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HUD'S FY 1998 BUDGET REQUEST

Some Requests for Funding May Be Unnecessary

Statement for the Record by
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Mr. Chairman and Members of the Subcommittee:

We are pleased to have this opportunity to comment on the Department of Housing and Urban Development's (HUD) fiscal year 1998 budget request. In our statement last year,¹ we focused on HUD's progress in addressing the management deficiencies that led us to designate the Department as one of our "high risk" areas. We also focused on various assumptions that HUD made in developing its budget request and on the impact of those assumptions on the Department's cost estimates for multifamily reengineering and for renewing Section 8 contracts for low-income rental assistance. This year, our primary focus is on HUD's request for over \$9 billion to renew rental assistance contracts, as well as on some of the assumptions that underlie HUD's estimate.

Our statement discusses (1) the estimates HUD used to develop its budget request for renewing Section 8 assisted housing contracts, (2) HUD's justification for 50,000 additional Section 8 certificates, (3) HUD's success in reducing the level of uncommitted public housing modernization funds held by housing authorities, and (4) HUD's request for \$100 million to fund the second round of the Empowerment Zone/Enterprise Community (EZ/EC) program. Our work is based on our review of HUD's fiscal year 1998 budget justification materials, our discussions of those materials with HUD officials, and an analysis that we and HUD performed of Section 8 budget authority reserves at HUD state offices in Georgia and Texas.

In summary, we found the following:

- HUD's fiscal year 1998 budget request for \$9.2 billion in budget authority to renew expiring Section 8 contracts for assisted housing includes amounts that may not be required or could be offset. First, HUD's request contains allowances for contingencies—costs that may or may not accrue or that cannot be precisely estimated—with an estimated value of \$531 million. However, because HUD also allows housing agencies that administer the tenant-based program to retain a large portion of their unspent reserves for contingencies, HUD may not need funding for the contingencies noted above. Second, in developing this budget request, HUD may be able to offset (reduce) some of its current renewal needs after it has identified all unspent budget authority accumulated over prior years—an effort it plans to complete by March 31, 1997. Finally, since its budget was released, HUD

¹Housing and Urban Development: Comments on HUD's FY 1997 Budget Request (GAO/T-RCED-96-205, June 17, 1996).

has found that two housing programs that provide project-based² assistance do not need to be renewed in fiscal year 1998, and therefore the programs do not require the \$90 million that HUD budgeted for them.

- HUD also has requested \$305 million in budget authority for fiscal year 1998 to fund 50,000 new Section 8 certificates. According to HUD, the certificates will accommodate family relocation caused by the Department's Welfare-to-Work initiative, but it is unclear how HUD estimated the number of units or justified their need. For example, HUD has neither given a basis for choosing 50,000 as its request nor provided a plan for distributing these certificates to states or urban centers according to their need. In addition, HUD plans to request an additional 50,000 units over the next 4 years, adding approximately \$2.4 billion in renewal costs through fiscal year 2002 for the additional 100,000 certificates.
- Over the past 3 years, public housing authorities (PHA) have decreased the amount of uncommitted public housing modernization funding that they have available for major modernization projects by approximately 30 percent. Despite this progress, approximately \$925 million remains uncommitted. In addition, several large troubled housing authorities have larger uncommitted balances than they did 3 years ago. Despite the pressure on HUD's budget because of the increasing need to renew Section 8 contracts, these housing authorities will continue to be granted additional funding in accordance with HUD's formula for awarding modernization grants.
- HUD's request for \$100 million to fully fund a second round of the Empowerment Zone/Enterprise Community program appears premature as it is unlikely that HUD can commit this amount during fiscal year 1998.

HUD's Fiscal Year 1998 Budget and Programs

Through its programs, HUD provides rental assistance to more than 4 million low-income tenants, has insured mortgages for about 23 million homeowners, has provided funding to help revitalize over 4,000 communities, and helps ensure equal access to housing. In recent years, approximately three-quarters of HUD's budget outlays have been for public and assisted housing programs. These programs are supported through annual appropriations (i.e., discretionary authority) that are subject to discretionary spending limits under the Budget Enforcement Act, as amended.

²HUD's Section 8 program provides rental subsidies for low-income families. These subsidies are linked to either the apartment (project-based) or the resident (tenant-based).

HUD's fiscal year 1998 budget proposal requests about \$24.8 billion in discretionary budget authority and plans about \$34 billion in outlays.³ This request represents a 28-percent increase in budget authority and a 2-percent increase in outlays compared with HUD's estimated outlay for fiscal year 1997. The significant increase in budget authority reflects the considerable growth from 1997 to 1998 in the number of multiyear contracts that need to be renewed under the Section 8 assisted housing program, including both the tenant-based and project-based programs.⁴ In 1997, HUD needed \$3.6 billion in budget authority to renew contracts. HUD estimates that it will need \$9.2 billion in budget authority in fiscal year 1998 to renew contracts for over half of all units assisted under Section 8. HUD's current policy is to renew expiring Section 8 contracts for 1 year at a time.

HUD's Request for Section 8 Contract Renewal Funding Includes Duplicative Contingency Factors and Unnecessary Line Items

HUD's \$9.2 billion estimate to renew Section 8 contracts in fiscal year 1998 includes about \$531 million in allowances for contingencies. Moreover, HUD's estimate does not identify or account for a potentially larger amount of excess budget authority—called contract reserves—that exists in individual housing authorities' accounts and is also available to address contingencies. HUD is currently identifying the amount of these other reserves; however, instead of using them to offset its fiscal year 1998 budget needs, the Department plans to allow housing authorities to retain much of their reserves to cover contingencies. HUD's estimated renewal costs also include about \$90 million for programs that do not need to be renewed in fiscal year 1998.

Tenant-Based Contract Renewal Request Includes Several Contingency Factors

HUD's tenant-based contract renewal estimate includes allowances for contingencies and assumptions that increase the budget request by about \$531 million. These include (1) \$162 million allowance for contingencies to cover uncertainties in the number of units to be renewed; (2) \$253 million to provide a 2-week funding allowance per housing unit to account for changes in economic conditions; (3) \$116 million to account for the anticipated effects of welfare reform on tenants' incomes and, in turn, on

³Budget authority is given to federal agencies to incur obligations and to make payments from the Treasury for a specified purpose. Outlays represent the issuance of checks, disbursements of cash, or electronic transfers of funds made to liquidate a federal obligation.

⁴For tenant-based certificates and vouchers, HUD contracts with local housing agencies, such as PHAs, to operate the program. The local housing agencies pay the rental subsidies to owners of private rental housing on behalf of the assisted households. For the project-based program, HUD contracts directly with and provides rental subsidies to the owners of private rental housing and state housing finance agencies, rather than contracting with local housing agencies. For both programs, assisted households generally pay 30 percent of their income for rent.

the rent that housing authorities can collect from these tenants. Neither HUD's budget justification materials nor our discussions with HUD officials provided specific justification or support for these allowances.

According to HUD officials, the contingency allowance of \$162 million is for possible errors in the estimated number of units that need to be renewed. Although HUD obtained the estimated number of units from its Central Accounting and Program System (HUDCAPS),⁵ in commenting on a draft of this testimony, HUD's Deputy Secretary said that not all contracts are included in HUDCAPS. For example, the accounting system does not include contracts in process from prior year funding, contracts not yet awarded for funded units, and housing units that have been converted from project-based to tenant-based assistance. Accordingly, HUD officials believe that they need a 2-percent contingency in the budget to address these unknown costs.

Second, the average unit cost of \$6,386 that HUD used to develop its total fiscal year 1998 estimate of tenant-based renewal needs includes a contingency factor to account for unexpected program costs. According to HUD officials, unexpected program costs occur when, for example, rents increase or tenants' incomes decrease. We estimate that this contingency factor provides 2 additional weeks of funding for each unit and increases the total request for contract renewal funding by \$253 million.

A third contingency factor accounts for the impact of welfare reform on tenants' rent contributions. HUD estimates this impact to be about \$92 per unit, per year and includes it in the average annual cost of tenant-based units, thus increasing HUD's contract renewal request by about \$116 million. HUD officials told us that this amount compensates for the reductions in tenants' contributions to rents anticipated when tenants lose their welfare benefits. These reductions increase HUD's contribution to the rental payment.

Unspent Budget Authority Also Is Available to Cover Contingencies

In recent years, HUD has been reconciling PHAS' Section 8 contract accounts to determine how much unspent budget authority is available to renew expiring contracts. The Department expects to complete this process by March 31, 1997. By the end of fiscal year 1996, HUD had identified approximately \$1.6 billion in unspent budget authority—or excess contract reserves—which it used to extend the funding for expiring

⁵HUDCAPS is the agency's new tenant-based program management and accounting information system implemented in Sept. 1995.

Section 8 tenant-based contracts. This action, which took place too late in the budget process to be reflected in the fiscal year 1997 budget, shows up for the first time in the fiscal year 1998 budget. In the meantime, HUD has identified additional reserves, a portion of which it believes can be used to further reduce the amount of budget authority needed to renew contracts in fiscal year 1998. HUD plans to calculate this reduction and provide this information to the Congress after completing the reconciliation process.

HUD officials told us that the Department will use the following process to determine the amount by which it can reduce its fiscal year 1998 budget request. After HUD finalizes the amount of the reserves, it will continue its policy of allowing housing authorities to limit the portion of their reserves that can be used to extend expiring contracts. This policy limits HUD's ability to offset its budget request for contract renewals with accumulated unspent budget authority and raises the amount of budget authority that HUD must request. Specifically, HUD has determined that a housing authority can use its reserves to extend contracts only if the housing authority first retains a minimum of 50 percent of the funding needed to fully fund all of the housing authority's Section 8 units for 1 fiscal year. Although not all housing authorities have sufficient excess contract reserves to do this, HUD officials believe that this policy ensures that in most cases reserve funds will be available to cover increased program costs or other contingencies such as potential increases in rents or the loss of tenants' income.

HUD officials could not explain whether these contingencies could be addressed by the various allowances for contingencies that we described earlier, and they did not have a basis for specifying that the 50-percent level was an appropriate amount for housing authorities to retain. While these costs may occur and establishing some contingency amount for them may be reasonable, the 50-percent reserve is in itself a contingency allowance and apparently duplicates the other contingency factors that HUD has built into its budget request. In commenting on a draft of this testimony, the Deputy Secretary agreed that housing authorities' reserves are a source of contingency funding. He said that the size of the reserve depends on the nature of an authority's portfolio of tenant-based assistance and that these reserves are an area that is under review by the Department.

Premature Funding Requests Increase HUD's Project-Based Contract Renewal Estimate

HUD's budget request for Section 8 contract renewal funding includes two line items for project-based housing assistance that HUD has since determined do not require renewal in fiscal year 1998. These two line items total almost \$90 million in requested budget authority. The first item is a request for \$54 million and is part of HUD's portfolio reengineering program to restructure some project-based contracts.⁶ The \$54 million provides new Section 8 budget authority for projects that HUD's budget assumes will be reengineered before their current Section 8 contracts expire. However, because these contracts provide below-market rents, HUD officials told us that reengineering these projects is highly unlikely until the contracts expire in fiscal year 2000, if then. As a result, this line item does not need to be included in the fiscal year 1998 request. The second item is a request for \$35 million to renew expiring vouchers set aside for disabled persons. HUD officials stated that this money is not needed because the contracts were fully funded in fiscal year 1995 and do not expire until fiscal year 2000; consequently, funds are not needed in fiscal year 1998.

Justification for Increasing Size of Section 8 Program Is Unclear

For fiscal year 1998, HUD has requested \$305 million in budget authority to fund 50,000 incremental (new) certificates to help families required to move because of the Department's Welfare-to-Work initiative. However, it is unclear how HUD determined that 50,000 vouchers would be needed to help families relocate or how HUD would distribute the new certificates to states and urban centers where this need is likely to be felt. HUD officials told us that the Department has not analyzed the potential need for this new kind of assistance, but on the basis of studies by HUD and others of the general need for affordable housing, they believe that the overall need nationwide for more assisted housing justifies these incremental certificates.

Furthermore, the 50,000 units are part of a larger, 5-year plan to increase the tenant-based program by 100,000 units. HUD officials told us that this plan is part of the administration's continued commitment to expand the availability of tenant-based rental assistance, within the context of a budget that reaches balance in fiscal year 2002. The cumulative effect of adding these new units would be to increase renewal costs by approximately \$2.4 billion through fiscal year 2002.

⁶Portfolio reengineering is HUD's program to restructure the Federal Housing Administration's insured debt on multifamily property.

Balances of Uncommitted Modernization Funding Have Decreased, but Some Housing Authorities' Balances Have Increased

For fiscal year 1998, HUD is requesting \$2.5 billion for public housing capital activities, the same amount it received in fiscal year 1997. These funds are distributed to public housing authorities, which are then responsible for committing and spending these funds to modernize their public housing units. In 1994, we reported that housing authorities had an aggregate backlog of \$1.4 billion in modernization funds.⁷ The backlog comprises funds that have been available to the housing authorities for more than 2 years but have not been committed for use—HUD officials believe that 2 years is an adequate period within which to spend funds for capital purposes. Currently, housing authorities have approximately \$925 million in backlogged funding.

Failing to commit modernization funds in a timely manner means that vacant and deteriorated public housing remains unsuitable for habitation and that the programs are not serving the needs of low-income families. We reported in 1994 that 22 large housing authorities had been granted \$4.8 billion in fiscal year 1991 and prior years' approved funds and that of that amount, \$808 million, or 17 percent, remained uncommitted as of September 30, 1993. Since we issued that report, HUD has worked with housing authorities to reduce their backlogs. As of September 30, 1996, the same 22 large housing authorities we reported on almost 3 years ago had been granted a total of \$8 billion in fiscal year 1994 and prior years' funds. Of that amount, \$785 million, or about 10 percent, was in the combined backlogs of these 22 authorities. While these housing authorities' approved funds increased 68 percent during this time, their total backlog decreased 3 percent. HUD officials told us that they have been successful in helping housing authorities reduce their backlogs by providing greater flexibility, by streamlining regulations, and providing technical assistance, particularly to the troubled or near-troubled housing authorities.

Notwithstanding HUD's overall success in reducing the modernization backlog, the sizes of the backlogs at several large housing authorities have actually increased since we reported in 1994. For example, the Washington, D.C., Housing Authority, as of the end of September 30, 1996, had a backlog of \$115 million, or 39 percent of its fiscal year 1994 and prior years' approved funds. For the same period, the New Orleans Housing Authority had a backlog of \$72 million, or 32 percent of its total approved funds, and the San Francisco Housing Authority had a backlog of \$31 million, or 15 percent of its approved balance. Of the 22 PHAs reviewed, 6 have larger backlogs than they did 3 years ago, including the 3

⁷Public Housing: Information on Backlogged Modernization Funds (GAO/RCED-94-217FS, July 15, 1994).

PHAS noted above. Of these six PHAS, four had a backlog that was higher as a percentage of their total than they had in 1994. In commenting on a draft of this testimony, the Deputy Secretary said that he expects HUD to rectify the backlog of those four PHAS by fiscal year 1998. Moreover, he said that HUD is holding new modernization funding for these four PHAS until they have adequate capacity to administer the funding effectively.

Regardless of the size of its backlog or its capacity to effectively commit funds, a housing authority still receives an annual modernization grant under the program's allocation formula. Although HUD can, under the regulations, recapture modernization funding that has gone uncommitted for more than several years, officials told us that this seldom occurs. Thus, the effect of formula funding is to increase the backlog of modernization funding—notwithstanding HUD's hold on the funds—for those PHAS that continue to be unsuccessful in committing their modernization grants. This, in turn, increases HUD's need for new budget authority.

The Empowerment Zone/Enterprise Community Program May Not Need Full Funding in Fiscal Year 1998

HUD's fiscal year 1998 budget proposal includes \$100 million for a second round of the Empowerment Zone/Enterprise Community (EZ/EC) program. According to HUD's budget request, the Department anticipates fully committing these funds during fiscal year 1998. However, many steps must be taken before HUD can grant these funds. For example, legislation must be passed to authorize the second round of designations.⁸ Subsequently, HUD must write related regulations, invite communities to apply for program grants, allow time for communities to prepare and submit their applications, evaluate the applications, and select the communities that would receive these funds. During the first round of this program, HUD required 16 months after the Congress passed the legislation to designate the EZs and ECs.

Unless the Congress passes authorizing legislation soon, HUD is not likely to be ready to use the majority of these funds during fiscal year 1998. This means that HUD's request of \$100 million in fiscal year 1998 could be premature. HUD's director and deputy director of economic development told us that although they have not prepared a schedule for the second round, they anticipate that they can draw from experiences in the first round to accelerate the community designation process. In addition, these officials said that they would prefer to have the funding available at the same time that they are revising the regulations and program guidance so

⁸Legislation was proposed by the administration during the 104th Congress, but it was not enacted. In January and February 1997, authorizing legislation was introduced in the Senate and the House of Representatives, respectively, but has not yet been enacted.

that HUD and the potential program participants can be assured that the program will receive the funds they need.

In commenting on a draft of this testimony, the Deputy Secretary strongly disagreed with our conclusion that funding the EZ/EC proposal is premature. He said that it is not credible for HUD to conduct a demanding competition without funds in hand to reward winners. Nevertheless, we continue to believe that HUD likely will not need most of these funds until fiscal year 1999.

Conclusions

HUD may not need all the budget authority that it has requested for the Section 8 program in fiscal year 1998 because it has built in several allowances to cover unexpected costs, while at the same time it has access to unspent budget authority from prior years that also can be used to address unexpected costs. Because Section 8 contract renewals are such a large proportion of HUD's budget request this year and in the foreseeable future and because we have questions about the need for the several contingency factors that HUD has included in its budget request for contract renewal authority, we believe that this request bears close scrutiny.

HUD's request for \$100 million to fund the EZ/EC program appears premature because the time required to pass legislation, write regulations, and select program participants is likely to extend into fiscal year 1999.

In a recent testimony submitted to the Subcommittee on VA, HUD, and Independent Agencies, House Committee on Appropriations, we suggested that the Congress may wish to examine the above issues and take them into consideration when setting HUD's appropriations.⁹

Agency Comments

We provided a draft of this testimony to HUD for its review and comment. In commenting on the draft, HUD's Deputy Secretary said that he was very concerned that we may have made misinterpretations that portray the Department in an unnecessarily negative way. For example, he said that our characterizing several categories of funding as contingencies is not totally accurate. He believes that these budget categories represent legitimate budgeting techniques or that they should not be categorized as contingencies. He did agree, however, that PHAS' excess contract reserves

⁹HUD's 1998 Budget Request: Some Requests for Funding May Be Unnecessary (GAO/T-RCED-97-108, Mar. 18, 1997.)

are a source of contingency funding, and he said that HUD will report the final balances in PHAS' reserve accounts to the Appropriations Committees when they are known.

We disagree with the Deputy Secretary that our testimony misinterprets agency actions. During our work, we requested justification and support for various budget items included in HUD's budget request. We also met with HUD officials to obtain a better understanding of their justification for the specific budget items we questioned. HUD officials were unable to provide adequate justification, and until they can provide it we believe that the Congress should continue to question the areas we identified in our testimony.

Where appropriate in our testimony, we have recognized the Deputy Secretary's concerns or we have added information to clarify our remarks. Where we and HUD disagreed regarding an estimated figure, we have used HUD's figures which show a lower contingency allowance in each case.

Related GAO Products

Housing and Urban Development: HUD's Management Deficiencies, Progress on Reforms, and Issues for Its Future (GAO/T-RCED-97-89, March 6, 1997).

Public Housing: Status of the HOPE VI Demonstration Program (GAO/RCED-97-44, Feb. 25, 1997).

Housing and Urban Development: Potential Implications of Legislation Proposing to Dismantle HUD (GAO/RCED-97-36, Feb. 21, 1997).

Managing for Results: Using GPRA to Assist Congressional and Executive Branch Decision-Making (GAO/T-GGD-97-43, Feb. 12, 1997).

HUD: Field Directors' Views on Recent Management Initiatives (GAO/RCED-97-34, Feb. 12, 1997).

GAO High-Risk Series (GAO/HR-97-1, Feb. 1997).

High-Risk Series: Department of Housing and Urban Development (GAO/HR-97-12, Feb. 1997).

Public Housing: HUD Should Improve the Usefulness and Accuracy of Its Management Assessment Program (GAO/RCED-97-27, Jan. 29, 1997).

Multifamily Housing: Effects of HUD's Portfolio Reengineering Proposal (GAO/RCED-97-7, Nov. 1, 1996).

Public Housing: Partnerships Can Result in Cost Savings and Other Benefits (GAO/RCED-97-11, Oct. 17, 1996).

Housing and Community Development Products 1995 (GAO/RCED-96-248W, Aug. 1996).

Multifamily Housing: HUD's Portfolio Reengineering Proposal: Cost and Management Issues (GAO/T-RCED-96-232, July 30, 1996).

Multifamily Housing: Issues Facing the Congress in Assessing HUD's Portfolio Reengineering Proposal (GAO/T-RCED-96-231, July 26, 1996).

Executive Guide: Effectively Implementing the Government Performance and Results Act (GAO/GGD-96-118, June 20, 1996).

Housing and Urban Development: Comments on HUD's FY 1997 Budget Request (GAO/T-RCED-96-205, June 17, 1996).

Housing and Urban Development: Limited Progress Made on HUD Reforms (GAO/T-RCED-96-112, Mar. 27, 1996).

Housing and Urban Development: Public and Assisted Housing Reform (GAO/T-RCED-96-22 and GAO/T-RCED-96-25, Oct. 13, 1995).

Public Housing: Converting to Housing Certificates Raises Major Questions About Cost (GAO/RCED-95-195, June 20, 1995).

Public Housing: Funding and Other Constraints Limit Housing Authorities' Ability to Comply With One-for-One Rule (GAO/RCED-95-78, Mar. 3, 1995).

Housing and Urban Development: Reforms at HUD and Issues for Its Future (GAO/T-RCED-95-108, Feb. 22, 1995).

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

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