Office
441 G Street, NW, Room 2T23
Washington, DC 20548

Dear Ms. England-Joseph:

On behalf of Secretary Cuomo, thank you for the opportunity to review and comment on the draft of your proposed report to the Congress entitled Section 8 Project-Based Housing Assistance: HUD's Processes for Evaluating and Using Unexpended Balances are Ineffective, GAO/RCED-98-202. Department staff from the Offices of the Chief Financial Officer and Housing have had an opportunity to read the draft document, and the comments provided reflect these collective reviews.

1. We agree with the data presented in the report, but not always with the emphasis in the associated text. For example, we believe the presentation could have been strengthened significantly by: (a) organizing the key comparative data which HUD provided in a consolidated table; and (b) better emphasizing the risks associated with the various scenarios. The report highlights a HUD-prepared Annual Adjustment Factor Freeze analysis which uses the low 1999 Budget inflation assumptions and essentially "freezes" much of the burn on these contracts at current rates for long periods. The report leaves the impression that Section 8 rents and tenant incomes will change very little from current levels and that this assumption is the most conservative estimate for shaping public policy with respect to remaining balances. It leads to a conclusion that remaining balances can be diverted out of the project-based inventory with no long-range consequences. This is not so. Rather, each dollar used now will have to be replaced dollar for dollar with discretionary Budget Authority at some point in the future. A more realistic assumption is that rents and incomes will increase in the future (notwithstanding current law limiting certain rent increases), and this will result in a growing drain on the obligated balances on these contracts. HUD believes that amendment estimates are very sensitive to inflation rates and that amendment shortfall and recapture estimates should be

See comment 1.

See comment 2.

See comment 1.

See comment 3.

See comments 1 and 3.

expressed as a range, based on alternative inflation assumptions. There is no one right estimate for amendment requirement needs over the 1998-2035 budget horizon. A consolidated table with a better discussion of risks and assumptions would have much better served the reader.

2. We agree with the recommendation to revise our procedures to annually review the unexpended balances of the Section 8 project-based balances and to insure that funding requests for the Section 8 project-based program take into account the availability of unexpended balances.

3. We agree with the second recommendation, but we need to insure that such balances are not needed for any program shortfall in the "out" years. It is important to recognize that future year projections can vary significantly and are sensitive to inflation, legislative changes, and assumptions regarding rents and tenant income. To that end, it would be helpful to the reader if Tables 3.2, 3.3, and 3.4, as presented in the report, be consolidated into one table. With appropriate foot-notes, one then could more easily discern that the range of net funding needs over the life of the contracts varies from $1.5 billion to $14.2 billion, depending upon several alternative assumptions.

Thank you for discussing your reports' findings and conclusions in the closeout conference.

Sincerely,

Richard F. Keevey
Chief Financial Officer

GAO Comments

1. We believe that our presentation of HUD's analyses of Section 8 project-based funding needs is appropriate. The report gives more emphasis to one analysis because that analysis is based on the legislatively mandated limits on rent increases for certain properties and the Office of Management and Budget's economic assumptions for the fiscal year 1999 budget. In contrast, the other two analyses of long-term amendment needs that HUD prepared do not reflect the legislatively mandated limits and thus tend to overstate the increases in Section 8 assistance that many properties would receive under current law. Accordingly, we do not agree with HUD's assertion that these analyses reflect more realistic assumptions concerning amendment needs for the Section 8 project-based program.

2. Our report does not conclude that remaining balances can be diverted from the program. However, we do not agree that HUD is in a position to conclude that each dollar taken from Section 8 project-based amendment funding would necessarily have to be replaced at some point in the future. Before a reliable conclusion on the long-term funding needs of the Section 8 project-based program can be made, HUD needs to implement our recommendation to improve the methodology used to estimate future expenditure rates for the Section 8 project-based contracts because the methodology currently used may substantially overstate expenditure rates. In addition, HUD needs to establish controls to ensure that the data used in its analyses are complete, current, and accurate. Once these actions are completed, we believe the Department will be in a better position to reach reliable conclusions concerning its short- and long-term funding needs.

3. We agree with HUD that estimates of long-term amendment needs are sensitive to assumptions regarding inflation. In fact, the report clearly states that HUD's long-term amendment needs could increase substantially if inflation rates prove to be higher than currently estimated. In addition, our report does recognize that HUD views the three analyses as a potential range of amendment funding needs.

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