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HOUSING AND URBAN DEVELOPMENT

Comments on HUD's Fiscal Year 1999 Budget Request

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

We are pleased to have the opportunity to comment on the Department of Housing and Urban Development's (HUD) fiscal year 1999 budget request. HUD has proposed a fiscal year 1999 appropriation of approximately \$25 billion to support a variety of housing and community development programs. As you requested, we reviewed the reasonableness of selected aspects of HUD's fiscal year 1999 budget request. Our statement today is based on our recently completed and ongoing work and will discuss (1) actions HUD has taken or plans to take to improve its budget estimates, (2) the reasonableness of HUD's estimate for Section 8 tenant-based assistance,¹ (3) HUD's justification for its Section 8 project-based amendment request, (4) HUD's request for funding to assist the homeless, (5) HUD's request for \$100 million to fund its new Regional Connections Initiative, and (6) the future budgetary implication of welfare reform. Appendix I contains the scope and methodology of our review.

In summary, we found the following:

- Recognizing the need to improve its budget estimating process with better oversight and documentation, HUD has started to improve its process by modifying its organizational structure to increase oversight among the staff responsible for formulating budget estimates. However, many of HUD's planned improvements—such as Office of Budget's analysis of program office submissions—were not implemented in time to affect the Department's fiscal year 1999 budget estimate but, according to HUD officials, will be in place to enhance the fiscal year 2000 process.
- HUD's request for \$4.7 billion to renew Section 8 tenant-based assisted housing contracts for fiscal year 1999 could be reduced by \$439 million. This is the amount of excess budget authority in the Section 8 moderate rehabilitation program that could be used in place of new budget authority to renew expiring housing assistance contracts. In addition, because this excess budget authority exists, HUD may not need the \$70 million it has requested for Section 8 moderate rehabilitation amendment funding.
- HUD's budget request for \$1.3 billion in Section 8 project-based amendment funding—funds needed to cover shortfalls in long-term Section 8 contracts—substantially exceeds the amounts that HUD's

¹The Section 8 housing assistance program, named for the revised section 8 of the U.S. Housing Act of 1937, was originally established by the Housing and Community Development Act of 1974 (P.L. 93-383). It includes tenant-based assistance for specific households and project-based assistance for specific properties.

analyses indicated are needed. According to HUD officials, the excessive amount reflects a policy decision by the Office of Management and Budget and HUD to augment the request due to the long-term need for amendment funding.

- To help address the needs of the nation's homeless, HUD has requested 34,000 new Section 8 vouchers. Congressional concern exists over the high proportion of funding for assistance for the homeless that was spent on supportive services instead of on direct housing. Although these new vouchers will increase the amount of direct housing assistance for the homeless, HUD has not developed the eligibility standards or other planning criteria for these new vouchers that would facilitate implementing the program.

- HUD's budget request for \$100 million for the Regional Connections Initiative (RCI), a new set-aside within the Community Development Block Grant program to address key regional issues, does not provide enough detail to indicate whether this is a reasonable funding level for the program. The additional support that HUD provided, however, does not recommend a significant federal effort to address regional problems. Nevertheless, HUD officials believe the funding level is a manageable set-aside. Because of the work required to initiate a new program like this, we question whether the funds can be awarded in fiscal year 1999.

- Welfare reform may have a substantial future impact on HUD's spending for assisted housing for low-income households. However, estimating the impact may not be possible because the states' differing welfare reform provisions will create varied state-by-state and year-by-year impacts.

HUD's Fiscal Year 1999 Budget and Programs

Established in 1965, HUD is the principal federal agency responsible for programs in four areas—housing assistance, community development, housing finance, and regulatory issues related to areas such as lead-based paint abatement and fair housing. To carry out its many responsibilities, HUD was staffed by 9,885 employees as of January 1998.

- Housing Assistance: HUD provides (1) public housing assistance through allocations to public housing authorities and (2) private-market housing assistance through rental subsidies for properties, referred to as project-based assistance, or for tenants, known as tenant-based assistance. In contrast to entitlement programs, which provide benefits to all who

qualify, the benefits of HUD's housing assistance programs are limited by budgetary constraints to only about one-fourth of those who are eligible.

- Community Development: Primarily through grants to states, large metropolitan areas called entitlement areas, small cities, towns, and counties, HUD provides funds for local economic development, housing development, and assistance to the homeless. The funding for some programs, such as those for the homeless, may also be distributed directly to nonprofit groups and organizations.

- Housing Finance: The Federal Housing Administration (FHA) insures lenders—including mortgage banks, commercial banks, savings banks, and savings and loan associations—against losses on mortgages for single-family properties, multifamily properties, and other facilities. The Government National Mortgage Association, a government-owned corporation within HUD, guarantees investors the timely payment of principal and interest on securities issued by lenders of FHA-insured and VA- and Rural Housing Service-guaranteed loans.

- Regulatory Issues: HUD is responsible for regulating interstate land sales, home mortgage settlement services, manufactured housing, lead-based paint abatement, and home mortgage disclosures. HUD also supports fair housing programs and is partially responsible for enforcing federal fair housing laws.

HUD's programs are supported through annual appropriations (discretionary budget authority) that are subject to discretionary spending limits under the Budget Enforcement Act, as amended. For fiscal year 1999, HUD requested about \$25 billion in discretionary budget authority, which, in combination with available budget authority from prior years, will help support about \$33.2 billion in outlays.² This request represents a 4-percent increase in budget authority and a negligible increase in estimated outlays over fiscal year 1998.

²Budget authority is the authority provided by federal law to incur obligations that will result in outlays. Appropriations are the most common means of providing budget authority. Outlays are the measure of federal spending and are payments to liquidate obligations.

HUD Plans Management Reforms to Improve Budget Estimates

As we reported in February 1998, accurate budget estimates are essential for federal agencies to meet their fiscal responsibilities because such estimates facilitate sound policy decisions and effective funding trade-offs.³

Unfortunately, for years HUD had difficulty submitting accurate budget estimates. Recognizing the need to improve its budget process with better oversight and documentation, HUD has developed and begun implementing corrective actions.

HUD recently placed all departmental budget operations under the Office of the Chief Financial Officer (CFO) to ensure that budgeting is integrated with financial management oversight. In the past, HUD's budget operations have been fragmented and disjointed, preventing clear accountability and necessary coordination. This problem was the result of the CFO's inability to link budgeting with strategic planning and financial management, according to HUD's Management Reform Plan. As another improvement, HUD is hiring a chief financial officer for all program divisions to mirror the operations of the Department's Office of the CFO. Previously, the program division's budget director and comptroller reported to a deputy assistant secretary. Under the new structure, the division's budget director and comptroller will report to the division's CFO, who will coordinate with the agency's CFO and the division's program staff to ensure adequate oversight.

In addition to organizational changes, the Office of the CFO plans to develop budget estimating policies and procedures that build in enough time for adequate coordination, oversight, and communication. However, HUD did not implement many of the changes in time to affect the Department's fiscal year 1999 budget estimate. According to HUD's Director of the Office of Budget, time constraints prevented his office from performing analytical reviews of program office submissions. He said that his Office was limited to reviewing the fiscal year 1999 budget estimates for numerical accuracy and that this Office could not always question the estimates' reasonableness or underlying basis. He believes that the planned improvements should be operational in time for HUD's fiscal year 2000 budget submission.

³Section 8 Tenant-Based Assistance: Opportunities to Improve HUD's Financial Management (GAO/RCED-98-47, Feb. 20, 1998).

HUD's Request for Section 8 Tenant-Based Assistance Could Be Reduced

HUD has significantly improved its budgeting for tenant-based contract renewals by omitting duplicative contingency allowances and accounting for excess budget authority in the Section 8 certificate and voucher programs. However, HUD's request for \$4.7 billion to renew Section 8 tenant-based contracts could still be reduced by the amount of excess budget authority in HUD's moderate rehabilitation program, or \$439 million.⁴ In addition, because excess budget authority exists in the moderate rehabilitation program, HUD may not need the \$70 million it has requested for moderate rehabilitation amendments.

In contrast to the Department's Section 8 tenant-based contract renewal request for fiscal year 1998, HUD's request for fiscal year 1999 does not appear to contain any duplicative contingency factors. Instead, HUD's improved budget estimate for fiscal year 1999 is based on actual expenditure data adjusted for inflation. In addition, HUD used \$3.7 billion of excess budget authority recaptured from the Section 8 tenant-based program to offset the cost of contract renewals in fiscal year 1999.

Although HUD has improved its budget-estimating process, we believe that the Department is still overestimating its need for contract renewal funding because \$439 million in excess budget authority in the moderate rehabilitation program could be used to renew expiring contracts in lieu of requesting new budget authority. As shown in table 1, HUD determined in January 1998, that the gross excess budget authority in the Section 8 moderate rehabilitation program was about \$814 million. Of that amount, the Department estimates that it will need \$191 million to meet funding shortfalls in the program and \$184 million to cover contingencies, such as decreases in tenants' incomes or unexpected rent increases. (HUD believes, however, that it needs statutory authority from the Congress to use excess budget authority to cover some of these funding shortfalls.) The remaining \$439 million is the budget authority that HUD considers to be in excess of the Section 8 program's needs.

⁴For the tenant-based program, HUD contracts with state and local housing agencies to manage the program's certificates and vouchers, which assist 1.4 million households. These agencies make payments to private-sector landlords to subsidize the rents of certificate and voucher holders.

Table 1: Excess Budget Authority in the Section 8 Moderate Rehabilitation Program Dollars in Millions

Gross excess budget authority as of 1/15/98	\$814
Less: excess budget authority needed to fund shortfalls	(191)
Less: reserve for contingencies	(184)
Excess budget authority	\$439

Source: HUD's Office of Public and Indian Housing.

According to HUD officials, the Department has not decided yet whether to recapture this budget authority or how much it would recapture. Although HUD did not complete its analysis of excess budget authority in the moderate rehabilitation program in time to include this amount in its initial budget submission for fiscal year 1999, we believe sufficient time remains before conference for HUD to revise its fiscal year 1999 request to reflect the \$439 million in excess budget authority available to reduce the cost of renewing contracts.

HUD's January 1998 analysis also shows that a request for \$70 million to amend Section 8 moderate rehabilitation contracts may not be needed. Generally, amending contracts refers to changing specific housing assistance contracts to add more funding. According to HUD officials, the \$70 million was included in the budget as a placeholder until the Department completed its analysis of excess budget authority in the moderate rehabilitation program. As noted above, HUD's analysis shows that sufficient excess funding exists in the program to make the request for \$70 million unnecessary. If the Congress grants HUD the authority it believes it needs to use excess budget authority to cover funding shortfalls in the program, Department officials told us that they would not need this \$70 million in amendment funding.

HUD's Project-Based Amendment Request May Be Overstated

According to HUD, the total amount of Section 8 project-based amendment funding needed for fiscal year 1999 is \$1.7 billion. These total amendment needs are then reduced by a \$463 million offset coming from estimated "recapture amounts"—that is, balances remaining on expiring contracts that may be recaptured and used to fund contract amendments.⁵ As a result, HUD's fiscal year 1999 budget requests \$1.3 billion for Section 8

⁵The project-based contracts were entered into beginning in the 1970s and 1980s, typically for 15-, 20-, or 40-year periods. While the funds provided for these long-term contracts have exceeded actual needs in some instances, they have been insufficient in other instances to make rental assistance payments through the terms of the contracts. Beginning in the early 1990s, the Department started requesting amendment funding for the contracts with insufficient funding.

project-based amendments. We do not believe that HUD's request for Section 8 project-based amendment needs is adequately supported. Furthermore, HUD's budget request for Section 8 project-based amendment funding substantially exceeds the amounts that HUD's analyses indicated are needed.

The support HUD provided to us for its amendment budget request was an analysis dated April 1997. The analysis was formulated using a methodology that HUD refers to as "leveling," under which funding shortfalls are spread over the remaining term of the contract rather than beginning in the year the contract is projected to run out of money. For example, for a contract costing \$1 million a year with 10 years remaining and \$9 million available, the \$1 million shortfall would be spread in \$100,000 increments over the next 10 years, rather than being identified as a shortfall of \$1 million in the 10th year. HUD officials told us the goal of the leveling methodology is to enable the Department to request a consistent annual amount to fund amendments and to avoid requesting large amounts in later years.

The April 1997 analysis, derived from the Budget Forecast System, which the Department uses to estimate its Section 8 amendment needs for budgeting purposes, indicates a total amendment need of \$1.2 billion in fiscal year 1999, or about \$500 million less than the total amount identified in HUD's budget request for fiscal year 1999. HUD officials said that this additional \$500 million reflects a policy decision by the Office of Management and Budget and HUD to augment the request because of the long-term funding need for amendments.

In addition, an analysis of Section 8 project-based amendment needs that we obtained from HUD in February 1998 shows that substantially higher amounts of recapture funds are projected to become available in the next several years than those that are reflected in the budget. HUD prepared this analysis at our request to address problems that we identified in HUD's previous analyses of its Section 8 amendment needs. Among other things, we found the previous analyses did not include Section 8 project-based funding that HUD received in its fiscal year 1997 appropriation and erroneously excluded about 1,800 Section 8 contracts. The February 1998 analysis indicates that \$2.6 billion in recaptures are projected to become available in fiscal year 1998, compared with the \$463 million recapture amount used to offset the 1999 budget request. We are currently reviewing this analysis as part of the work we have underway examining HUD's

unexpended Section 8 project-based balances.⁶ We plan to issue our report in July 1998.

HUD’s Newest
Homeless Initiative
Increases Direct
Housing Assistance
for the Homeless

For fiscal year 1999, HUD is requesting \$958 million to fund its ongoing programs for the homeless and \$192 million for 34,000 new Section 8 vouchers for homeless individuals or families. Although congressional concern exists about the proportion of homeless funding spent on supportive services as compared to the amount spent on direct housing assistance, HUD’s request for 34,000 new vouchers for the homeless would increase housing assistance for the homeless. However, HUD has not developed the eligibility standards or other planning criteria for these vouchers that would facilitate program delivery.

Half of HUD’s Funding for
Competitive Homeless
Grants in Fiscal Year 1996
Was Spent on Supportive
Services

Congressional concern has been expressed about the proportion of HUD’s homeless funding that is used for supportive services compared to housing assistance. Moreover, a House bill introduced in 1997 proposed placing a cap on the percentage of total funding that grantees can use for services for the homeless. In fiscal year 1996, the latest year for which HUD has detailed information on the allocation of its homeless assistance funds, 51 percent of the competitive funding HUD awarded to grantees was spent on supportive services as opposed to direct housing assistance. Table 2 shows the breakdown between services and housing for three of HUD’s competitive homeless assistance programs.⁷

Table 2: Proportion of Homeless
Grants Spent on Supportive Services
Versus Assisted Housing in Fiscal
Year 1996

Dollars in millions

Program	Total funds awarded	Percentage spent on supportive services
Single Room Occupancy	\$47.8	0
Shelter Plus Care	88.7	0
Supportive Housing	576.6	63
Total	\$713.1	51

Source: HUD’s Office of Community Planning and Development.

⁶This review is required by the emergency supplemental appropriations law enacted in June 1997 (P.L. 105-18).

⁷HUD’s Homeless Assistance Grants program consolidates the activities of HUD’s six McKinney homeless assistance programs (Supportive Housing, Single Room Occupancy, Shelter Plus Care, Emergency Shelter Grants, Safe Haven, and Rural Homeless Housing Assistance) and the Innovative Homeless Initiatives Demonstration program. Table 2 only includes competitive-based grants that were funded in fiscal year 1996.

HUD officials explained that they award the grants on the basis of the level of demand from grant applicants, and grantees' requests for services are high compared to requests for housing. They also speculated that it is difficult for organizations to obtain needed services through other agencies, which is why they may be using HUD resources to fill the gap. HUD officials further commented that funding this need is consistent with the agency's Continuum of Care approach that seeks to end homelessness by bringing together all parts of the community to provide a coordinated system of care for homeless men, women, and children. In commenting on a draft of this testimony, the Department said that in all instances it encourages housing as the end result.

**New Initiative Would
Provide Additional
Housing but Might Benefit
From More Detailed
Planning**

With its fiscal year 1999 budget request for \$192 million to fund 34,000 new Section 8 vouchers for homeless individuals or families, HUD proposes to increase the amount of funding for direct housing assistance. These vouchers will be used to assist families that have achieved a sufficient level of independence to move to permanent housing that is linked to services. The vouchers are intended for homeless individuals and families who would otherwise have the greatest difficulty securing permanent housing resources, as determined through the approved Continuum of Care approach.

However, unlike the Department's fiscal year 1999 budget request for 50,000 new welfare-to-work vouchers, HUD's request for new vouchers for the homeless does not describe the criteria that would be used to distribute the vouchers. For example, under HUD's welfare-to-work voucher proposal, any housing agency requesting permission to distribute vouchers must (1) prepare a plan that includes the criteria to be used to select the recipients and (2) describe the proposed strategy for counseling tenants, providing assistance in seeking housing, and reaching out to landlords. Furthermore, the agency must determine that obtaining tenant-based housing assistance is critical for the applicant to obtain or retain employment and that the applicant is not already receiving tenant-based assistance. If HUD developed similar requirements for the recipients of vouchers for the homeless, the program's implementation could likely begin shortly after the funding is received, strengthening the program's efficiency.

We believe that the lack of planning raises concerns about how quickly and effectively this program can be implemented. HUD, on the other hand, stated that it has a structure in place through its continuum of care grant

process as well as public housing authorities that are experienced in administering the Section 8 voucher program. Nevertheless, further details by HUD on how such a program will work would be useful in any debate on expanding the housing assistance provided to the homeless.

Key Report Underlying HUD's Regional Connections Initiative Does Not Recommend a Significant Federal Effort

HUD's fiscal year 1999 budget proposal includes \$100 million for a new Community Development Block Grant (CDBG) set-aside—the Regional Connections Initiative (RCI). RCI is intended to help states and localities develop and implement strategic plans that address key regional issues facing the nation's metropolitan and rural communities. HUD is planning to award grants under the program to states and localities on a competitive basis. HUD's interest in developing a program designed to encourage and facilitate efforts to address regional issues seems justified in light of the Department's mission.

However, given that RCI is a new initiative, HUD's budget justification does not provide enough detail to determine whether \$100 million is a reasonable funding level. Moreover, the key study (still in draft form) underlying this new initiative does not recommend a significant federal effort to address regional problems because little consensus exists at the local and state levels for such an effort. In addition, the study concluded that in the future, emerging regional efforts could raise questions about the appropriate federal role. According to HUD officials, the RCI funding level was a judgment call and was considered a manageable set-aside under the CDBG program.

In addition, HUD officials believe that the \$100 million requested for RCI will be awarded in fiscal year 1999. However, several tasks need to be accomplished before these funds are committed, including selecting an RCI advisory board of community development experts, writing program regulations, developing a notice of funding availability, allowing applicants time to prepare their proposals, reviewing submitted applications, and deciding which applicants will receive RCI funds. To accomplish these tasks, HUD expects to use expertise from outside the Department to help design and review the RCI grant program in time to allow funds to be awarded in fiscal year 1999. Because of the tasks and coordination necessary, however, we question whether such an ambitious schedule is workable for this new initiative.

While Potentially Significant, Predicting the Impact of Welfare Reform on HUD's Future-Year Budgets May Not Be Possible

As welfare reform is implemented throughout the nation, it could have implications for HUD's future year budgets. HUD estimates that one-third of the households receiving rental assistance from HUD depend on cash welfare assistance for some or all of their income. Under welfare reform, cash assistance programs became time-limited, work-dependent, and generally less available. Because residents pay a portion of their income for rent, any reduction in cash assistance without a commensurate increase in wage income would result in reduced rental payments from tenants. Managers at most of the 18 housing agencies we visited while conducting our ongoing work expressed concern about barriers their residents face in finding employment within their states' time limits. Under existing program regulations, reductions in tenant rental payments would increase the size of the payments that HUD makes to housing agencies and private landlords on behalf of low-income tenants to make up the difference between the tenants' rental payments and the housing units' operating cost or rent.

While welfare reform may have a significant impact on HUD's future year budgets, measuring the potential impact may not be possible. One reason is that the impact of welfare reform will vary from state to state and from year to year because states have differing welfare reform provisions, making the development of national estimates of the impact of welfare reform on HUD nearly impossible. In Massachusetts, for example, recipients will begin to hit the state's time limits for cash assistance in December 1998, while in Minnesota, recipients will not reach the time limits until July 2002. A second reason is that conclusions drawn about welfare reform's impact on recipients generally may not apply to those who also receive housing assistance because evidence suggests that welfare recipients receiving housing assistance may have greater difficulty finding and retaining employment than other welfare recipients. Furthermore, HUD does not collect the detailed data on recipients' education, work, and welfare histories needed to assess likely outcomes for its tenants. Finally, while the general health of the economy is a major factor in the recent decline in welfare caseloads, the future course of the economy cannot be predicted with any certainty.

Conclusion

We believe that HUD is generally moving toward more supportable budget estimates. For example, HUD recently prepared a new analysis of the Section 8 moderate rehabilitation program showing that sufficient excess budget authority exists to cover both program shortfalls and unexpected costs and still have \$439 million remaining in excess budget authority. This

means that a separate funding request for amendments may not be necessary. In the Section 8 project-based program, however, HUD's budget estimate is not consistent with its analysis of amendment needs. As HUD continues to refine its analyses in these areas, the Department will have the opportunity to amend its budget estimate before the Congress votes on HUD's appropriation bill in the fall. In addition, we found that for some new initiatives—such as vouchers for the homeless and the Regional Connections Initiative—to be effective in fiscal year 1999, HUD may need to complete appropriate and perhaps ambitious planning.

Matters for Congressional Consideration

The Congress may wish to consider reducing HUD's request for Section 8 contract renewals to account for the \$439 million in excess budget authority in the Section 8 moderate rehabilitation program. Because HUD has set aside excess budget authority in the moderate rehabilitation program, the Congress may also wish to consider not funding HUD's request for \$70 million to amend moderate rehabilitation contracts. Finally, the Congress may wish to seek assurances from HUD that these programs will be ready to effectively commit funds and review HUD's \$192 million request for vouchers for the homeless and its \$100 million request for the Regional Connections Initiative.

Agency Comments

We provided a draft of this statement to HUD for its review and comment. The Department provided comments on several issues, including its request for new Section 8 vouchers for the homeless and its Regional Connections Initiative. In response to our concerns about the planning accomplished for these two programs, HUD said that it expects housing authorities to compete for and administer the vouchers for the homeless. For the Regional Connections Initiative, HUD said that it recognizes that a limited number of localities and states are ready and willing to participate in this effort, but that the \$100 million proposed funding will still accommodate a meaningful initiative. We made appropriate changes in the statement to reflect HUD's concern; however, we continue to believe that the quality of planning for these new efforts will be critical to their effectiveness in fiscal year 1999.

Objective, Scope, and Methodology

The Chairman and Ranking Minority Member of the Subcommittee on VA, HUD, and Independent Agencies, Senate Committee on Appropriations, requested that we assess the reasonableness of selected aspects of HUD's fiscal year 1999 budget request. To accomplish this task, we reviewed HUD's February 1998 Congressional Justifications for 1999 Estimates. We also interviewed appropriate officials in HUD's Offices of the Chief Financial Officer, Public and Indian Housing, Housing, and Community Planning and Development to obtain more information on planned uses for funding requested. When available, we reviewed this additional information. Finally, we based portions of this statement on our recently issued report on HUD's financial management of its Section 8 tenant-based program as well as on our current work focusing on HUD's financial management of the Section 8 moderate rehabilitation and project-based programs and the impact of welfare reform on public and assisted housing.

We conducted our work in February and March 1998 in accordance with generally accepted government auditing standards.

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