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FEDERALLY ASSISTED HOUSING

Expanding HUD's Options for Dealing with Physically Distressed Properties

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to follow up on our earlier testimony on the Department of Housing and Urban Development's (HUD) Section 8 project-based assisted housing programs.[1] Under these programs, HUD pays a portion of the rent for low-income families living in privately owned rental housing. HUD provides this assistance for over 20,000 privately owned properties nationwide at an estimated annual cost of $5.8 billion. The mortgages for about 10,000 of these properties are also insured or held by HUD.

Although many of these properties are considered to be in good physical condition, our previous testimony focused on assisted properties where low-income families are living in very poor physical conditions. Because of the Subcommittee's ongoing concern about these conditions and questions raised about HUD's ability to effectively respond to these problems, you asked us to (1) compare the costs of rehabilitating two physically distressed properties with the costs of other alternatives for housing the tenants, (2) determine the views of tenants and community leaders on these options, and (3) identify legislative and administrative factors limiting HUD's discretion in dealing with physically distressed properties.

At the Subcommittee's request, our testimony today is based on analyses of two properties discussed in our earlier testimony: Edgewood Terrace Apartments in Washington, D.C., and 6000 South Indiana Apartments in Chicago, Illinois. While we recognize that factors other than cost can influence decisions about dealing with distressed properties, the current budgetary climate requires federal agencies to carefully weigh the cost implications of their policy decisions. As directed by the Subcommittee, we compared the costs of rehabilitating the two properties and the costs of housing tenants in these properties after rehabilitation with the costs of providing alternative housing assistance. Although our analyses assumed that HUD's choices among the options were not restricted by current laws and regulations, our earlier testimony and this statement discuss factors limiting HUD's discretion in dealing with federally subsidized properties.

In conducting our analyses, we had the two properties appraised, met with tenants and community leaders to obtain their views on the options we examined, and met with HUD officials to discuss and document actions the Department has taken to deal with these and similarly distressed properties. In addition, we met

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[1]Federally Assisted Housing: Conditions of Some Properties Receiving Section 8 Project-Based Assistance Is Below Housing Quality Standards (GAO/T-RCED-94-273, July 26, 1994).

with HUD attorneys to discuss current laws on property disposition that affect HUD's decisions.

In summary, we found the following:

- -- Because the costs of the housing alternatives differ depending on the property, physically distressed properties need to be analyzed on a case-by-case basis. Rehabilitating Edgewood Terrace Apartments could cost millions of dollars more than providing the tenants with alternative housing in the community. At 6000 South Indiana Apartments, the costs of rehabilitation are comparable with the costs of providing alternative housing.

- -- Although tenants were generally very dissatisfied with the current conditions at both Edgewood Terrace Apartments and 6000 South Indiana Apartments, their views were mixed on whether they would prefer to remain in their current residences or be given the choice of moving elsewhere. Community leaders in the neighborhoods of both properties generally believe that the properties should be rehabilitated.

- -- Current laws limit HUD's discretion in dealing with physically distressed properties. Providing HUD with more options could allow the Department to make more cost-effective decisions about its housing assistance.

- -- HUD lacks a comprehensive strategy for focusing on these properties, and its management information systems are poor. As a result, the Department is not systematically identifying and addressing conditions in its most physically distressed properties.

Before discussing these findings in detail, we would like to provide you with some background information.

BACKGROUND

HUD's Section 8 project-based rental assistance programs[2] were

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[2]Unlike tenant-based subsidies, project-based subsidies are attached to particular property units. The primary project-based assistance programs are the (1) Section 8 Property Disposition program, which provides assistance to ensure that properties acquired by HUD through foreclosure and eventually resold are maintained as low-income housing; (2) Section 8 Loan Management Set-Aside program, which provides assistance to projects with HUD-insured and HUD-held mortgages that are experiencing immediate or potentially serious financial difficulties; and (3)
(continued...)

established under Section 8 of the United States Housing Act of 1937, as amended (42 U.S.C. 1437 et seq.). The subsidies provided under these programs allow about 1.5 million lower-income households to obtain housing from private owners. Households receiving this assistance must live in designated properties, and they are generally required to pay 30 percent of their income for rent. HUD enters into housing assistance payment contracts with the owners of the properties and provides rent subsidies to them. The subsidy represents the difference between the tenant's payment and the agreed-upon rent. Because these rent subsidies are attached to particular units, tenants who move lose their rental assistance unless they move to another subsidized unit.

In addition to project-based assistance, two types of tenant-based rental assistance--certificates and vouchers--are provided under HUD's Section 8 programs. Another 1.3 million households use certificates or vouchers to obtain housing. Tenant-based assistance differs from project-based assistance in that households may use certificates or vouchers to rent from owners of their choice, provided the units meet HUD's requirements for rent levels and housing quality standards for decent, safe, and sanitary housing.

Physically distressed multifamily properties, including some receiving Section 8 project-based assistance, may require additional financial assistance from HUD to improve their conditions and ensure their continued financial viability. The primary forms of remedial assistance available are the Flexible Subsidy Program and the Section 8 Loan Management Set-Aside Program. The Flexible Subsidy Program provides, among other things, reduced-interest loans to improve the physical conditions of older properties that receive interest subsidies for their HUD-insured mortgages.[3] The Section 8 Loan Management Set-Aside Program provides additional funds to a distressed property through increases in rental income.

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[2](...continued)
Section 8 New Construction and Substantial Rehabilitation programs, which provide assistance to private developers to construct new units or to substantially rehabilitate units for rental to low- and moderate-income families.

[3]During the 1960s, two major low-interest mortgage loan programs were created to offer incentives for the development of affordable rental housing. Under the Section 221(d)(3) Below Market Interest Rate program and the Section 236 Mortgage Insurance and Interest Reduction Payments program, sponsors of low- and moderate-income housing received subsidies on interest rates for their HUD-insured mortgages and rent subsidies for qualified tenants.

COSTS OF ALTERNATIVES DIFFER DEPENDING ON THE PROPERTY

The costs of the alternatives--rehabilitating and continuing to provide project-based rental subsidies or providing alternative housing through certificates and vouchers--varied between the two properties we reviewed. Rehabilitating Edgewood Terrace Apartments to preserve all its units would be more costly than providing certificates or vouchers to an equivalent number of families and significantly more costly than providing such assistance only to the tenants currently residing there. At 6000 South Indiana Apartments, the rehabilitation costs are comparable to the cost of providing the tenants with certificates or vouchers.

Edgewood Terrace Apartments

At Edgewood Terrace Apartments, a 292-unit complex in northeast Washington, D.C., HUD provides Section 8 project-based assistance for 114 units, all of which were occupied as of August 31, 1994. The remaining 178 units are vacant. The property was sold to its current owner in 1983. Subsequently, the owner defaulted on the federally insured mortgage, which HUD now holds. HUD is considering several proposals from a nonprofit corporation that wants to acquire Edgewood Terrace Apartments.

We analyzed the costs over 15 years of three options for this complex:[4]

-- rehabilitating the entire complex and providing Section 8 project-based assistance for all 292 units,

-- providing 292 families with certificates or vouchers that would allow them to obtain alternative housing,[5] and

-- providing certificates or vouchers to the 114 families currently receiving assistance.

To evaluate the rehabilitation costs, we began with a detailed assessment of capital needs prepared by the nonprofit corporation interested in acquiring the property. According to this assessment, it will cost approximately $20.8 million to comprehensively rehabilitate the property.

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[4]We chose 15 years because it is the expected length of a Section 8 contract.

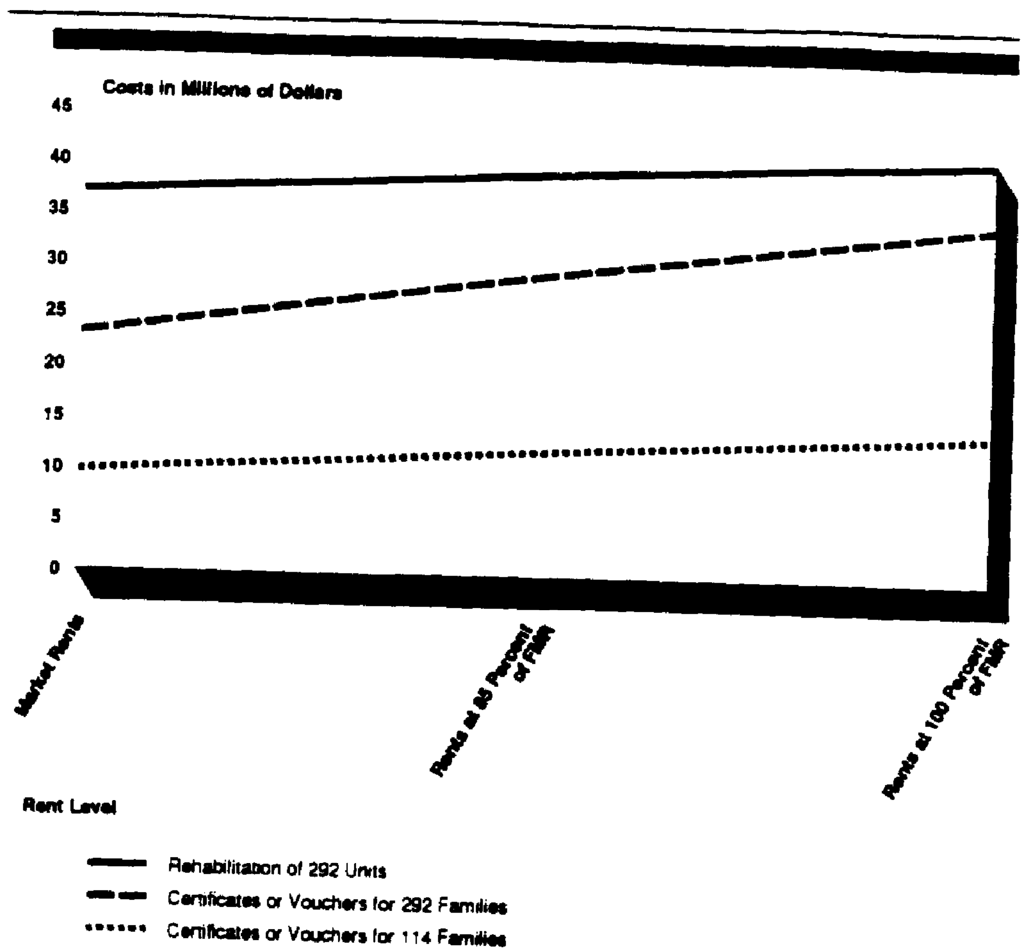
[5]Providing Section 8 subsidies for 292 families, whether through rehabilitation or the alternative option of certificates and vouchers, represents the maximum potential federal cost under either option. Subsidizing fewer units would result in comparable cost reductions for both options.

Next, we examined alternatives for financing the costs of rehabilitation through a mixture of debt financing (mortgage) and cash investment. Because the amount of cash investment is directly related to the property's rental income, we assumed three different rent levels in our analysis. The first level of rents represents a slight upward adjustment of the market rents currently charged for unsubsidized units in well-maintained properties in the neighborhood of Edgewood Terrace Apartments. This upward adjustment recognizes the value of the improvements that would be made to the property through rehabilitation. We set the next two rent levels at different percentages of the HUD-established fair market rent (FMR)[6] for the entire market area in order to evaluate different combinations of the initial cash investment required and the amount of debt that could be supported by the property's rental income. We also used these rent levels to compare the costs of rehabilitation and continued rental subsidies with the costs of housing tenants with certificates and vouchers.

As figure 1 shows, the costs to rehabilitate Edgewood Terrace Apartments and provide 15 years of subsidized assistance to its tenants is clearly higher than providing certificates and vouchers to either 292 or 114 families. Depending on the rent level established for the units, and therefore the government's continuing subsidy, we estimate that the costs to rehabilitate plus provide project-based assistance for all 292 units will range from $36.9 million to $40.9 million. Providing certificates or vouchers for 292 families for 15 years would cost from $23.1 million to $34.6 million, depending on the rents certificate and voucher holders are charged for their units. The least costly alternative is to provide comparable assistance to the 114 families now receiving Section 8 subsidies. We estimate these costs to range from $9.8 million to $14.3 million.

[6]In general, the fair market rent (FMR) for an area is the amount needed to pay the gross rent (shelter plus utilities) for modest, decent, safe, and sanitary housing. HUD sets the FMR at the 45th percentile of a market area's rental housing; that is, the level at which about 45 percent of an area's rental housing can be obtained.

Figure 1: Comparative Costs of the Three Options at Three Rent Levels



Note: Costs are stated as the present value of costs over a 15-year period.

Comparing the cost of rehabilitating Edgewood Terrace Apartments with the cost of providing a comparable number of families with certificates and vouchers depends on two key variables: first, the way the rehabilitation costs are financed; and second, the rent levels and the government's resulting cost for units chosen by families using the certificates or vouchers. Any of the rehabilitation and continued subsidy costs shown in figure 1 can be compared with the cost of providing certificates and vouchers at various rent levels. However, regardless of which option is chosen, certificates and vouchers are always less costly than rehabilitation and the related subsidies for Edgewood Terrace Apartments.

For example, financing the $20.8 million in rehabilitation costs at market rents would require an initial cash investment of about $15.1 million (see app. I). This cash investment, along with the $21.8 million[7] in rental subsidies that would be needed to support 292 families in the rehabilitated property for 15 years, equals the total cost of $36.9 million shown in figure 1. When these costs are compared with the cost of providing families with certificates or vouchers in neighborhoods where rents are 85 percent of FMRs,[8] certificates and vouchers would be less expensive by about $7.8 million ($36.9 million minus $29.1 million). If, on the other hand, a greater portion of the rehabilitation costs were financed through higher rents (assume 100 percent of the FMR), then the total cost of rehabilitating the property and providing rental subsidies over 15 years would be about $40.9 million. If this total is compared with the costs of providing subsidies for 15 years to tenants electing to use vouchers and certificates in areas where market rents are comparable to those in the Edgewood area, the cost difference between the options would increase to about $17.8 million ($40.9 million minus $23.1 million).

As expected, the comparative costs of providing certificates and vouchers for only 114 families would be substantially less than rehabilitating the entire complex of 292 units. Specifically, if these 114 families relocated to properties where rent levels were 85 percent of the FMR, and the rehabilitation of Edgewood Terrace Apartments were financed at similar rents, the cost difference between these options would be about $29.1 million (39.0 million in rehabilitation and related Section 8 subsidies minus $9.9 million, the costs of certificates or vouchers over 15 years for 114 families).

In our cost computations for certificates and vouchers we included the costs of relocating the tenants and disposing of Edgewood Terrace Apartments. Also, we recognize that comparing the costs of rehabilitation with the costs of certificates and vouchers presumes that these two options are equally viable; that is, that rental units are available in the community at or below the FMR and that landlords will be willing to rent to tenants who use

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[7]Our rental subsidy cost estimates represent the net present value of future rental subsidies, discounted at an annual rate of 7.5 percent.

[8]Edgewood Terrace Apartments is located in an area where good-quality housing rents at about 70 percent of the FMR. Consequently, when making comparisons between rehabilitating and providing certificates and vouchers, it is important to recognize that areas where rents are at 85 and 100 percent of the FMR have greater economic value, generally because of added amenities, than the Edgewood market area.

certificates or vouchers. In appendix II, we discuss the viability of this type of assistance in the Washington, D.C., market.

Finally, while the principal focus of our analyses comparing the two options was on cost, we recognize that other factors associated with the property also need to be considered. For example, Edgewood Terrace Apartments is well located with respect to employment, neighborhood services, and public transportation. It also has excellent access to hospitals, colleges, and businesses. Given these and other advantages, if the property were rehabilitated it could offer excellent potential as a low-income housing resource. However, this potential has to be weighed against the significant costs of rehabilitation. For every $1 million spent to rehabilitate a property like Edgewood in excess of the cost to provide alternative housing through certificates and vouchers, approximately 150 more families could be provided with housing assistance for 1 year. This is not an inconsequential number considering the nation's sizeable homeless population and the fact that today, for every household that receives housing assistance, two other eligible households do not.

6000 South Indiana Apartments

We also analyzed the cost of rehabilitating 6000 South Indiana Apartments and compared it with the cost of providing 70 families with certificates or vouchers. At this 12-story property, located on the south side of Chicago, Illinois, HUD provides Section 8 project-based assistance for 68 of the 70 units. As of September 30, 1994, nine units were vacant. In 1988, the project's owner defaulted on the federally insured mortgage, which HUD now holds. Earlier this year, HUD approved a substantial increase in the property's rents in order to fund renovations estimated to cost $1.3 million.

Again, comparisons between the costs of rehabilitating 6000 South Indiana Apartments and the costs of providing an equivalent number of families with certificates or vouchers depends on both how the rehabilitation is financed and how much rent is charged on units for families using certificates and vouchers. Given the actual financing arrangements made for rehabilitating these apartments and, considering the additional costs of providing 15 years of Section 8 assistance to the residents, we estimate the total costs to be $5 million. While there is some variation in costs between this option and that of relocating the tenants and providing them with certificates or vouchers for 15 years, the cost of the latter option also approximates $5 million.

VIEWS OF TENANTS AND COMMUNITY LEADERS

In order to solicit the views of a broad group of tenants, we either posted notices at the properties inviting tenants to meet with us or contacted them directly by telephone. The tenants we spoke with, although generally dissatisfied with the physical conditions at both Edgewood Terrace and 6000 South Indiana Apartments, had mixed views on whether they would prefer to continue living in their current residences or be given the chance to move elsewhere with a certificate or voucher. However, community leaders active in community development, business, government, and social services in the neighborhoods of these properties generally agreed that both should be rehabilitated and preserved as low-income housing. They noted, however, that the social problems affecting the tenants and the properties would also have to be addressed to ensure the properties' viability.

Tenants' Views

The majority of tenants that we spoke with at Edgewood Terrace characterized the condition of their apartments as either fair, poor, or very poor. Tenants were also unhappy with the way the property has been managed over the years and the way its physical condition has been allowed to deteriorate. Many also noted that the property and surrounding neighborhood suffer from a serious drug problem. Despite these problems, however, some of the tenants noted that they like Edgewood because, among other things, it is convenient to amenities such as stores and transportation.

When asked whether they would like to continue living in Edgewood or be given the chance to find alternative housing using a voucher or certificate, tenants responded differently, in part depending on their age. Many of the elderly tenants we spoke with said that they would rather continue to live in Edgewood than move.[9] However, they noted that they would like to see major improvements in Edgewood's physical condition, the way the property is managed, and the security that is provided. They would also like to see the drug problem eliminated. Among the reasons they cited for wanting to stay at Edgewood were its convenience to shopping and the length of time they have lived there. Some also expressed concern about whether they would be able to locate alternative housing using a voucher or certificate. (See app. II.)

Many of the nonelderly tenants we spoke with said they would rather move from Edgewood. However, some had concerns about whether they would be able to locate alternative housing.

At 6000 South Indiana Apartments, almost all of the tenants we spoke with said that their units were in fair, poor, or very poor condition. Many expressed concern about problems with gangs and drugs in the neighborhood. Tenants cited mismanagement by the owner as the primary cause of the building's poor physical condition. The majority of those we interviewed said they would

[9]HUD defines an elderly person as one who is 62 years of age or older.

move to other housing if they could obtain the same low rent they are paying now.

Community Leaders' Views

The community leaders near Edgewood Terrace Apartments favored rehabilitation because they considered the property a valuable housing resource that had fallen into disrepair as a result of years of mismanagement and poor oversight by housing officials. They generally agreed, however, that without efforts to address the social and economic needs of the tenants, physical improvements to the property would not be enough. In their view, the tenants at Edgewood need access to social services, education, training, and jobs.

Community leaders in the neighborhood of 6000 South Indiana Apartments were also in favor of rehabilitating the property rather than giving the tenants vouchers or certificates to move elsewhere. In their view, rehabilitation would help the community avoid the problems of having another vacant building or vacant lot. They also considered it important to address the social and economic needs of the tenants. Community leaders blamed HUD for not taking swift action against the owner when the property's problems became known in 1989.

CERTAIN REQUIREMENTS LIMIT HUD'S DISCRETION IN DEALING WITH PHYSICALLY DISTRESSED PROPERTIES

Current legislation and regulations on property disposition limit HUD's discretion in dealing with physically distressed properties. Under these requirements, HUD must generally provide Section 8 project-based assistance to units in a project that previously received it. Other units in the property that did not receive project-based assistance may be subject to restrictions on the amount of rent that can be charged. In addition, if HUD cancels Section 8 project-based assistance at a project in serious disrepair, it cannot now use those funds for other housing assistance.

Preservation Requirements Limit HUD's Options

In disposing of a multifamily property that it owns, HUD must decide whether to preserve it as rental housing for low-income persons or not to preserve it, possibly resulting in the property's demolition. The Multifamily Housing Property Disposition Reform Act of 1994 mandates that HUD follow certain procedures when disposing of multifamily properties. One of the act's major goals is to preserve housing so that it remains available to and affordable by low-income persons.

Under the law, if HUD decides to preserve the property as low-income rental housing, it may provide project-based assistance to the new owner or certificates or vouchers to the property's tenants. However, these options are subject to certain requirements and limitations, depending on whether the project was originally (1) subsidized with mortgage-related assistance, (2) subsidized with Section 8 project-based rental assistance, or (3) unsubsidized.

In general, HUD must provide Section 8 project-based assistance to any units in a project that previously received it. If a project received mortgage-related assistance, HUD is required to ensure that any units that did not previously receive project-based assistance remain available to and affordable by low-income persons, and new owners may be required to establish restrictions on use or rent levels so the units remain affordable.

With the goal of creating mixed income projects, the act permits HUD to reduce the number of units that receive project-based assistance in subsidized projects if HUD (1) uses either rent restrictions or project-based assistance to set aside an equal number of units in unsubsidized properties in the same market area to be used as affordable housing for very-low-income families and (2) makes tenant-based assistance available to every low-income family residing in a unit for which HUD is required to provide project-based assistance.

HUD is subject to certain limitations if it decides to provide tenant-based assistance rather than project-based assistance to a project. Tenant-based assistance can only be offered

-- in lieu of project-based assistance when projects are located in markets that have an adequate supply of habitable and affordable low-income housing,

-- if HUD determines that low-income housing will be available to the tenants who receive such assistance, and

-- for up to 10 percent of the aggregate number of subsidized or formerly subsidized units that HUD disposes of in any fiscal year.

HUD may decide not to preserve a physically distressed property as rental housing for low-income persons, which may result in the property's demolition. However, under HUD's regulations, this decision may be made only under one or more conditions, including the following: (1) the costs of rehabilitation are such that rents for existing housing will be higher than 144 percent of the FMR for subsidized projects and the rents obtainable in the market for unsubsidized projects; (2) preservation is not feasible because of environmental factors that cannot be mitigated by HUD or the purchaser of the property; (3) rehabilitation would cost substantially more than constructing new housing; or (4) HUD conclusively demonstrates that decent and affordable low-income housing is not needed in the community for current residents or people who want to live in the community.

Proposed Legislation Would Increase HUD's Discretion and Focus Attention on the Most Severely Distressed Properties

Legislation has been proposed that would (1) increase HUD's discretion in dealing with physically distressed properties (S. 2281) and (2) direct HUD to give priority to its most severely distressed properties and make decisions that consider both the costs and social implications of different housing alternatives (H.R. 5115). However, it is still unclear how the preservation requirements discussed above would affect the implementation of these legislative proposals.

HUD has the authority to terminate project-based assistance in properties that are in poor physical condition. However, under appropriations law, if this assistance is terminated, these "recaptured" funds must be returned to the Treasury and cannot be used by HUD to relocate tenants in decent housing in the community. Under one provision in S. 2281, HUD would be allowed to use these recaptured funds to provide either certificates or vouchers to the tenants or alternative project-based assisted housing.

This proposed provision raises a question as to how the preservation requirements would apply when HUD becomes the owner of a property that is forced into foreclosure proceedings as a result of HUD's decision to terminate the property's contract for project-based assistance. As mentioned previously, HUD is generally required to provide project-based assistance to those units that previously received it. Consequently, if appropriations law were changed to give HUD the authority to use recaptured project-based assistance funds to relocate tenants in decent housing in the community, HUD might need an equivalent amount of additional budget authority to provide project-based assistance if it wished to sell a distressed property.

H.R. 5115, recently introduced by the Subcommittee Chairman, is aimed at improving HUD's management of the Section 8 project-based assistance program. In summary, the bill calls for HUD to (1) identify severely troubled properties; (2) analyze the financial and social impacts in order to assist the Department in determining what remedial actions need to be taken on distressed properties; and (3) choose the most cost-effective action to take, while considering its effect on tenants, owners, and the community.

HUD LACKS INFORMATION TO SYSTEMATICALLY IDENTIFY AND ADDRESS CONDITIONS IN THE MOST PHYSICALLY DISTRESSED PROPERTIES

HUD's ability to identify and address conditions in the most physically distressed properties is impaired because the Department lacks the information needed to do so. Furthermore, HUD has not yet begun, as required by law, to collect information on the financial and other assistance needed by owners of older, assisted multifamily properties. Although HUD has begun several initiatives, it has not initiated a comprehensive effort to identify those Section 8 properties in the worst physical condition, nor has it developed a strategy to systematically address the problems with those properties. Doing so is critical in order to (1) determine with greater certainty the magnitude of the problem nationwide and (2) give priority to those families living in the worst conditions. The Congress and the administration also need this information in considering the implications of different housing polices and choices.

Problems in HUD's Data Systems Impede Effective Actions

As we stated in our July testimony, one of HUD's major limitations is poor management information systems. More specifically, HUD's ability to routinely identify and monitor properties in deteriorating physical condition is impaired because the Department's information systems do not contain the data needed to do so. HUD is making progress in improving its financial systems, which supply key data for evaluating the financial solvency of properties. However, until these data can be integrated with data on the properties' physical conditions, HUD's oversight of the inventory of assisted properties will continue to be impaired.

Comprehensive Needs Assessments Are Not Being Submitted for Assisted Multifamily Properties

Under the Housing and Community Development Act of 1992, as amended, owners of older, assisted multifamily properties are required to submit comprehensive needs assessments to HUD. Each assessment, which is to be prepared by an entity independent of the owner, must contain a description of the current and future financial or other assistance needed to ensure that the property is well maintained and financially viable. The assessment must also describe any resources available for meeting the current and future needs of the property and the likelihood of obtaining these resources.

These assessments would provide HUD with useful information for making decisions about how to address any identified problems. Furthermore, HUD is required to use these assessments as the basis for its decisions on assisting physically and financially troubled projects under the Flexible Subsidy and Loan Management Set-Aside programs. According to HUD officials, however, owners are not submitting these comprehensive needs assessments because HUD has not yet issued guidelines or regulations implementing the requirement that they do so.

In addition, HUD has yet to systematically identify those projects with the most severe physical problems. While improved management information systems are critical for the ongoing management of HUD's inventory of assisted properties, and needs assessments are crucial for determining repair costs, current limitations in these data sources do not preclude HUD from systematically identifying those assisted properties that are in the worst physical condition. Simple walk-through inspections by either HUD field office staff or outside inspectors could provide HUD with information on how many properties are in conditions similar to those we discussed at the July 1994 hearing. This information, together with data from the past inspection reports on the properties, would put HUD in a position to (1) systematically notify property owners of the need to address physical problems at the properties and (2) take appropriate enforcement actions when owners do not bring their properties into compliance with housing quality standards.

CONCLUSIONS

Each federally assisted property that has fallen into serious disrepair needs to be analyzed on a case-by-case basis to compare the cost of rehabilitation and the associated costs of providing rent subsidies that continue after the property is rehabilitated with the cost of providing the tenants with certificates or vouchers. Among the more important factors to be analyzed are the total cost of rehabilitation, market rents in the area in which the property is located, applicable fair market rents, vacancy rates, and the views of tenants and community leaders on what should be done with the property.

Current housing policies have generally supported preserving subsidized housing and have not required HUD to consider housing alternatives. One way of preserving properties like Edgewood Terrace Apartments is through government-supported rents well above local market levels.

As we stated in our earlier testimony, the current budgetary climate requires all federal agencies to consider the cost implications of their policy decisions. Yet in dealing with its portfolio of physically distressed properties, HUD is limited by legislation that precludes it from using funds recaptured from terminated Section 8 contracts to relocate tenants from severely distressed properties to other properties of higher quality. Current laws also limit HUD's discretion to use certificates or vouchers in dealing with physically distressed properties.

Providing HUD with greater flexibility in using certificates and vouchers would require congressional action.

In dealing with distressed properties, it is important that HUD balance fiscal responsibility and the interests of affected tenants and communities. We support the provisions of H.R. 5115 that would require these cost implications, along with other factors like the views of tenants and community leaders, to be carefully weighed in HUD's decisions on how to proceed with individual properties. We also support the bill's provision that would authorize the Department to use recaptured Section 8 program funds to relocate tenants currently living in physically distressed properties by offering them certificates and vouchers. Debate on this bill might also consider broadening the general authority of the Department to use certificates and vouchers as an option in disposing of formerly subsidized properties.

Finally, HUD is limited by the lack of a comprehensive strategy focusing on the properties and by inadequate information systems. As we recommended in our July 1994 testimony, HUD needs to develop such a strategy to address the very poor physical conditions of properties like Edgewood Terrace Apartments and 6000 South Indiana Avenue. We said that as part of this strategy, HUD should, through the use of its field staff or with the help of outside contractors (1) promptly identify all Section 8 assisted properties with severe physical problems and offer affected tenants temporary assistance to relocate to safe and decent housing, (2) systematically notify owners of the problems identified, and (3) take appropriate enforcement actions in cases in which owners do not bring their properties into compliance with housing quality standards. Also, to the extent that budgetary or legislative constraints prevent HUD from addressing these conditions, and limit its options in disposing of physically distressed properties, we recommended that HUD provide the Congress with an assessment of the resources and legislative changes the Department needs.

COST OF FINANCING THE REHABILITATION OF EDGEWOOD TERRACE APARTMENTS AT FOUR RENT LEVELS

	Market rents	Rents at 85 percent of FMR	Rents at 100 percent of FMR	Rents at 132 percent of FMR
Potential rental income				
Efficiency (20)	$ 480/mo.	$ 538/mo.	$ 633/mo.	$ 836/mo.
1 bedroom (81)	560/mo.	611/mo.	719/mo.	949/mo.
2 bedroom (76)	660/mo.	717/mo.	844/mo.	1,114/mo.
3 bedroom (43)	760/mo.	977/mo.	1,149/mo.	1,517/mo.
4 bedroom (72)	810/mo.	1,177/mo.	1,385/mo.	1,828/mo.
Yearly income at 100 percent occupancy	$ 2,353,440	$ 2,898,534	$ 3,410,040	$4,501,253
Calculation of maximum mortgage				
Effective gross income (97 percent occupancy)	2,282,837	2,811,578	3,307,739	4,366,215
Total operating expenses/replacement reserve	(1,500,967)	(1,500,967)	(1,500,967)	(1,500,967)
Net operating income	781,870	1,310,611	1,806,772	2,865,248
Debt financing supported by rent levels (15-year term at interest rate of 9.37 percent)	5,715,252	9,580,203	13,207,002	20,944,171
Calculation of cash subsidy				
Total rehabilitation expense	20,777,608	20,777,608	20,777,608	20,777,608
Debt financing supported by rent levels	5,715,252	9,580,203	13,207,002	20,777,608
Cash investment needed	15,062,356	11,197,405	7,570,606	0

Note: FMR = fair market rent.

VIABILITY OF CERTIFICATES AND VOUCHERS AS AN ALTERNATIVE TO REHABILITATION IN THE WASHINGTON, D.C., MARKET

To evaluate whether certificates and vouchers are a viable alternative to rehabilitating Edgewood Terrace Apartments, we considered several additional issues. We looked at the vacancy rates in the community to determine whether units are available at or below the fair market rent (FMR). We also considered whether landlords are willing to rent to tenants with certificates and vouchers. Finally, we examined the rents that tenants using certificates and vouchers would likely have to pay to rent units that meet housing quality standards.

According to 1990 Census data, the vacancy rate for units renting at or below the FMR was about 8 percent in Washington, D.C., and 11 percent for the Washington, D.C., metropolitan statistical area. We were unable to obtain other statistically reliable data to update these figures.

In examining whether landlords are willing to rent to tenants with this type of assistance, we contacted the Department of Public and Assisted Housing in Washington, D.C., in an attempt to get an indication of whether such families are experiencing difficulty in locating rental housing. This Department, which administers the city's certificate and voucher programs, did not respond to our request for information. Nevertheless, we note that several thousand families in Washington, D.C., are successfully using certificates and vouchers. In addition, the willingness of landlords to accept tenants with such assistance was the subject of a study commissioned by the National Multifamily Housing Council.[10] The Council's final report concluded that several fundamental changes to the requirements and regulations of the certificate and voucher programs could significantly increase private owners' participation. These changes focused on increasing the accountability and responsibility of the housing authorities that administer the program, the owners who rent units under the program, and the residents who live in the Section 8 units, while still maintaining the program's goals of providing affordable, good quality housing to low-income families. We recognize that, even if these changes are made, families can still experience difficulty in finding affordable rental housing in specific neighborhoods.

As noted in the body of our testimony, if tenants at Edgewood Terrace Apartments were provided with certificates or vouchers and chose to relocate in more expensive neighborhoods, either at 85

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[10] Final Report on Recommendations on Ways to Make the Section 8 Program More Acceptable in the Private Rental Market, Abt Associates, Inc. (Cambridge, Mass: Mar. 1994).

APPENDIX II

percent of the FMR or at 100 percent of the FMR, the costs of this assistance could be significantly less than the costs of rehabilitating the property.

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