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HOUSING AND URBAN
DEVELOPMENT

Reinvention and Budget Issues

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Mr. Chairman and Members of the Committee:

We are pleased to be here today to offer our observations on the Department of Housing and Urban Development's (HUD) budget for fiscal year 1996. In its budget proposal, HUD has requested about \$26.3 billion in budget authority and plans the same amount in outlays. Compared with fiscal year 1995 levels, this represents about a 2-percent increase in budget authority and a 2-percent decrease in outlays. The budget reflects HUD's proposed first steps in transitioning to the new agency envisioned in its December 1994 reinvention blueprint.

Our testimony will be based on work we have carried out during the past several years on ways to strengthen HUD's programs, as well as our preliminary analysis of information contained in the President's fiscal year 1996 budget request and the Department's fiscal year 1996 budget summary. Although little detail has been provided, we will also address aspects of HUD's reinvention blueprint. Today I will focus on (1) challenges that HUD faces in implementing a budget based on the reinvention blueprint within the time frames envisioned, (2) the potential impact of long-term management deficiencies on HUD's ability to implement the blueprint, and (3) observations on the budgetary savings that HUD is proposing to achieve over the next 5 years.

In summary,

- Implementing the blueprint on which the budget is predicated will be extremely difficult and will take HUD longer than the 3 years originally projected. If the Congress supports HUD's reinvention strategy, implementing it will require major legislative actions and the design of formulas for allocating funds that are now awarded competitively. It will also place more responsibility on the states and localities to develop new plans to implement the programs and to develop performance measures.
- Laying the massive changes envisioned under the blueprint on top of the long-standing departmentwide deficiencies that exist at HUD poses daunting challenges for the Department. The Department's weak internal controls, ineffective organizational structure, insufficient mix of staff with the proper skills, and inadequate information and financial management systems led us to designate HUD as a "high risk area." In a report issued today, along with reports on the other 17 high risk areas that we have tracked over the past few years, we point out that HUD's Secretary and top

management team have given high priority to correcting these deficiencies.¹

- The long-term savings projected in HUD's fiscal year 1996 budget request result primarily from shortening the length of Section 8 contracts and thereby deferring costs to later years, freezing or reducing program spending levels, and making other unspecified and technical changes. Even with these projected savings, the size of HUD's budget will remain substantial.

First, let me summarize the major components of HUD's reinvention blueprint and the plans for implementing it through HUD's fiscal year 1996 budget.

HUD'S REINVENTION BLUEPRINT AND THE FISCAL YEAR 1996 BUDGET

The reinvention blueprint envisions major changes in HUD's programs and organization, ending in three principal results: (1) removing public housing authorities from subsidy programs and making them compete with the private market; (2) consolidating 60 major categorical programs into 3 flexible, performance-based funds; and (3) establishing an entrepreneurial, government-owned Federal Housing Administration (FHA).

To begin transforming public housing, the 1996 budget proposes to consolidate the funding for public housing into two accounts-- one for operations and one for capital projects, such as modernizing viable projects, demolishing nonviable projects, and constructing replacement housing where feasible.

As a first step toward consolidating categorical programs, HUD's fiscal year 1996 budget calls for converting many of them into seven funds that will be merged in subsequent years into the three funds envisioned in the blueprint. The seven funds listed in this budget are intended to shift substantial control of resources from HUD to state and local governments. These funds would support a wide range of activities, such as affordable housing and community-based economic development.

To address the third reinvention objective, HUD's budget envisions a 2-year transition to a new FHA corporation beginning in fiscal year 1996. During this period, FHA's existing insurance programs would be consolidated and a process for restructuring the debt on FHA's current portfolio of insured multifamily properties would begin.

¹Department of Housing and Urban Development (High-Risk Series, GAO/HR-95-11, Feb. 22, 1995).

IMPLEMENTING HUD'S REINVENTION
PLAN WILL BE DIFFICULT

Accomplishing HUD's reinvention blueprint, on which the fiscal year 1996 budget is predicated, will require the completion of many significant tasks--an endeavor that HUD officials believe will take longer than the 3 years originally projected. If the Congress supports HUD's reinvention strategy, implementing it will require major legislative actions, revisions to HUD regulations, and the design of formulas for allocating funds that are now awarded competitively. It will also place more responsibility on the states and localities to develop new plans to implement the programs and to develop performance measures. Considerable effort will also be needed to transform FHA as envisioned in the blueprint.

Reinventing Public Housing

Some of the most radical changes to existing programs are planned in the area of public housing. Under the blueprint, public housing residents will receive portable rental assistance certificates wherever practicable, permitting them to seek better housing elsewhere. In addition, under the blueprint, states, local jurisdictions, and neighborhoods would be given the flexibility to design public housing programs to meet their needs while at the same time the public housing stock would be forced to compete with other housing stock in the local area. For public housing, major legislative and regulatory changes would include the following:

- repealing the current requirement that housing agencies replace on a one-for-one basis any units they demolish or sell;
- eliminating current federal preference rules for the occupancy of public housing;
- consolidating a variety of public housing capital programs into a single capital grant to housing agencies;
- consolidating funding for anti-crime purposes, coordinating services, and providing operating subsidies for public housing into a single fund; and
- requiring HUD to assume control over troubled public housing authorities.

Already, HUD is finding out that its plans for converting all public housing to assistance provided directly to tenants within 3 years are overly optimistic. Program officials now estimate that the transition will take at least 8 years. As a result, the two funds into which HUD is proposing to consolidate all public housing programs will continue at least through fiscal year 2002. This

timing differs from that projected in the fiscal year 1996 budget, which assumes that both of these funds will be terminated at the end of fiscal year 1997 and folded into a fund for tenant-based certificates in fiscal year 1998.

HUD believes the extension from fiscal year 1998 to fiscal year 2002 is necessary to (1) allow public housing authorities to expend the over \$9 billion of modernization and other funds already provided by the Congress so that their housing stock can become competitive with the private market's and (2) prevent the loss of valuable housing stock that might take longer than 2 to 3 years to be made marketable but that residents and local governments agree should be preserved. HUD officials recognize that there is still a substantial backlog of modernization needs and that billions of dollars have been invested in much of this stock. If public housing subsidies were converted to tenant-based certificates before the properties became competitive, the properties would lose vital rental income which may prevent them from remaining available as affordable low-income housing.

Consolidating Additional Programs

HUD may have difficulty implementing its proposals to consolidate several programs because of the time that may be required for HUD to work out program details and for communities to develop the plans and performance measures needed to implement the consolidated programs. HUD has proposed a Community Opportunity Fund that largely builds on the Community Development Block Grant program and an Affordable Housing Fund that consolidates programs for housing production, rehabilitation, and homeownership. HUD proposes that local communities determine how these funds will be spent on the basis of a community-prepared consolidated plan. HUD has also proposed to consolidate the existing McKinney Act programs for assisting the homeless into a single formula-driven grant with similar planning requirements.

The intent of creating each of these funds is (1) to give states and localities greater flexibility in how they spend funds and (2) to achieve accountability for results. Our report on comprehensive community revitalization efforts, which is being released today, indicates that community organizations would favor this type of funding approach.² Community development experts advocate a multifaceted, comprehensive approach to address the complex, interrelated problems in distressed urban areas. Flexible funding facilitates this approach. However, HUD's proposals will take time to implement because many communities have relatively little experience with the comprehensive planning envisioned by

²Community Development: Comprehensive Approaches Address Multiple Needs but Are Challenging to Implement (GAO/RCED/HEHS-95-69, Feb. 8, 1995).

HUD. In addition, we found through our work that community development researchers have had difficulty in developing performance measures for revitalization efforts because communities' needs differ and some activities may not be quantifiable.

Developing formulas for allocating funds to programs for assisting the homeless may pose additional challenges. As we reported last year, HUD's earlier efforts to combine selected McKinney Act entitlement and demonstration programs were stopped when disagreements arose over how to design an allocation formula that reflected localities' relative need for homeless assistance.³ Program consolidation legislation proposed by HUD last year called for allocating funding much as it is allocated in the Emergency Shelter Grant and Community Development Block Grant programs.

Transforming FHA

Considerable effort will also be needed to transform FHA into the entrepreneurial, government-owned corporation envisioned in the blueprint. For example, for single-family housing, the blueprint proposes that FHA will increasingly rely on third-party partners to design products that meet market needs and to ensure that FHA's insurance and credit enhancement are delivered as efficiently and effectively as possible.

Specific information on the markets FHA will serve, the relationship it will establish with partners in the housing market, and the expected mix of products it expects to offer is, however, not available. FHA is currently preparing a business plan to provide information on these subjects, as well as defining the resource requirements necessary to support FHA's new entity. FHA expects that this plan will be completed by April 1995. Accordingly, the budget figures proposed for the FHA insurance funds are preliminary and will need to be revised after the business plan is completed.

LONG-TERM MANAGEMENT DEFICIENCIES WILL ALSO AFFECT HUD'S ABILITY TO IMPLEMENT THE BLUEPRINT

A key challenge facing HUD today is correcting the fundamental deficiencies that led us to designate it as a high-risk area in January 1994. At a minimum, laying the massive changes envisioned in the blueprint on top of the current initiatives to correct significant management deficiencies poses a daunting challenge for the agency. Furthermore, HUD's ability to effectively implement

³Homelessness: McKinney Act Programs Provide Assistance but Are Not Designed to Be the Solution (GAO/RCED-94-37, May 31, 1994).

the reinvention blueprint may be seriously impeded by these long-standing, systemic management deficiencies.

Four long-standing departmentwide deficiencies led to our designation of HUD as a high risk agency. These deficiencies were weak internal controls, an ineffective organizational structure, an insufficient mix of staff with the proper skills, and inadequate information and financial management systems. Internal control weaknesses, such as a lack of necessary data and management processes, were a major factor leading to the incidents of fraud, waste, abuse, and mismanagement that have come to be known as the 1989 HUD scandals. Organizational problems have included overlapping and ill-defined responsibilities and authorities between HUD headquarters and field organizations and a fundamental lack of management accountability and responsibility. Having an insufficient mix of staff with the proper skills has hampered the effective monitoring and oversight of HUD programs and the timely updating of procedures. Poorly integrated, ineffective, and generally unreliable information and financial management systems have failed to meet program managers' needs and have not provided adequate control over housing and community development programs.

In our high-risk series report on HUD, we point out that HUD's Secretary and top management team have given high priority to correcting these deficiencies.⁴ They and other HUD managers and staff committed substantial effort during 1994 to formulating and planning significant changes in the way the agency is managed. We recognize HUD's efforts but note in the report that the mammoth task of effectively implementing these plans still lies ahead.

The extent to which reinvention alternatives are implemented at HUD will be decided by the Congress through the legislative and appropriation processes. However, no matter what form HUD finally takes, strong internal controls, an effective organizational structure, a sufficient mix of properly skilled staff, and adequate information and financial management systems will remain key ingredients to the proper management and control of risks.

HUD'S BUDGET SAVINGS PROJECTIONS

I would now like to comment briefly on the savings that HUD projects in the budget over the next 5 years. HUD's fiscal year 1996 budget summary identifies savings of \$51 billion in budget authority and \$13 billion in outlays for fiscal years 1996 through 2000. These savings are based on a comparison with HUD's current services budget, which does not reflect the reinvention proposal and assumes, instead, that existing laws, regulations, and policies

⁴GAO/HR-95-11.

will remain in effect.⁵ Few of the identified savings appear to be directly related to the reinvention proposal. The majority of the long-term savings stem from across-the-board cuts and unspecified technical changes. Another large portion of the savings in budget authority--41 percent--represents short-term savings achieved by reducing the length of Section 8 contracts--an action that defers costs to later years. However, from another perspective, the budget request represents an increase in budget authority of about \$21 billion and an increase in outlays of about \$11 billion for the period 1996 through 2000 if funding were frozen at the fiscal year 1995 level and no adjustments were made for inflation.

Savings in Outlays

Over 80 percent--\$10.7 billion--of the projected \$13 billion savings in outlays is to come from three areas:

- About \$3.4 billion is expected to come from policy changes in rental assistance programs. Savings in rental assistance programs can be effected in various ways, including: (1) reducing the number of households assisted; (2) requiring families to pay a larger percentage of their income toward rent; (3) increasing the income levels of households receiving assistance so that their contributions toward rent would increase; and (4) reducing the maximum rent that the government will subsidize. HUD's budget proposal focuses on the latter two options by (1) giving greater preference to families that are either working or are enrolled in job or education programs, (2) reducing the "oversubsidizing" of private landlords by renewing project-based assistance contracts at lower levels that reflect the properties' lower market value and by scaling back automatic rent increases, and (3) reducing tenant-based subsidies by lowering the allowable "fair market rents." While these actions should lead to reductions in outlays in rental assistance, there will also be costs to HUD's mandatory account associated with restructuring debt on insured multifamily properties so that assistance contracts can be scaled back to market rents. HUD's fiscal year 1996 budget includes \$643 million in costs related to such restructuring. However, it offsets these and other costs with \$1.66 billion in savings resulting from "program reforms." The budget does not explain what reforms will produce these savings.

- Another \$3.3 billion reduction in outlays is expected to result from the phased-in reductions HUD expects to make in

⁵Current services budgets that reflect the anticipated costs of continuing federal programs at present levels without policy or legislative changes are developed as part of the annual budget process.

budget authority over the next 5 years. The budget summary does not provide additional detail on these reductions.

-- The largest reduction--\$4.0 billion--is expected to come from "technical adjustments and other changes." The HUD budget documents provide little additional information on these savings.

Savings in Budget Authority

Over 95 percent of the \$51 billion savings expected in budget authority come from actions to (1) reduce the terms for Section 8 housing assistance contracts, (2) freeze or reduce program spending levels, and (3) technical amendments and other unspecified changes.

Changes in the length of the terms of Section 8 rental assistance contracts account for 41 percent--\$20.7 billion--of the projected budget authority savings. The changes in the terms of the Section 8 contracts represent a reduction in the number of years for which budget authority will be requested rather than a reduction in the amount of assistance to be provided to recipients. Until recently, budget authority for Section 8 contracts was typically given out on a 5-year basis. The fiscal year 1996 budget estimate proposes that expiring Section 8 contracts be renewed and new "incremental" contracts be awarded for shorter terms--for 2 years up until the year 2000 and 1 year thereafter, according to senior HUD officials. HUD's current services budget assumes that contract renewals will be for 3 years and incremental contracts for 5 years. While this plan reduces the amount of budget authority needed for Section 8 contracts in the short term, the initial reductions in budget authority will be made up for in later years as the shorter-term contracts roll over.

Another 41 percent of the savings in budget authority is expected to come from freezing all HUD programs at their fiscal year 1996 levels and making additional across-the-board reductions for major programs, by 3, 5, 7, and 9 percent in fiscal years 1997, 1998, 1999, and 2000, respectively. In addition, about 16 percent is to come from technical adjustments and other changes. According to HUD, these reductions are necessary to comply with the discretionary budget caps in law and the extension of these caps through fiscal year 2000 proposed by the administration. HUD's budget summary does not provide additional information on these savings.

While these savings, if realized, will help curb the growth in HUD's budget over the next 5 years, the size of HUD's budget will remain substantial. HUD's fiscal year 1996 budget proposal projects budget authority of \$149.6 billion and outlays of \$145.9 billion for fiscal years 1996 through 2000. As shown in appendixes I and II, these amounts are less than HUD estimates would be required if current laws, regulations, and policies were to remain

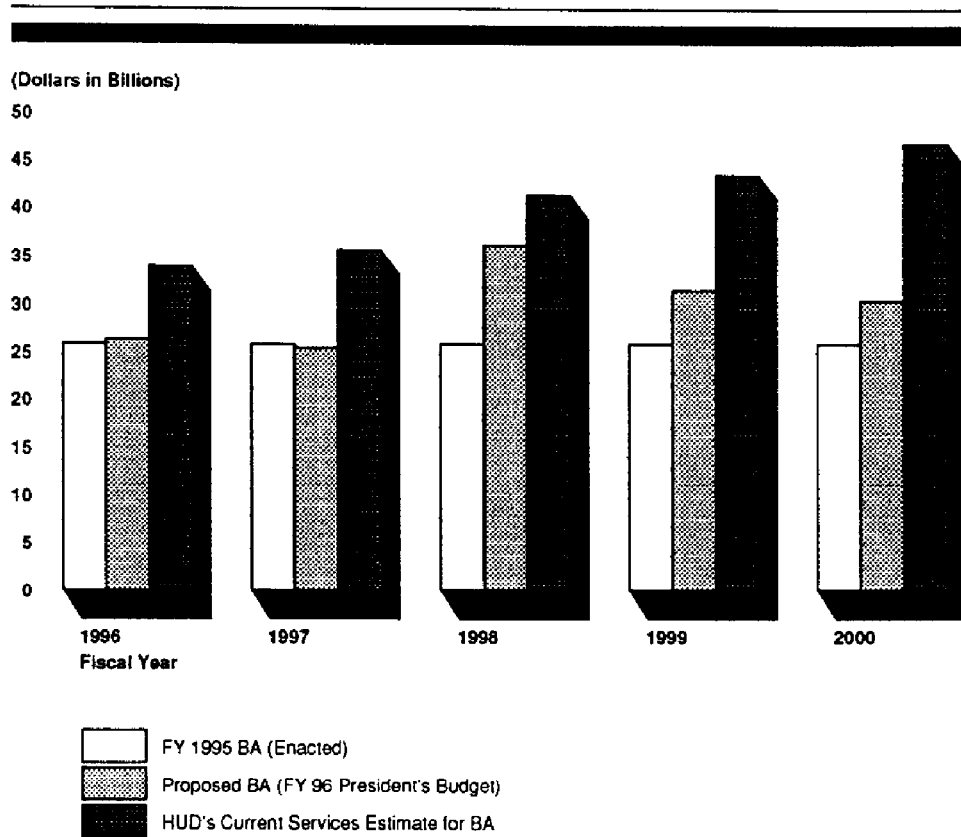
in effect. However, budget authority and outlays for fiscal years 1996 through 2000 are higher than would be needed if funding were frozen at the fiscal year 1995 level and no adjustments were made for inflation. Looked at this way, the budget request represents an increase in budget authority of about \$21 billion and an increase in outlays of about \$11 billion for the period 1996 through 2000.

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In summary, Mr. Chairman, as discussed today, HUD's fiscal year 1996 budget tries to address, in very difficult budget times, HUD's extremely large financial and social responsibilities. While HUD's budget is directly linked to its reinvention blueprint, much of the detailed information needed to fully understand the blueprint is still being developed. Similarly, while HUD's budget projects budget authority and outlay savings over the next five years, all of the information needed to assess the accuracy of the savings and to understand their programmatic impact is also not yet available. What is clear is that--even if these savings are realized--the size of HUD's budget will remain substantial.

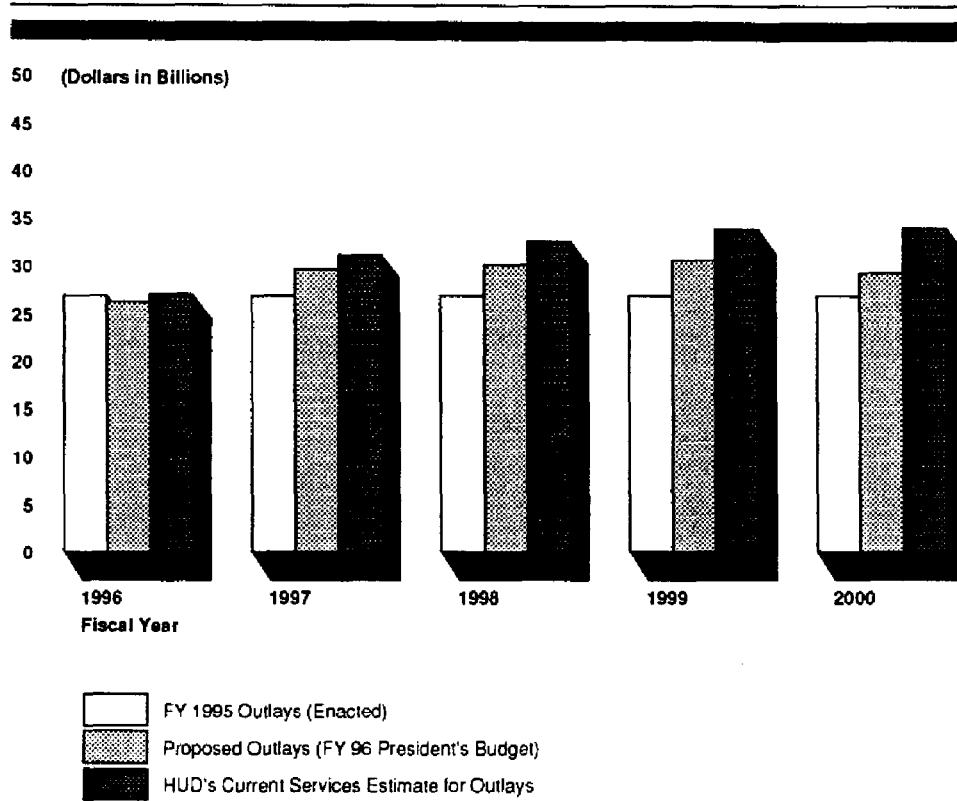
This concludes my prepared remarks. We will be pleased to answer any questions that you and other Members of the Committee might have. We look forward to working with the Committee as you consider issues related to HUD's budget.

A Comparison of Budget Authority for FY 1995,
Proposed FY 1996, and Current Services Estimate



Current services budgets that reflect the anticipated costs of continuing federal programs at present levels without policy or legislative changes are developed as part of the annual budget process.

A Comparison of Outlays for FY 1995,
Proposed FY 1996, and Current Services Estimate



Current services budgets that reflect the anticipated costs of continuing federal programs at present levels without policy or legislative changes are developed as part of the annual budget process.

Selected GAO Products

Department of Housing and Urban Development (High-Risk Series, GAO\HR-95-11, Feb. 22, 1995).

Community Development: Comprehensive Approaches Address Multiple Needs but Are Challenging to Implement (GAO/RCED/HEHS-95-69, Feb. 8, 1995).

Housing and Urban Development: Major Management and Budget Issues (GAO/T-RCED-95-86, Jan. 19, 1995, and GAO/T-RCED-95-89, Jan. 24, 1995).

Federally Assisted Housing: Expanding HUD's Options for Dealing With Physically Distressed Properties (GAO/T-RCED-95-38, Oct. 6, 1994).

Federally Assisted Housing: Condition of Some Properties Receiving Section 8 Project-Based Assistance Is Below Housing Quality Standards (GAO/T-RCED-94-273, July 26, 1994, and Video GAO/RCED-94-01VR).

Public Housing: Information on Backlogged Modernization Funds (GAO/RCED-94-217FS, July 15, 1994).

Homelessness: McKinney Act Programs Provide Assistance but Are Not Designed to Be the Solution (GAO/RCED-94-37, May 31, 1994).

Section 8 Rental Housing: Merging Assistance Programs Has Benefits but Raises Implementation Issues (GAO/RCED-94-85, May 27, 1994).

Lead-Based Paint Poisoning: Children in Section 8 Tenant-Based Housing Are Not Adequately Protected (GAO/RCED-94-137, May 13, 1994).

HUD Information Resources: Strategic Focus and Improved Management Controls Needed (GAO/AIMD-94-34, Apr. 14, 1994).

Multifamily Housing: Status of HUD's Multifamily Loan Portfolios (GAO/RCED-94-173FS, Apr. 12, 1994).

Community Development: Block Grant Economic Development Activities Reflect Local Priorities (GAO/RCED-94-108, Feb. 17, 1994).

Housing Finance: Expanding Capital for Affordable Multifamily Housing (GAO/RCED-94-3, Oct. 27, 1993).

Assisted Housing: Evening Out the Growth of the Section 8 Program's Funding Needs (GAO/RCED-93-54, Aug. 5, 1993).

Government National Mortgage Association: Greater Staffing Flexibility Needed to Improve Management (GAO/RCED-93-100, June 30, 1993).

Multifamily Housing: Impediments to Disposition of Properties Owned By the Department of Housing and Urban Development (GAO/T-RCED-93-37, May 12, 1993).

HUD Reforms: Progress Made Since the HUD Scandals but Much Work Remains (GAO/RCED-92-46, Jan. 31, 1992).

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