United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Housing and Transportation, Committee on Banking, Housing, and Urban Affairs, U.S. Senate

November 2002

PUBLIC HOUSING

HOPE VI Leveraging Has Increased, but HUD Has Not Met Annual Reporting Requirement

G A O

Accountability * Integrity * Reliability

GAO-03-91

Contents

United States General Accounting Office
Washington, DC 20548

November 15, 2002

The Honorable Jack Reed
Chairman, Subcommittee on
Housing and Transportation
Committee on Banking, Housing,
and Urban Affairs
United States Senate

Dear Mr. Chairman:

For years, some of the nation's public housing sites have exemplified urban decay and substandard living conditions. In an effort to address these longstanding problems in a new way, the Congress, in October 1992, established the Urban Revitalization Demonstration Program, administered by the Department of Housing and Urban Development (HUD). The program, commonly known as HOPE VI, provides grants to public housing authorities to replace severely distressed public housing units with attractive, economically viable communities that often combine public housing with other affordable or market-priced housing units (see fig. 1). Through fiscal year 2001, the Congress appropriated almost $5 billion for the HOPE VI program, and HUD used the majority of this funding to award 165 revitalization grants to 98 public housing authorities.

Figure 1: The Oaks at Durkeeville, Jacksonville, Florida

Before HOPE VI renovation

After HOPE VI renovation

Source: Printed with the permission of the Jacksonville Housing Authority.

To increase the number of affordable housing units developed at HOPE VI sites, HUD encouraged housing authorities to use their HOPE VI grants to attract, or leverage, funding from other sources, including other federal, state, local, and private-sector sources. In our July 1998 report on the program, we found that financial leveraging had increased over time and that this trend was expected to continue.[1] Housing authorities that received revitalization grants in fiscal years 1993 through 2001 estimate that they will be able to obtain an additional $9 billion in public and private funds for their HOPE VI sites. Projects funded with a combination of public and private funds are known as mixed-finance projects.

The HOPE VI program is also intended to improve the lives of public housing residents through community and supportive services, such as childcare, transportation, job training, job placement and retention services, and parenting classes. Although HUD, as required by law, limits the portion of HOPE VI grant funds that grantees may spend for these services, it encourages housing authorities to leverage additional funds that are not subject to HUD's limits.

As required by the Quality Housing and Work Responsibility Act of 1998 (the Act), HUD adopted a revised total development cost policy in 1999. This policy, as specified by the Act, limits the amount of public housing funds, including HOPE VI funds, that housing authorities may spend to construct a public housing unit.[2] This per-unit limit, which does not apply to leveraged funds, is equal to an amount that HUD has determined is adequate to develop a unit of good and sound quality. The Act also requires HUD to report annually to the Congress on the costs of public housing units revitalized at HOPE VI sites.

You requested that we comprehensively review the HOPE VI program. Because of the scope of the request, we agreed with your office to provide the information in a series of reports. This first report focuses on the financing of HOPE VI developments. Specifically, as agreed with your office, we describe the extent to which grantees have (1) leveraged funds from other sources, particularly other federal sources; (2) leveraged funds specifically for community and supportive services; and (3) complied with

[1]U. S. General Accounting Office, *HOPE VI: Progress and Problems in Revitalizing Distressed Public Housing*, GAO/RCED-98-187 (Washington, D.C.: July 20, 1998).

[2]Public housing authorities also receive annual grants to fund capital improvements at public housing developments.

HUD's funding limits for developing public housing units and budgeted additional funds not subject to these limits. Because the Act requires HUD to report HOPE VI cost information to the Congress, we also discuss the extent to which HUD has complied with this requirement.

To address these objectives, we obtained and analyzed funding information from HUD's HOPE VI reporting system. This system contains information on all the revitalization grants awarded through fiscal year 2001, including projected budgets and funding sources. To assess the reliability of this projected funding data, we reviewed information about the system and performed electronic testing to detect obvious errors in completeness and reasonableness. We also reviewed all the mixed-finance proposals approved through fiscal year 2001. (Grantees submit mixed-finance proposals, which include information on the sources and uses of funds, when they are ready to proceed with a mixed-finance phase of development.) In addition, we interviewed the HUD headquarters officials responsible for administering the program. We performed our work from November 2001 through September 2002 in accordance with generally accepted government auditing standards. Appendix I provides additional details on our scope and methodology.

Results in Brief

According to our analysis of HUD data, housing authorities expect to leverage, for every dollar received in HOPE VI revitalization grants awarded through fiscal year 2001, an additional $1.85 in funds from other sources. However, HUD considers the amount of leveraging to be slightly higher because it treats as "leveraged" both (1) HOPE VI grant funds competitively awarded for the demolition of public housing units and (2) other public housing capital funds that the housing authorities would receive even in the absence of the revitalization grants. HUD data also indicate that 46 percent of all resources budgeted for HOPE VI sites are from federal sources. However, HUD does not treat funds that grantees receive through low-income housing tax credits as federal funds. These credits—which provide tax incentives for private investment in the development and rehabilitation of housing for low-income households—represent forgone federal income and, therefore, are a direct cost to the federal government. Our analysis of the mixed-finance proposals HUD approved through fiscal year 2001 indicates that, when low-income housing tax credit funding is included, 79 percent of the budgeted funds are from federal sources. The remaining 21 percent of budgeted funds are from nonfederal sources, including private sources (12 percent) and state and local governments (9 percent).

Housing authorities that have received revitalization grants expect to leverage $295 million in additional funds for community and supportive services. The majority of these leveraged funds are anticipated by authorities that received grants in recent fiscal years (1999 through 2001). Overall, housing authorities have budgeted a total of about $714 million in HOPE VI revitalization grant funds and leveraged funds for community and supportive services. Leveraging for community and supportive services increased dramatically after 1997, when HUD instituted incentives to encourage this practice. Specifically, 22 percent of the total funds budgeted by fiscal year 1997 grantees for community and supportive services consisted of leveraged funds, while 59 percent of the total funds budgeted by fiscal year 2001 grantees consisted of leveraged funds.

Our review of HUD-approved mixed-finance proposals shows that housing authorities have complied with HUD's total development cost policy when developing public housing units at HOPE VI sites. However, housing authorities have often budgeted additional funds that are not subject to the funding limits in the policy. As specified in the Quality Housing and Work Responsibility Act of 1998, HUD's policy applies only to the use of public housing funds, and it excludes some costs from counting against the limits, such as those incurred for removing or replacing extensive underground utility systems or constructing extensive street and other public improvements. For the mixed-finance proposals we reviewed, the average amount of public housing funds budgeted per public housing unit on costs subject to HUD's funding limits was $98,097. The average amount of total funds budgeted per unit was $171,541.

Although HUD has been required to report leveraging and cost information to the Congress annually since 1998, it has not done so. Section 535 of the Quality Housing and Work Responsibility Act of 1998 requires HUD to submit an annual report to the Congress on the HOPE VI program. The Act provides that this annual report is to include, among other things, the cost of public housing units revitalized under the program and the amount and type of financial assistance provided under and in conjunction with the program. HUD has not issued these required annual reports to the Congress. However, in June 2002, HUD submitted a report to the House and Senate appropriation committees as directed by *House Conference Report 107-272.* This report includes some of the information required in the annual report, such as the extent of leveraging. According to HUD officials, they have also provided program information to the Congress through budget documents, the agency's annual performance and accountability reports, and testimonies by HUD officials. However, neither HUD's most recent budget justification nor its most recent performance and accountability report contains detailed information on the amount of leveraged funds or the cost of public housing units revitalized under the HOPE VI program. To enable the Congress to better determine the program's cost to the federal government and assess its cost effectiveness, we are recommending that HUD provide the annual reports on the HOPE VI program to the Congress as required by the Act. HUD agreed with our recommendation and plans to submit an annual report for fiscal year 2002.

Background

In 1989, the Congress established the National Commission on Severely Distressed Public Housing (the Commission) to explore the factors contributing to structural, economic, and social distress in public housing; identify strategies for remediation; and propose a national action plan to eradicate distressed conditions by the year 2000. In 1992, the Commission reported that approximately 86,000, or 6 percent, of the nation's public housing units were severely distressed. According to the Commission, these units qualified as severely distressed because of their physical deterioration and uninhabitable living conditions; high levels of poverty; inadequate and fragmented services; institutional abandonment; and location in neighborhoods often as blighted as the sites themselves. Although the Commission did not identify specific locations as severely distressed, it recommended that funds be made available to address distressed conditions, and that these funds be added to the amounts traditionally appropriated for modernizing public housing. The Commission also encouraged the development of supportive services for residents in distressed housing developments.

In response to the Commission's report, Congress established the Urban Revitalization Demonstration Program, more commonly known as HOPE VI, at HUD. By providing funds for a combination of capital improvements and community and supportive services, the program seeks to (1) improve the living environment for public housing residents of severely distressed public housing through the demolition, rehabilitation, reconfiguration, or replacement of obsolete public housing; (2) revitalize sites on which such public housing is located, and contribute to the improvement of the surrounding neighborhood; (3) provide housing that will avoid or decrease the concentration of very low-income families; and (4) build sustainable communities. To achieve these objectives, the program provides demolition and revitalization grants to public housing authorities (PHA). Demolition grants fund the demolition of distressed public housing, the relocation of residents affected by the demolition, and the implementation of supportive services for permanently relocated residents. Revitalization grants fund, among other things, the capital costs of major rehabilitation, new construction, and other physical improvements; demolition of severely distressed housing; and community and supportive service programs for residents, including those relocated as a result of revitalization efforts. Through fiscal year 2001, HUD had awarded 177 demolition grants totaling approximately $293 million and 165 revitalization grants totaling about $4.5 billion.

According to HUD, HOPE VI started as an embellished modernization program but has evolved into a comprehensive and complex transformation in how housing authorities provide affordable housing to low-income families. A significant stage in that evolution was the issuance of the Mixed-Finance Rule in 1996.[3] Under this rule, for the first time PHAs were allowed to use public housing funds designated for capital improvements, including HOPE VI funds, to leverage other public and private investment to develop public housing units. The rule also permitted PHAs to provide public housing capital funds to a third party so that the third party could develop public housing units. The third party would then own the resulting public housing units and could receive capital or operating assistance for the units from HUD through the PHA. HUD emphasizes that this mixed-finance approach to public housing development is the single most important development tool currently available to PHAs. The approach encourages the formation of new public and private partnerships to ensure the long-term sustainability of the public housing development and surrounding community. The mixed-finance approach can produce developments that include both public housing and nonpublic housing units, such as low-income housing tax credit units or market rate units.

Mixed-finance HOPE VI projects are often undertaken in development phases. A housing authority may not begin a phase to be financed with a combination of public and private funds until it has submitted, and HUD has approved, a mixed-finance proposal for that phase. The mixed-finance proposal presents the fundamental information that HUD needs to evaluate a mixed-finance phase. For example, it contains basic descriptive information such as the number and types of units planned, the development schedule, the sources and uses of funding, and the operating budget for the phase. Because of the time that is needed to plan HOPE VI projects and develop specific proposals, most of the proposals that HUD

[3] See 24 CFR 941, Subpart F.

approved through fiscal year 2001 were funded with revitalization grants awarded several years earlier.

PHAs with revitalization grants can use a variety of other public and private funds to develop their HOPE VI sites. Public funding can come from federal, state, and local sources. For example, PHAs can use federal resources HUD has already awarded for capital improvements at public housing developments. These capital funds can be used for a variety of purposes, including the development, financing, and modernization of public housing and the replacement of obsolete utility systems and dwelling equipment. PHAs can also use funds raised through federal low-income housing tax credits. Under this program, states are authorized to allocate federal tax credits as an incentive to the private sector to develop rental housing for low-income households. After the state allocates tax credits to developers, the developers typically offer the credits to private investors. The private investors use the tax credits to offset taxes otherwise owed on their tax returns. The money private investors pay for the credits is paid into the projects as equity financing. In addition, PHAs may obtain some of the funding needed for infrastructure and public improvements from state and local governments. Private sources can include private mortgage financing and financial or in-kind contributions from nonprofit organizations. See appendix II for more information on the types of funds that may be invested at HOPE VI sites.

Housing Authorities Are Leveraging Additional Funds

According to our analysis of HUD data, housing authorities expect to leverage, for every dollar received in HOPE VI revitalization grants awarded through fiscal year 2001, an additional $1.85 in funds from other sources. Our figure is slightly lower than the $2.07 that HUD considers to be the projected amount leveraged per HOPE VI dollar because, unlike HUD, we do not consider funds such as HOPE VI demolition grants to be leveraged funds. Also, HUD data indicate that, of the total funds that housing authorities with revitalization grants have budgeted for their HOPE VI sites, 46 percent come from federal sources. However, this percentage does not include funds that grantees receive through low-income housing tax credits, which are a direct cost to the federal government. Our analysis of all mixed-finance proposals HUD approved through fiscal year 2001 indicates that 79 percent of the budgeted funds came from federal sources, when low-income housing tax credit funding was included.

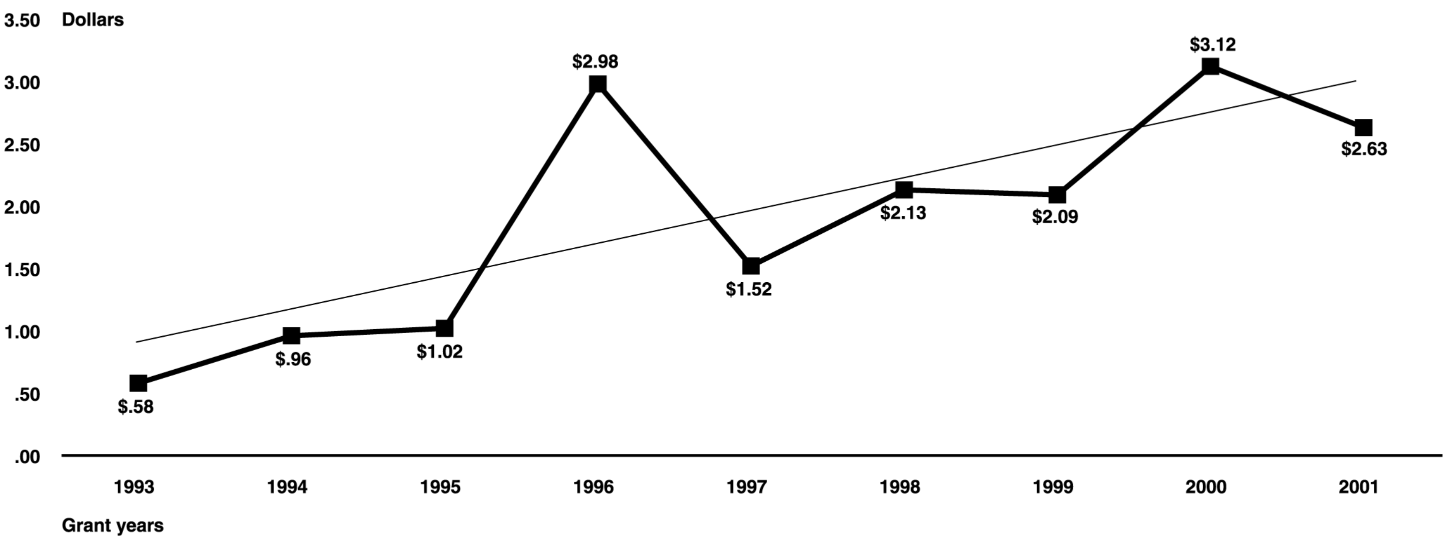
Leveraging Has Increased over the Life of the HOPE VI Program

Our analysis of data in HUD's HOPE VI reporting system shows that housing authorities that received HOPE VI revitalization grants in fiscal years 1993 to 2001 expect to leverage an additional $1.85 for every HOPE VI dollar received.[4] However, HUD considers the amount of leveraging to be an additional $2.07 for every HOPE VI dollar received because it includes other HUD-provided public housing funds as leveraged funds. In total, $964 million in public housing funds have been budgeted for HOPE VI sites. The $964 million includes capital funds and $150 million in HOPE VI demolition grant funds. Grantees would have received the capital funds regardless of whether they received a HOPE VI revitalization grant, and the demolition grants are another category of HOPE VI funds. When the $964 million in public housing funds are not included as leveraged funds, the overall projected leveraging per HOPE VI dollar is reduced from $2.07 to $1.85.

Even when public housing funds are excluded from leveraged funds, our analysis of HUD data shows that leveraging has increased over the life of the HOPE VI program. According to HUD's HOPE VI reporting system, housing authorities that received a revitalization grant in fiscal year 1993 expected to raise an additional $0.58 (excluding public housing funds) for every HOPE VI grant dollar awarded to them. By fiscal year 2001, housing authorities expected to augment every HOPE VI revitalization grant dollar awarded to them with an additional $2.63 from other sources (excluding public housing funds). Though mixed-finance development was not an official option for housing authorities until 1996, housing authorities were permitted, prior to 1996, to use a mix of public funds to redevelop distressed public housing sites. According to HUD officials, the amounts leveraged by housing authorities should increase over time, as potential investors become more familiar with the HOPE VI program and housing authorities become more sophisticated in seeking and securing other sources of funds. Figure 2 shows that amounts leveraged by housing authorities have generally increased over time.

[4] Although some of the projected leveraged funding is for grants awarded in the early years of the program, the amounts are still estimates because only 15 grants have been totally completed.

Figure 2: Projected Amount Leveraged with HOPE VI Grant Funds (with Trend Line)



Source: GAO analysis of data from HUD's HOPE VI reporting system (as of June 30, 2002).

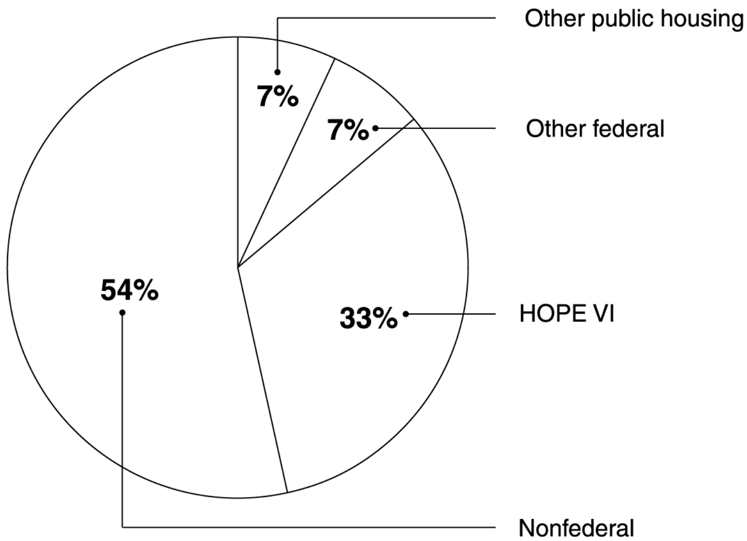
Most Leveraged Funds Come from Federal Sources

Our analysis of the mixed-finance proposals that HUD approved through fiscal year 2001 shows that 79 percent of the funding comes from federal sources. However, HUD's data shows that 46 percent of all resources budgeted for HOPE VI sites come from the federal government. HUD's HOPE VI reporting system contains funding projections for all revitalization grants awarded through fiscal year 2001. As shown in figure 3, the reporting system divides budgeted resources into four categories, as follows:

- HOPE VI funds—HOPE VI revitalization grant funds awarded to a housing authority;
- other public housing funds—other HOPE VI funding, such as demolition grants, and resources HUD allocates to housing authorities, such as capital funds;
- other federal funds—all other federal sources of funding; and
- nonfederal funds—funds from state and local governments, private funds, and equity raised from low-income housing tax credits.

The sale of low-income housing tax credits to investors generates private capital to acquire, construct, or rehabilitate housing targeted to households earning less than 60 percent of median income; therefore, HUD defines the funds generated as private funds. However, tax credits represent forgone federal income and, therefore, are a direct cost to the federal government. Our reports have consistently described low-income housing tax credits as federal housing assistance.[5]

Figure 3: HUD Data on Budgeted Funding Sources



Note: Numbers do not add because of rounding.

Source: GAO analysis of data from HUD's HOPE VI reporting system (as of June 30, 2002).

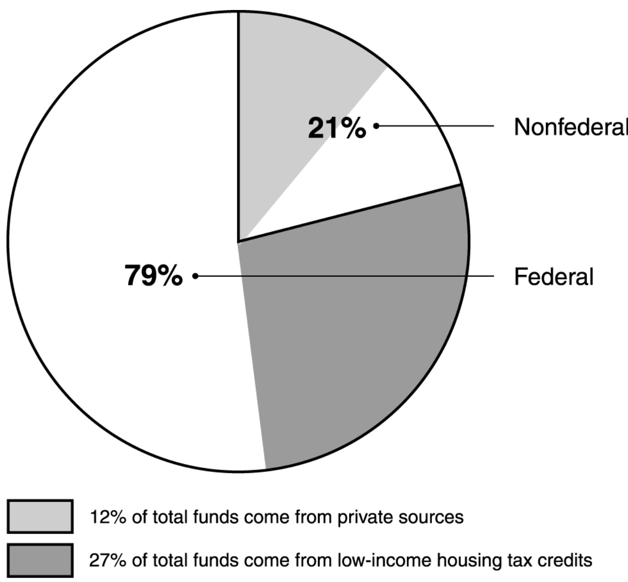
Because housing authorities do not have to report individually each source included in the nonfederal funding category, we could not use the data in HUD's HOPE VI reporting system to determine the specific amounts raised through low-income housing tax credits. In order to distinguish low-income housing tax credit funds from nonfederal funds, we examined 85 mixed-finance proposals that HUD had approved through the end of fiscal year 2001.[6] These proposals list all of the funding sources and amounts separately. As shown in figure 4, our analysis shows that 79 percent of all the budgeted funds come from federal sources—HOPE VI funds, other public housing funds, and other federal funds, including equity raised from

[5]For example, in January 2002 we compared the cost of the low-income housing tax credit program to that of other federal housing programs and reported that the tax credit program cost the federal government $3.5 billion in forgone tax revenue in fiscal year 1999. See *Federal Housing Assistance: Comparing the Characteristics and Costs of Housing Programs*, GAO-02-76 (Washington, D.C.: Jan. 31, 2002).

[6]Of the 87 mixed-finance proposals HUD approved through fiscal year 2001, 85 proposals contained the documentation we needed to perform our analysis.

low-income housing tax credits. Equity raised from low-income housing tax credits made up 27 percent of total budgeted sources.[7] Nonfederal funds comprised 21 percent of all budgeted resources—12 percent from private sources and 9 percent from state and local sources.

Figure 4: Funds Budgeted in Approved Mixed-Finance Proposals



Source: GAO analysis of 85 mixed-finance proposals approved through fiscal year 2001.

Leveraged Funds Comprise an Increasing Percentage of Funds Budgeted for Community and Supportive Services

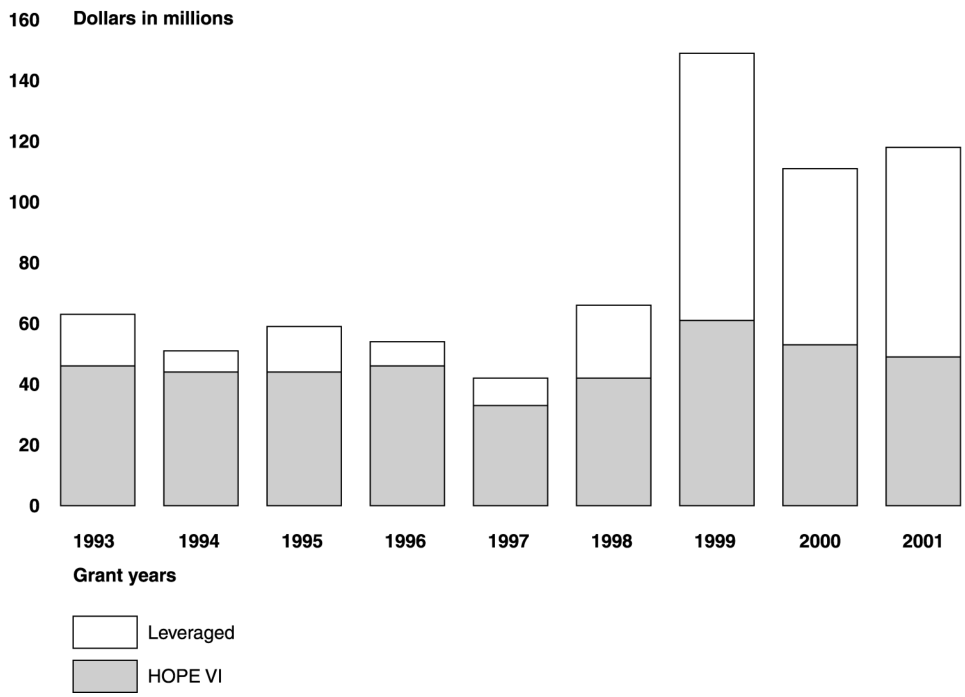
Overall, housing authorities that received revitalization grants in fiscal years 1993 to 2001 have budgeted a total of about $714 million for community and supportive services—$418 million in HOPE VI funds (59 percent) and $295 million (41 percent) in leveraged funds.[8] The $418 million in HOPE VI funds accounts for 9 percent of total revitalization grant funds awarded. HUD's annual notice of funding availability—which sets forth the program's current requirements and available funds—sets a limit on the amount of grant funds that housing authorities can spend on supportive services. All of the notices since 1999 have included incentives that encourage housing authorities to leverage additional funds for

[7]The amount of tax credit equity listed in each approved budget does not represent the full cost to the federal government, because the amount of equity raised is less than the amount of tax credits provided for a project.

[8]Numbers do not add because of rounding.

supportive services. There is no cap on the amount of leveraged funds that housing authorities can spend on supportive services. Housing authorities are encouraged to obtain in-kind, financial, and other types of resources necessary to carry out and sustain supportive service activities from organizations such as local Boards of Education, public libraries, private foundations, nonprofit organizations, faith-based organizations, and economic development agencies. As shown in figure 5, the amount of funds set aside by each year's grantees for supportive services has varied over the life of the program.

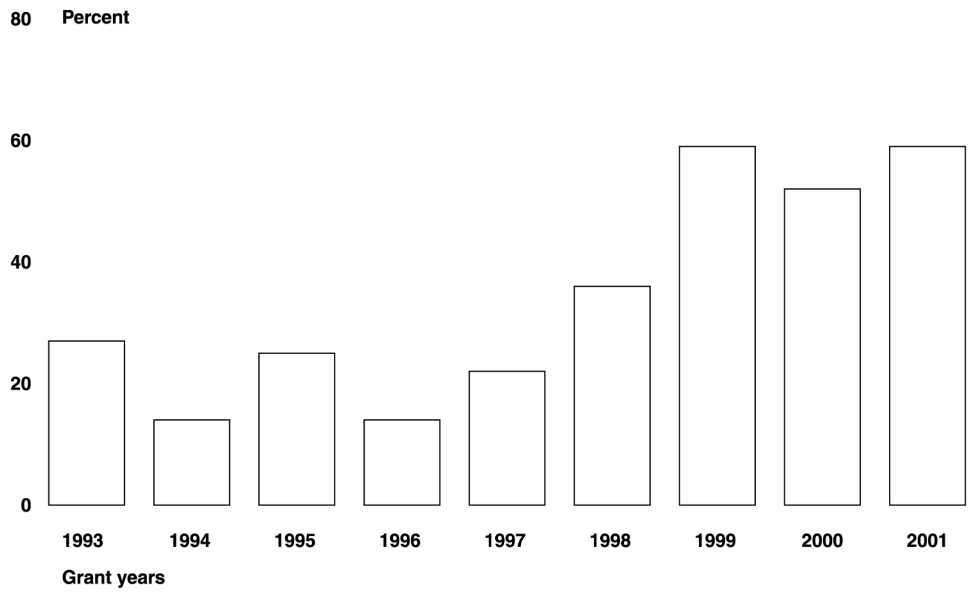
Figure 5: Funds Budgeted for Community and Supportive Services



Source: GAO analysis of data from HUD's HOPE VI reporting system (as of June 30, 2002).

Although the majority of funds budgeted overall for supportive services are HOPE VI funds, the amount of non-HOPE VI funds budgeted for supportive services has increased dramatically since the program's inception. As shown in figure 6, the percentage of total supportive services funding made up of leveraged funds jumped significantly after 1997. Specifically, while 22 percent of the total funds budgeted for supportive services by fiscal year 1997 grantees consisted of leveraged funds, 59 percent of the total funds budgeted by fiscal year 2001 grantees consisted of leveraged funds. This increase may be attributable, in part, to the fact that, starting in fiscal year 1998, HUD began to consider the leveraging of additional resources (for physical improvements and supportive services) as one of its criteria for evaluating grant applications. Since 1999, HUD has specifically considered the extent to which PHAs have leveraged funds for supportive services.

Figure 6: Percentage of Total Funds Budgeted for Community and Supportive Services That Are Leveraged



Source: GAO analysis of data from HUD's HOPE VI reporting system (as of June 30, 2002).

Housing Authorities Have Complied with HUD's Funding Limits and Budgeted Additional Funds Not Subject to These Limits

Housing authorities have complied with HUD's limits on the amounts of public housing funds that may be used to develop public housing units at HOPE VI sites. They have also budgeted funds from other sources that are not subject to these limits. As required by the Quality Housing and Work Responsibility Act of 1998, HUD adopted a revised total development cost policy in 1999.[9] This policy, as specified in the Act, limits the amount of public housing funds, including HOPE VI funds, that housing authorities can spend to construct public housing units. These funding limits are the amounts that HUD has determined are adequate to develop units of good and sound quality. As mandated in the Act, some demolition, site remediation, and extraordinary site costs—costs that HUD has determined

[9]The current policy is contained in PIH Notice 01-22.

are not purely development-related costs—are excluded. Specifically, demolition and site remediation costs are prorated with respect to the number of new public housing units being developed on the site. For example, if a PHA is planning to demolish 300 public housing units and to put 100 new public housing units back on the site, it has to consider only one-third of the demolition and remediation costs when comparing public housing development costs with the funding limit. Extraordinary site costs—such as removal or replacement of extensive underground utility systems, construction of extensive street and other public improvements, and dealing with flood plains—are also excluded. An independent engineer must verify extraordinary site costs. Our analysis of 77 (out of 87) approved mixed-finance proposals shows that housing authorities have complied with HUD's cost policy.[10]

The actual costs of developing units at HOPE VI sites are often higher than the public housing funds budgeted for developing public housing units.[11] In the 64 mixed-finance proposals for which there was sufficient detailed information to perform our analysis, $525 million in public housing funds, including HOPE VI funds, were subject to HUD's established funding limits.[12] However, total funds of $1.3 billion were approved in the mixed-finance proposals. Therefore, the average amount of public housing funds (including HOPE VI funds, capital funds, and other public housing development funds) budgeted per public housing unit subject to HUD's funding limits was $98,097, while the average amount of total funds budgeted per unit was $171,541.[13]

[10]The documentation on housing authorities' compliance with HUD's cost policy was not available for 10 of the 87 mixed-finance proposals approved through fiscal year 2001.

[11]Though HUD's total development cost policy applies only to public housing funds, other investors in HOPE VI sites provide cost control. For example, state agencies that award tax credits review proposed projects, monitor the reasonableness of project costs, and take responsibility for ensuring that projects stay in compliance with rent and unit restrictions and that approved projects receive only the tax credits necessary to make the project work. The Internal Revenue Service is responsible for monitoring compliance with federal guidelines and state performance.

[12]The detailed total development cost–limit information we needed to perform our analysis was not available for 23 of the 87 mixed-finance proposals approved through fiscal year 2001.

[13]The two per-unit figures are in 2002 dollars.

HUD Has Not Complied with the Annual Reporting Requirement

HUD has been required to report leveraging and cost information annually to the Congress since 1998; however, it has not done so. Section 535 of the Quality Housing and Work Responsibility Act of 1998 requires HUD to submit an annual report to the Congress on the HOPE VI program. As provided by the Act, this annual report is to include, among other things, the cost of public housing units revitalized under the program and the amount and type of financial assistance provided under and in conjunction with the program.

Agency officials in charge of the HOPE VI program acknowledge that HUD has not issued the annual reports to the Congress required under the Act. They noted that they have provided program information through other means. In June 2002, HUD submitted a report to the House and Senate appropriation committees as directed by *House Conference Report 107-272.* This report discusses best practices and lessons learned in the HOPE VI program between 1992 and 2002. It also includes some of the information required in the annual report, such as the extent of leveraging.

HOPE VI officials also noted that they have provided information to the Congress through other means that the agency has deemed appropriate, such as budget documents, the agency's performance and accountability reports, and testimonies by HUD officials. However, neither HUD's most recent budget justification nor its most recent performance and accountability report contains detailed information on leveraging or the cost of public housing units developed under the HOPE VI program. Although HUD's fiscal year 2003 budget justification provides information on the amount of outside funds leveraged by HOPE VI funds, it does not describe the sources of these funds or provide cost information. Further, HUD's fiscal year 2001 performance and accountability report focuses on four key outputs of the HOPE VI program: families relocated, units demolished, new and rehabilitated units completed, and units occupied. The report does not provide information on HOPE VI leveraging or the cost of units developed under the program. Agency officials responsible for administering HOPE VI agreed that preparing the annual report as required under the Act would help provide the Congress and other interested stakeholders with useful information with which to assess the cost effectiveness and results of the program.

Conclusions

The Congress faces difficult choices when deciding how to provide affordable housing. One of the objectives of the HOPE VI program is to leverage program funds, and such leveraging has increased over the life of the HOPE VI program—albeit primarily from other federal sources.

However, HUD's HOPE VI reporting system does not identify funds that housing authorities obtain specifically from low-income housing tax credits, which are a direct cost to the federal government, as federal funds. Furthermore, applying HUD's total development cost policy does not provide a comprehensive picture of the actual costs of developing units at HOPE VI sites. This policy, which HUD established in accordance with the Quality Housing and Work Responsibility Act of 1998, was not intended to determine the actual cost of development at HOPE VI sites. Instead, it is designed to determine cost limits for the development of public housing with public housing funds. The type of data that HUD is required to report annually to the Congress would provide information needed to evaluate the program's cost to the federal government and its cost effectiveness.

Recommendation for Executive Action

We recommend that the Secretary of Housing and Urban Development provide annual reports on the HOPE VI program to the Congress as required by law and include in these annual reports, among other things, information on

- the amounts and sources of funding used at HOPE VI sites, including equity raised from low-income housing tax credits, and
- the total cost of developing public housing units at HOPE VI sites, including the costs of items subject to HUD's development cost limits and those that are not.

Agency Comments and Our Evaluation

We provided a draft of this report to HUD for its review and comment. In a letter from the Assistant Secretary for Public and Indian Housing (see app. III), HUD stated that it found the report to be fair and accurate in its assessment of HOPE VI financing. HUD also agreed with our recommendation to submit annual reports and noted that it plans to submit an annual report for fiscal year 2002 by December 31, 2002. According to the agency, the fiscal year 2002 report will include the amounts and sources of funding used at HOPE VI sites, including equity raised by low-income housing tax credits categorized as private sources, and the total cost of developing public housing units at HOPE VI sites. HUD also provided clarifications on several technical points, which have been included in the report as appropriate.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 15 days after the date of this letter. At that time, we will send copies of this report to the

Ranking Member, Subcommittee on Housing and Transportation, Senate Committee on Banking, Housing, and Urban Affairs; the Chairman and Ranking Minority Member, Senate Committee on Banking, Housing, and Urban Affairs; the Chairman, Vice Chairman, and Ranking Minority Member, Subcommittee on Housing and Community Opportunity, House Committee on Financial Services; and the Chairman and Vice Chairman, House Committee on Financial Services. We will also send copies to the Secretary of Housing and Urban Development and the Director of the Office of Management and Budget. We will make copies available to others upon request. This letter will also be available at no charge on GAO's home page at http://www.gao.gov.

Please call me at (202) 512-8678 if you or your staff have any questions about this report. Key contributors to this report are listed in appendix IV.

Sincerely yours,

David G. Wood

David G. Wood
Director, Financial Markets and
Community Investment

Appendix I: Objectives, Scope, and Methodology

Our objectives were to describe the extent to which housing authorities with HOPE VI revitalization grants have (1) leveraged funds from other sources, particularly other federal sources; (2) leveraged funds specifically for community and supportive services; and (3) complied with HUD's funding limits for developing public housing units and budgeted additional funds not subject to these limits. We also determined the extent to which HUD has reported cost information to the Congress.

To determine the extent to which grantees have leveraged federal and nonfederal funds, we analyzed data from HUD's HOPE VI reporting system and reviewed all mixed-finance proposals approved through September 30, 2001. Specifically, we obtained data as of the quarter that ended June 30, 2002, for all 165 revitalization grants awarded through fiscal year 2001. We used this data to determine the projected amount of funds leveraged per HOPE VI dollar. In addition, we analyzed HUD's data to determine the percentage of total funding that grantees expect to derive from HOPE VI revitalization grants, other public housing funds, other federal funds, and nonfederal funds. To assess the reliability of HUD's data, we reviewed information about the system and performed electronic testing to detect obvious errors in completeness and reasonableness. To determine the federal and nonfederal funds actually obtained by grantees, we requested excerpts from all of the mixed-finance proposals approved through the end of fiscal year 2001. For example, we requested the budget that shows the sources and uses of funds and the total development cost limit analysis. Although HUD reported that it had approved 87 mixed-finance proposals through September 30, 2001, it was able to provide the documentation we needed to analyze funding sources only for 85 proposals. The two remaining proposals lacked sufficient budget information for us to perform our analysis. The 85 mixed-finance proposals we reviewed were for phases to be constructed under 48 different revitalization grants and represented 13 percent of all funds budgeted through June 30, 2002, and 16 percent of all revitalization grant funds budgeted over the life of the program. To gain an understanding of the mixed-finance development approach, we interviewed headquarters officials in HUD's Office of Public Housing Investments and reviewed HUD's *Mixed-Finance Guidebook*.

To determine the extent to which grantees have budgeted leveraged funds specifically for community and supportive services, we analyzed financial data from HUD's HOPE VI reporting system reported as of June 30, 2002. Specifically, we used this data to identify the amounts of HOPE VI revitalization funds and leveraged funds budgeted for supportive services overall and by grant year. We also used this data to determine the proportion of HOPE VI funds budgeted for supportive services relative to the total amount of HOPE VI revitalization grant funds awarded. Moreover, we used this data to identify trends in the use of leveraged funds for supportive services. To determine why the use of leveraging increased after 1997, we interviewed headquarters officials in HUD's Office of Public Housing Investments and reviewed HUD's guidance to grantees and the notices of funding availability for fiscal years 1993 through 2001.

To determine the extent to which grantees have complied with HUD's funding limits for developing public housing units and have budgeted additional funds not subject to these limits, we reviewed HUD's total development cost policy and established what costs are subject to the policy and what costs are excluded. We then analyzed all 87 mixed-finance proposals approved through fiscal year 2001 to determine if they complied with HUD's cost policy. We were not able to determine compliance for 10 of the 87 proposals because the documentation provided did not contain the level of detail required. In order to compare the per-unit cost of a public housing unit according to HUD's cost policy with the actual cost of developing the unit, we again analyzed the mixed-finance proposals. For 64 of the 87 mixed-finance proposals, we determined the per-unit cost of a public housing unit according to HUD's cost policy, which includes only public housing funds and excludes certain costs. For the same 64 proposals, we then determined the actual per-unit cost by dividing the total funds budgeted by the total number of units. We were not able to perform these analyses for 23 of the 87 proposals because the Office of Public Housing Investments could not provide the detailed total development cost limit analysis needed. For example, in some cases, the office was able to provide only the information necessary to calculate the per-unit cost of a public housing unit for an entire HOPE VI project, as opposed to the particular phase for which we had the approved budget.

To determine the extent to which HUD has reported cost information to the Congress, we reviewed the HOPE VI reporting requirements in the Quality Housing and Work Responsibility Act of 1998. We then interviewed headquarters officials in HUD's Office of Public Housing Investments to determine the type of program information the Department has reported to the Congress, and in what format. Finally, we reviewed HUD's fiscal year 2003 budget justification and its fiscal year 2001 performance and accountability report.

We performed our work from November 2001 through September 2002 in accordance with generally accepted government auditing standards.

Appendix II: Examples of HOPE VI Funding Sources

Public housing authorities (PHA) with HOPE VI revitalization grants use funds from a variety of federal and nonfederal sources to develop their HOPE VI sites. Federal sources include additional public housing funds, other HUD funds, and low-income housing tax credits. Nonfederal sources include state and local funds, private donations, and tax-exempt bonds. Listed below are brief descriptions of some of these funding sources.

Federal sources:

Capital Fund Program (CFP)

Under CFP, HUD provides annual formula grants to PHAs for capital and management activities, including the development, financing, and modernization of public housing. The funds may not be used for luxury improvements, direct social services, costs funded by other HUD programs, or ineligible activities, as determined by HUD on a case-by-case basis.

Community Development Block Grant (CDBG) Program

The CDBG funding that HUD provides is split between states and local jurisdictions called "entitlement communities." Funds are awarded on a formula basis to entitled metropolitan cities and urban counties. States distribute the funds to localities that do not qualify as entitlement communities. CDBG funds can be used to implement a wide variety of community and economic development activities directed toward neighborhood revitalization, economic development, and improved community facilities and services.

Comprehensive Grant Program (CGP)

Under CGP, HUD provided funds, on a formula basis, to help large PHAs (those with at least 250 units) correct physical, management, and operating deficiencies and keep units in the housing stock as safe and desirable homes for low-income families. The Quality Housing and Work Responsibility Act of 1998 shifted CGP into the Capital Fund.

Comprehensive Improvement Assistance Program (CIAP)

Under CIAP, HUD provided competitive grants to help smaller PHAs (those with fewer than 250 units) to correct physical, management, and operating deficiencies and keep units in the housing stock as safe and desirable homes for low-income families. The Quality Housing and Work

Responsibility Act of 1998 shifted assistance to smaller PHAs from the competitive CIAP to a formula grant under the Capital Fund in 1999.

Historic Rehabilitation Tax Credits

Historic rehabilitation tax credits are available to rehabilitate certified historic structures that will need substantial rehabilitation. Eligible applicants receive a tax credit equal to 20 percent of the amount of qualified rehabilitation expenditures.

Home Investment Partnership Program (HOME)

Through HOME, HUD provides annual formula grants to states and localities to fund a wide range of activities designed to build, buy, or rehabilitate affordable housing or provide direct rental assistance to low-income people. Specifically, states and localities use HOME funds for grants, direct loans, loan guarantees or other forms of credit enhancement, rental assistance, and security deposits.

Low-Income Housing Tax Credits (LIHTC)

Under the LIHTC program, states are authorized to issue federal tax credits for the acquisition, rehabilitation, or new construction of affordable rental housing. The credits are generally sold to outside investors to raise development funds for a project. These outside investors use the tax credit to offset taxes otherwise owed on their tax returns. To qualify for credits, a project must have a specific proportion of its units set aside for lower-income households, and the rents on these units must be limited to 30 percent of qualifying income. The amount of credit that can be provided to a project is determined by size of the allocation, eligible costs, number of tax credit units, type of credit, and investor pricing. Credits are provided for 10 years. State housing credit agencies usually award tax credits through competitive rounds. Each state receives an annual allocation of $1.75 per capita. States must reserve a minimum of 10 percent of the credits for nonprofit developers.

Major Reconstruction of Obsolete Projects (MROP)

Under MROP, which last funded new development in 1994, HUD provided funds to PHAs to perform major reconstruction of obsolete public housing or to maintain or expand the supply of housing for low-income families. Projects formerly funded as MROP are now funded through the Capital Fund.

Operating Fund

Through the Operating Fund, HUD provides PHAs with a subsidy, on a formula basis, to fund the operating and maintenance expenses of the developments they own or operate. It enables PHAs to keep rents affordable for lower-income families and to cover a variety of expenses, including maintenance, utilities, and tenant and protective services.

Public Housing Drug Elimination Program (PHDEP)

Eligible PHAs received PHDEP grants from HUD to reduce or eliminate drug-related crime in and around public housing. Grantees were encouraged to develop a plan that included initiatives that could be sustained over a period of several years for addressing the problem of drug-related crime in and around public housing. The program was eliminated in the fiscal year 2002 HUD budget.

Renewal Community/Empowerment Zone/Enterprise Community Initiative (RC/EZ/EC)

In urban areas that HUD has designated as Renewal Communities, Empowerment Zones, and Enterprise Communities, grants and tax incentives are provided. They stimulate the creation of new jobs empowering low-income persons and families receiving public assistance to become economically self-sufficient, and they promote the revitalization of economically distressed areas.

Nonfederal sources:

Affordable Housing Program

The program subsidizes long-term financing for very low- , low- , and moderate-income families. The Federal Home Loan Banks provide from their annual net earnings low-cost funding and other credit to stockholder members on a districtwide competitive basis. Members—which include commercial banks, savings institutions, credit unions, and insurance companies—use this credit to meet the housing finance and credit needs of their communities.

Housing Trust Funds

Housing trust funds are distinct funds established by cities, counties, and states that permanently dedicate a source of public revenue to support the production and preservation of affordable housing. There are at least 257 housing trust funds in the United States. Housing trust funds support a variety of housing activities for low- and very low-income households, including new construction, preservation of existing housing, emergency repairs, homeless shelters, housing-related services, and capacity building for nonprofit organizations.

Private Sources

Nonprofit and faith-based organizations, developers, private banks and lending institutions, universities, large corporations, independently owned businesses, and residents of the HOPE VI projects provide resources for various purposes. For example, developers may have equity at risk, and future residents provide down payments on homeownership units. Universities donate land and assist in developing educational programs. National corporations provide training and employment for public housing residents.

State and Local Sources

State and local governments provide a range of resources, including capital improvement funds for infrastructure and community facilities and direct financial contributions or provision of in-kind services. Some municipalities provide tax-foreclosed properties for redevelopment, matching funds for community and supportive services, and assistance with zoning and other local requirements.

Tax-Exempt Bond Financing

Eligible issuers, such as housing finance agencies and local governments, sell bonds to investors with interest not subject to federal income tax and use proceeds to finance below-market rate–mortgage loans. The lower interest rate on the bond is passed on to borrowers as a reduced mortgage interest rate. The uses of the proceeds raised through tax-exempt bond financing include acquisition, rehabilitation, and construction.

Tax Increment Financing

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

Appendix III: Comments from the Department of Housing and Urban Development

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-5000

OCT 18 2002

OFFICE OF THE ASSISTANT SECRETARY
FOR PUBLIC AND INDIAN HOUSING

TO: David Wood, Director, Financial Markets and Community Investment,
U.S. General Accounting Office

FROM: Michael Liu, Assistant Secretary for Public and Indian Housing

SUBJECT: Comments on GAO Draft Report, "Public Housing: HOPE VI Leveraging Has Increased but HUD Has Not Met Reporting Requirements" (Report to the Chairman, Subcommittee on Housing and Transportation, Committee on Banking, Housing and Urban Affairs, United States Senate)

HUD respectfully submits the following information for consideration in the section of the GAO report designated for Agency Comments.

HUD would like to thank the U.S. General Accounting Office for its thorough and perceptive review of the HOPE VI Program and the opportunity to respond to this first report addressing the financing component of the program. In general, we find the report to be fair and accurate in its assessment of HOPE VI financing and would like to offer additional comments and information.

We are pleased about GAO's conclusion that HOPE VI leveraging has increased, as this validates the significance HUD has placed historically on leveraging as a fundamental program component. HUD regards the significant increases in leverage as a remarkable achievement, rising from an average leverage of $0.58 in 1993 to $2.63 in 2001. Taking GAO's report into consideration, HUD fully intends to continue emphasizing the importance of leveraging in the success of the HOPE VI program and working to further increase the amount of funds leveraged. Specifically, HUD will continue to encourage the use of equity from low-income housing tax credits as a source of financing. In addition, HUD plans to emphasize leveraging of resources that are free from any government support.

In regard to the issue of HOPE VI annual reports, we provide the following clarifying information. As GAO identified in the report, an annual report on the HOPE VI program is required under Section 24 of the U.S. Housing Act of 1937, as amended. The annual report requirement became law on October 21, 1998. Thus, annual reports should have been filed for fiscal years 1999, 2000, and 2001 (fiscal year 2002 just ended).

The Conference Report on the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act for fiscal year 2002, enacted November 26, 2001, directed HUD to file by June 15, 2002 a report on the lessons learned in HOPE VI, including best practices, the extent of leveraging and neighborhood economic development, and the extent to which HOPE VI can be a model for treatment of the distressed project-based section 8 stock. This report to Congress was filed on June 14, 2002.

As required by Section 24 of the Act, the annual report is to set forth the number, type and cost of public housing units revitalized; the status of projects identified as severely distressed public housing; the amount and type of financial assistance provided under and in conjunction with the HOPE VI Program; and the recommendations from HUD for statutory and regulatory improvements. This information was provided to Congress in the report submitted on June 14 or previously through other communications with Congress. Notwithstanding these points, HUD will compile and submit the fiscal year 2002 annual report by December 31, 2002.

Based on HUD's careful and thorough review of the report, the submission of HOPE VI annual reports appears as the primary recommendation. HUD agrees with the recommendation to submit annual reports, in accordance with the format required by Section 24 of the Act, and will submit an annual report for FY 2002 by December 31, 2002. Currently, HUD's HOPE VI reporting system does not provide the level of detail requested by GAO. However, we believe the system data will provide the information Congress has requested under the law. The FY 2002 annual report will include the amounts and sources of funding used at HOPE VI sites, including equity raised by low-income housing tax credits categorized as private sources, and the total cost of developing public housing units at HOPE VI sites.

We look forward to reviewing the ongoing results of your study on the various components of the HOPE VI program. Again, we thank you for your diligent and thoughtful review of the program.

Attachment: Attachment 1 – Additional Comments on the GAO Report

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Appendix IV: GAO Contacts and Staff Acknowledgments

GAO Contacts

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Acknowledgments

In addition to those named above, Anne Dilger, John McGrail, Sara Moessbauer, Lisa Moore, Ginger Tierney, Paige Smith, Mijo Vodopic, Carrie Watkins, and Alwynne Wilbur made key contributions to this report.

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