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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of Housing And Urban Development

More Can Be Done To Measure HUD's Success In Using Millions Of Dollars For Rehabilitating Housing

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION

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The Honorable Samuel R. Pierce, Jr.
The Secretary of Housing and
Urban Development

Dear Mr. Secretary:

This report discusses the current status of actions taken by the Department of Housing and Urban Development (HUD) on recommendations we made in a prior report on housing rehabilitation assistance provided under the Community Development Block Grant Program and the Section 312 Rehabilitation Loan Program. We believe the Department needs to develop reliable management data and performance standards for measuring how successful its actions have been. We further believe that the Department can provide a higher quality housing rehabilitation service for the same or even less money and that this could help lessen the impact of any reduction in Federal rehabilitation moneys resulting from the administration's recent proposal to terminate the Section 312 Program and provide housing rehabilitation support from the Community Development Block Grant Program.

The report was discussed with the Directors of the Rehabilitation Management Division, the Small Cities Division, and the Entitlement Cities Division; the Acting Director, Office of Block Grant Assistance; and the Acting General Deputy Assistant Secretary for Community Planning and Development. Their comments are included in the report where appropriate.

The report contains recommendations to you on pages 11, 12, 18, and 19. As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

B-171630

We are sending copies of this report to cognizant House and Senate legislative and appropriation committees; the Director, Office of Management and Budget; and to your Assistant Secretary for Community Planning and Development and Inspector General.

Sincerely yours,

Henry Eschwege

Henry Eschwege
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE SECRETARY OF
HOUSING AND URBAN DEVELOPMENT

MORE CAN BE DONE TO MEASURE HUD's SUCCESS IN USING MILLIONS OF DOLLARS FOR REHABILITATING HOUSING

D I G E S T

GAO examined the current status of actions the Department of Housing and Urban Development (HUD) is taking on recommendations GAO made in a previous report to the Congress entitled "Millions of Dollars for Rehabilitating Housing Can Be Used More Effectively" (CED-80-19, Dec. 7, 1979). In this report, GAO estimated that $150 million of a total $200 million in grants was directly granted to property owners to cover all of their rehabilitation costs in fiscal year 1980. By combining grant assistance to homeowners for housing rehabilitation with other funds, or by using loans to replace grants wherever feasible, GAO said that HUD should be able to more efficiently and effectively use millions of dollars annually in its Community Development Block Grant (CDBG) Program. (See pp. 4 and 5.)

HUD agreed with GAO that direct grants for housing rehabilitation were costly and sometimes inappropriate, but it disagreed with the recommendation in GAO's December 1979 report that CDBG regulations be amended to prohibit the use of grants unless grants are combined with other resources. Instead, HUD stated that it is seeking, through technical assistance efforts, to encourage communities to use deferred payment loans, variable interest rates and terms, and other financing methods which leverage, regenerate, or otherwise stretch available rehabilitation funds. HUD believes that, through concerted technical assistance, its efforts to encourage communities to use more cost-effective financing techniques can achieve the desired results without re-creating the restrictive, inflexible requirements of earlier Federal renewal efforts. HUD said that it opposes regulations or legislative change which reduce the local creativity which characterizes current CDBG rehabilitation efforts.

GAO agrees that HUD's technical assistance efforts should help in assisting communities to adopt more effective and efficient rehabilitation financing techniques; however, HUD lacks sufficient data to determine how successful its efforts have been to encourage the use of cost-effective financing techniques or whether additional steps are needed. If HUD intends to rely on its technical assistance efforts, then it needs to develop performance standards and compare them with reliable management data to enable HUD to measure overall progress in meeting its objectives. (See p. 6.)

GAO also found in its followup work that:

--Existing management information systems were producing inaccurate data, thus preventing HUD from effectively monitoring recent changes to restrict the use of section 312 funds for refinancing home mortgages. (See p. 13.)

--The improved use of available data systems and the establishment of performance standards could improve HUD's monitoring of and technical assistance to local communities in meeting section 312's objective of giving loan priority to low- and moderate-income persons. (See p. 16.)

<u>RECOMMENDATIONS TO THE SECRETARY, HUD</u>

To ensure that HUD's technical assistance efforts are helping local communities use the most cost-effective financing method available in their CDBG housing rehabilitation programs without incurring substantial costs in developing an elaborate, new, monitoring system, the Secretary should:

--Improve HUD's existing monitoring capabilities by revising the application forms for collecting information on the planned uses of block grant funds to require that, in the case of housing rehabilitation activities, local communities indicate the amount of funds they plan to budget for rehabilitation grants versus loans. (See p. 11.)

--Revise the grantee performance reports to require that information reported on block grant expenditures for housing rehabilitation indicate the amount spent through the use of rehabilitation grants versus loans. HUD should also incorporate this information on expenditures into its computer system as it has done for block grant budgets to enable routine and timely comparisons between planned and actual expenditures. (See p. 11.)

--Establish performance standards in conjunction with these block grant rehabilitation data systems, stating the Department's goals for using more cost-effective rehabilitation financing methods. (See p. 12.)

--Use the improved management data and accompanying performance standards to measure the progress area offices and communities are making to reduce their reliance on the use of direct grants in rehabilitating housing. HUD should also consider whether additional actions, such as incentives, are needed to reward communities for stretching block grant funds by adopting financing methods more cost effective than direct grants. (See p. 12.)

Further, to ensure that recent changes made in HUD's proposed regulations to improve the efficiency and effectiveness of the Section 312 Program are fully implemented and potential cost savings are achieved if the program is continued, GAO also recommends that the Secretary:

--Prepare periodic reports using existing data systems to routinely monitor the HUD objective that communities give loan priority to low- and moderate-income borrowers. (See p. 19.)

--Establish performance standards to be used with reliable management data on refinancing and loan priority given to low- and moderate-income borrowers, clearly stating HUD's goals for anticipated levels of performance. The performance standards should be communicated to field staffs and communities and used to focus HUD's technical assistance activities. (See p. 19.)

<u>AGENCY COMMENTS</u>

HUD officials, in commenting on the need to establish performance standards and management data to gauge the extent of progress being made in encouraging communities to adopt more cost-effective financing techniques, acknowledged that they currently lack sufficient data to determine their success and/or how much more needs to be done. They told GAO (1) that they are currently in the process of accumulating data on financing techniques being used by having their area offices survey entitlement communities using a questionnaire and (2) that a decision was made several years ago, prior to their recent policy change encouraging the greater use of cost-effective financing techniques, to rely on special surveys rather than overburden communities by routinely requiring that such information be reported. In light of their recent policy change and the growing concern over Federal expenditures, HUD officials agreed, that this decision should be reconsidered. (See p. 11.)

Contents

ABBREVIATIONS

CDBG	Community Development Block Grant
GAO	General Accounting Office
HUD	Department of Housing and Urban Development

CHAPTER 1

INTRODUCTION

The Department of Housing and Urban Development (HUD) assists local communities in rehabilitating housing through two major Federal programs--the Community Development Block Grant (CDBG) Program and the Section 312 Rehabilitation Loan Program. Together, these programs would have financed about $1.3 billion in housing rehabilitation in fiscal year 1981; however, this amount may not be realized because of the proposed budget reductions the Reagan administration and the Congress are considering.

CDBG, established by the Housing and Community Development Act of 1974 (42 U.S.C. 5301, et seq.), title I, as amended, provides funds to localities for a variety of community development activities designed to eliminate slums and blight, assist low- and moderate-income persons, and respond to urgent local needs. Currently, the largest single community activity conducted under CDBG is housing rehabilitation. Rehabilitation assistance is usually provided by local communities to individual homeowners through direct grants and loans or through private loan subsidies or guarantees. Individuals use these funds to repair, weatherize, or make cosmetic changes to their properties. Each locality generally determines its own program rules and regulations; thus, rehabilitation programs differ from community to community in terms of eligibility requirements, the maximum amount of money to be loaned and/or granted, and overall program objectives.

Over 1,500 localities throughout the United States have chosen to use some of their funds to operate property rehabilitation programs. The total CDBG dollars budgeted for rehabilitation loans and grants increased from $232 million in fiscal year 1975 to an expected $1.1 billion for fiscal year 1981.

The Section 312 Program, established by the Housing Act of 1964 (Public Law 88-560), as amended, authorizes HUD to make direct, low-cost loans to property owners for rehabilitating single-family and multifamily housing and nonresidential properties. Usually HUD does not handle the detailed administration of the program. Qualified property owners request and receive loans through local government housing and community development agencies. Borrowers can receive loans up to $27,000 for each residential dwelling unit, and loans must be repaid in 20 years or less at a 3-percent interest rate. 1/

HUD data shows that through September 1980 the aggregate value of section 312 rehabilitation loans totaled about $894 million, with some 760 cities and counties currently participating in the program. The Carter administration's budgets for fiscal years 1981 and 1982 would have provided about $182 million and $200 million, respectively, for this program. The Reagan administration in its revised fiscal year 1982 budget, however, requested that the program be terminated in 1981 and submitted a proposed rescission estimated at about $111 million. The Congress, while enacting a rescission, chose not to terminate the program and provided in the Supplemental Appropriations and Rescission Act, 1981 (Public Law 97-12), that the program be continued on a reduced funding level in 1981, using loan repayments to the Section 312 Loan Fund to make new direct loans.

The future continuation of the Section 312 Program is currently being considered by the Congress in its deliberations on the proposed Omnibus Reconciliation Act of 1981. The Senate-passed bill (S. 1377) provides authorization for the program to continue through fiscal year 1983, presumably with monies received from the repayment of prior loans, with the limitation that loans in fiscal years 1982 and 1983 be made only in connection with urban homesteading programs or multifamily properties. The House-passed bill (H.R. 3982), however, would repeal the Section 312 Program authorization and transfer the assets and liabilities of the Section 312 Loan Fund to a revolving fund for liquidating programs.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective in this assignment was to review the adequacy of actions HUD has taken to implement recommendations we made in a December 1979 report to the Congress on opportunities for more

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1/Federal rules and regulations scheduled to become effective on February 15, 1981, would have increased the maximum loan amount for residential properties from $27,000 to $33,500 per dwelling unit and would have established a sliding scale of interest rates for single-family properties, varied at 3, 6, and 9 percent, depending on the income of the borrower. These regulations, however, were withdrawn on February 9, 1981, in response to a January 29, 1981, Presidential memorandum which, among other things, directed executive agencies to postpone for 60 days the effective date of those regulations which have been published but have not yet taken effect. As of June 19, 1981, these regulations had not been resubmitted for publication pending final action on the Reagan administration's proposal to terminate the Section 312 Rehabilitation Loan Program.

effective use of millions of dollars for rehabilitating housing. 1/ This report discusses the status of these actions and contains additional recommendations to ensure that maximum benefits are achieved. Other recent reports address the overall effectiveness of the CDBG rehabilitation program 2/ and the status of HUD actions in implementing our prior reports' recommendations on housing and community development programs. 3/

Our December 1979 report was based on a comprehensive review of the section 312 and CDBG rehabilitation programs at HUD field offices and visits to 25 communities in nine States 4/ to determine if program funds were being spent efficiently and effectively. This followup report was based on more limited fieldwork during 1980 with visits to 24 communities and HUD offices in five States. 5/ We also obtained information on the housing rehabilitation programs from an additional 55 communities in these five States and New York. Some of this information was obtained by telephone and the remaining from HUD area offices.

During both reviews we examined policies, procedures, reports, and other records relating to the program and interviewed HUD program officials, community officials, rehabilitation contractors and consultants, and homeowners. We also examined loan and grant files and toured neighborhoods and individual homes being rehabilitated.

1/"Millions of Dollars for Rehabilitating Housing Can Be Used More Effectively" (CED-80-19, Dec. 7, 1979).

2/"The Community Development Block Grant Program Can Be More Effective in Revitalizing the Nation's Cities" (CED-81-76, Apr. 30, 1981).

3/"Further Actions Needed to Improve Management of HUD Programs" (CED-81-41, Feb. 26, 1981).

4/Connecticut, Florida, Georgia, Idaho, Massachusetts, North Carolina, Oregon, Rhode Island, and Washington.

5/New Jersey, North Carolina, Oregon, Virginia, and Washington.

CHAPTER 2

PERFORMANCE STANDARDS AND MANAGEMENT DATA ARE NEEDED TO ENSURE SAVING MILLIONS OF DOLLARS IN CDBG HOUSING REHABILITATION

By getting CDBG-assisted communities to combine grant assistance to homeowners with other funds or by using loans in place of grants, HUD could (1) more effectively use millions of dollars of CDBG rehabilitation funds annually or (2) substantially reduce its CDBG rehabilitation budget without adversely affecting the amount of housing rehabilitated. Although HUD agreed that direct grants for housing rehabilitation are costly and sometimes inappropriate, it disagreed with the recommendation in our December 1979 report that CDBG regulations be amended to prohibit the use of grants unless grants are combined with other resources. Instead, HUD stated that it is seeking, through technical assistance efforts, to encourage communities to use deferred payment loans, variable interest rates and terms, and other financing methods which leverage, regenerate, or otherwise stretch available rehabilitation funds. HUD believes that, through concerted technical assistance, its efforts to encourage communities to use more cost-effective financing techniques can achieve the desired results without re-creating the restrictive, inflexible requirements of earlier Federal renewal efforts. HUD said that it opposes regulations or legislative changes which reduce the local creativity which characterizes current CDBG rehabilitation efforts.

We agree that technical assistance should be provided to communities to encourage them to use more effective and efficient rehabilitation financing techniques. We believe, however, that if HUD intends to rely primarily on technical assistance "encouragement" to promote regenerative and leveraging financing techniques, HUD should improve its monitoring of program performance and establish performance standards to determine if its technical assistance efforts are successful in encouraging communities to use more cost-effective rehabilitation financing techniques. Currently, HUD does not have sufficient data to know how successful its encouragement efforts have been or whether additional steps are needed. Moreover, our talks with HUD area office officials--those in the best position to influence communities to use cost-effective financing techniques--disclosed substantial differences of opinion concerning HUD's policy on using such techniques. And, our tests in several communities indicate that this difference of opinion has been reflected in the use of the various financing methods.

DIRECT GRANTS ARE COSTLY AND INEFFICIENT

In our prior review we estimated that for fiscal year 1980, communities would budget about $200 million of their CDBG rehabilitation funds for grants to homeowners. Communities were expected to combine some of these grants with rehabilitation funds from other sources, such as homeowner savings or bank loans, thus leveraging, or multiplying, the amount of rehabilitation that could be accomplished with each grant. However, the majority of the grants--which could have amounted to more than $150 million based on HUD's prior records--may be awarded directly to property owners to cover all of their rehabilitation costs. These "direct grants" are a costly and inefficient use of limited program resources. Direct grants are lost forever; they are not recycled into a community's rehabilitation program, nor are they used to increase the rehabilitation done with CDBG funds.

There are several more efficient alternatives to direct grants--many of which were being used by some communities we visited--for example, direct loans, partial loans, subsidized private loans, guaranteed loans, and deferred payment loans. We pointed out in our prior report that each of these financing alternatives is more efficient than direct grants because each alternative either leverages the amount of rehabilitation that can be accomplished with CDBG funds in the current year and/or regenerates funds, through loan repayments, for rehabilitation in future years.

Despite the economic benefits of alternatives to direct grants, many communities we visited in our prior review were operating grant programs exclusively or predominantly. According to some HUD and community rehabilitation officials we talked with, direct grants were being used to provide financial assistance to homeowners because grants are (1) simple to administer, (2) needed to help low-income property owners who cannot afford to make additional monthly house payments, or (3) needed to help property owners who refuse loans. However, our analysis of these reasons showed that (1) small or inexperienced communities, which could have difficulty managing sophisticated financing programs, can maintain program simplicity and still use their funds more efficiently by using alternatives to grants, (2) deferred payment loans, which the homeowner does not repay until the rehabilitated property is sold or transferred, are a good alternative to direct grants for assisting low-income property owners who cannot afford to make additional monthly payments, and (3) when grants are available, many property owners obviously would prefer to accept a grant rather than a loan to pay for their housing rehabilitation costs.

Therefore, we concluded that the reasons cited by HUD and community officials do not adequately justify a community's use of direct grants in most cases. Our report stated that HUD and participating communities need to give greater consideration to using alternative financing techniques for housing rehabilitation and recommended that HUD amend the CDBG regulations to prohibit the use of direct grants unless they are combined with other resources. We also recommended that HUD provide technical assistance to communities to enable them to use deferred payment loans and other financing methods as substitutes for direct grants.

HUD FAVORS AN "ENCOURAGEMENT-TYPE" APPROACH TO PROMOTE REGENERATIVE FINANCING TECHNIQUES

In commenting on our report in September 1979 and February 1980, HUD did not agree with our recommendation to prohibit the use of grants unless they are combined with other resources. HUD said it believes that grants can play an important role in local rehabilitation efforts under some circumstances. HUD did agree, however, that grants are a costly method of providing rehabilitation assistance and that sometimes grants have been used in situations where other financing techniques would have been more appropriate. HUD said that it would continue to actively provide technical assistance to communities on the most efficient and effective rehabilitation financing techniques. In particular, HUD said that through workshops and seminars it was promoting the use of deferred payment loans and "0-percent" interest loans as alternatives to grants.

HUD also said it opposes regulations or legislative changes which reduce the local creativity which now characterizes CDBG rehabilitation efforts. Concerted technical assistance efforts can achieve the desired results without re-creating the restrictive, inflexible requirements of earlier Federal renewal efforts, according to HUD. For example, HUD cited a workshop and direct assistance efforts involving HUD, the State of Kentucky, and Kentucky regional planning agencies initiated in April 1979, which it said had resulted in preliminary bank commitments for loan-leveraging agreements in more than 20 Kentucky communities using CDBG funds for rehabilitation. At least 10 of these communities had operated a grant-only program in the past, and at least 5 had never had any local revitalization effort. HUD also said that it was engaged in similar technical assistance efforts throughout the country.

REGENERATIVE FINANCING PERFORMANCE STANDARDS AND MANAGEMENT DATA ARE NEEDED BECAUSE SUCCESSES HAVE NOT BEEN MEASURED

If HUD intends to rely primarily on an encouragement-type approach to promote more cost-effective financing techniques, we believe HUD needs to establish a data system and accompanying performance standards to determine whether the objectives of this approach are being achieved. HUD does not currently know how successful its efforts to promote cost-effective financing techniques have been or whether additional steps are needed. Discussions with HUD area office officials also disclosed substantial differences of opinion concerning HUD's policy on using such techniques. Some HUD area office officials are promoting regenerative financing techniques, but others are still promoting grants, and this has been reflected in the use of the various financing techniques.

Study shows that regenerative financing opportunities exist

In 1980, we made a limited study of the manner in which HUD area offices and small-city CDBG grantees in six States were responding to HUD headquarters' efforts to reduce communities' reliance on direct grants for housing rehabilitation. We found that, although many of the communities we visited or contacted were using or planned to use loans, loan and grant combinations, and other more cost-effective financing techniques in their housing rehabilitation programs, many other communities were still using grant programs exclusively or predominantly. For example, the following table shows the results of our survey of 79 communities in HUD's Buffalo, New York; Greensboro, North Carolina; Newark, New Jersey; Portland, Oregon; Richmond, Virginia; and Seattle, Washington; jurisdictions.

Communities Surveyed Having Rehabilitation Programs

HUD area office	Number of communities	Using grants only: Number	Using grants only: Percent	Using other than grants only: Number	Using other than grants only: Percent
Buffalo	6	1	17	5	83
Greensboro	30	23	77	7	23
Newark	10	2	20	8	80
Portland	2	1	50	1	50
Richmond	25	7	28	18	72
Seattle	6	2	33	4	67
Total	79	36	46	43	54

As the table shows, 46 percent of the small-city grantees we surveyed were providing rehabilitation assistance to homeowners in the form of grants only. Further, even in those communities whose rehabilitation programs provide several financing techniques, the use of methods other than grants may not be extensive. A Richmond area office official told us that although most Virginia grantee communities provide a variety of rehabilitation financing methods, only about 25 percent of the funds are used for loans and other nongrant disbursements. He estimated that about 75 percent of rehabilitation funds are still disbursed in the form of grants.

Not only did the financing practices vary widely among individual communities, so did the attitude of HUD area office representatives toward various financing methods. For example, HUD representatives in the Newark area office said that they informally encourage communities to use loans or other regenerative financing techniques and provide technical assistance and publications to help in such encouragement. Conversely, officials in HUD's Greensboro area office, where grants were most prevalent, encouraged communities to use grants.

The Richmond area office personnel said they were cautious about recommending other rehabilitation financing techniques because the community, particularly the smaller community, may not have the administrative capacity to effectively implement the recommended program. Several community officials we visited in Virginia told us that HUD representatives had neither recommended nor encouraged the rehabilitation financing technique they chose. However, as we stated previously, several alternatives to grants can provide smaller communities with both easy-to-administer financing programs and more effective uses of funds.

The contrasting positions on the part of HUD area office personnel may be due in part to the lack of clear guidance from HUD on its policy of encouraging the use of loans and other regenerative techniques to the maximum extent practicable. Neither HUD's CDBG regulations nor its technical assistance manuals specifically require communities to use cost-effective alternatives to grants whenever possible, although they do address rehabilitation and financing techniques. Booklets distributed to grantees and other interested parties discuss such topics as rehabilitation financing options available, how to design a housing rehabilitation program, advantages and disadvantages of various financing techniques, and suggestions on leveraging arrangements. We believe that if HUD is to take full advantage of regenerative financing opportunities, it will need to assure that its field personnel more consistently adopt HUD headquarters' policy in their technical assistance efforts and other dealings with grantee communities. One way for HUD to assure that full advantage is being taken of regenerative financing opportunities is to establish performance standards and a data system.

Need for performance standards and management data on the use of various financing methods

HUD has not established a data system for routinely collecting or maintaining information which shows, nationally or by locality, to what extent communities are using loans, grants, or the numerous other forms and combinations of rehabilitation funding. Without such information and related performance standards, HUD is not able to readily or thoroughly determine (1) to what extent its technical assistance efforts are working, (2) which area offices or communities may need attention, and (3) what further efforts are needed to educate both community officials and its own program managers.

Without establishing standards to determine if HUD's technical assistance efforts are successful in encouraging communities to use more cost-effective rehabilitation financing techniques, it will be difficult for HUD to communicate its expectations to community officials and to evaluate the effectiveness of its encouragement efforts. Encouraging grantees to use CDBG funds efficiently is not inconsistent with the Housing and Community Development Act. For example, section 104(i) of the act provides that when a revolving loan fund is established in a private financial institution to finance rehabilitation activities, HUD is to establish standards to assure that amounts deposited result in appropriate benefits in support of the grantee's rehabilitation program.

Also, HUD's response to a November 7, 1980, Office of Inspector General CDBG rehabilitation report shows that HUD is aware of the essential value of performance standards. Although not specifically concerning the type of financing methods to be used, the following excerpt illustrates the importance of performance standards. HUD stated in part that:

> "Improved monitoring and problem assessment are of little value unless there is some method to assure improvements in performance. HUD is reviewing the merits of an amendment to the CDBG program that would specify standards for minimum, effective rehabilitation performance and impose sanctions for failure to meet the standard or seek corrective action such as training or technical assistance. Area Offices would review a locality's plans for overcoming the identified problems. If the Area Office was not satisfied, the applicant's Block Grant application could be conditioned. Examples of the standards which might be developed include failure to meet housing quality standards for a specified percentage of units counted toward HAP [Housing Assistance Plan] goals or a ratio of administrative costs to rehabilitation production in excess of an established norm."

We believe that performance standards, as discussed on page 10, could be used by HUD in its monitoring efforts to assess the need for changes in its technical assistance efforts or for taking additional actions, such as incentives, to further encourage communities. Regarding data, HUD currently collects information from communities on what CDBG activities they plan to conduct during the upcoming program year and how much of their budgets they plan to spend on each activity. This data, required for both entitlement and small city grantees, has been computerized by HUD. For rehabilitation and preservation activities, HUD requires grantees to show how much of their funds they intend to budget for (1) rehabilitating public residential structures, (2) modernizing public housing, (3) rehabilitating private properties, (4) code enforcement, and (5) historic preservation. However, there currently is no requirement for grantees, in reporting on their planned rehabilitation activities, to provide any information on the financing techniques to be used by the community--direct loans versus direct grants or other financing methods. We believe that by making minor revisions to the forms used to collect budget information, HUD could significantly improve its monitoring capabilities by requiring local communities to at least distinguish between the amount of funds they plan to budget for rehabilitation grants versus loans. HUD's data processing personnel told us that this change is feasible from an operational standpoint.

The revisions we are suggesting for HUD's existing data system, while providing minimum baseline data on community rehabilitation financing, obviously could be further refined to provide greater detail on the type of financing assistance communities are providing. We believe the degree of sophistication needed should be tailored to the objectives HUD hopes to accomplish through local community rehabilitation programs.

In addition to collecting data on planned or budgeted CDBG activities, HUD requires communities to periodically submit information on actual expenditures--a more reflective indicator of performance. Grantee performance reports provide HUD an excellent means to accumulate data on the financing techniques communities' actually use. HUD could, through the revision of these existing data collection reports, establish a uniform, nationwide data base capable of providing HUD with the information it needs to fulfill its oversight and technical assistance responsibilities. In this regard, we believe that any management data collected on actual expenditures should be interfaced with the existing system on planned expenditures--providing HUD with data on planned versus actual results.

A comparison of planned and actual results with goals or standards for promoting cost-effective financing techniques could show the need for changes in technical assistance efforts or the need to provide incentives to further encourage communities to adopt alternative financing techniques. Incentives to reward communities for regenerating or stretching Federal funds could be implemented for small-city CDBG recipients through the selection rating system used in awarding grants and for entitlement cities through the award of additional section 312 funds, if they are available.

The incentives concept is not new. In fact, HUD is already using such an approach in some of its programs. For example, as discussed on pages 16 and 17, HUD is presently using a rewards/penalties concept in the Section 312 Program to provide incentives for efficient local operations to meet national program goals.

In this program, HUD adjusts individual community funding levels based on such performance factors as reducing loan delinquencies, giving loan priority to low- and moderate-income persons, and management efficiency.

As another example, HUD's fiscal year 1980 guidance on small-city CDGB applications advises its area offices that they should consider cost benefits and the manner in which CDBG funds will be used--outright grants or arrangements which recycle the funds, such as loans or lease-back arrangements--in judging the program impact of proposals for CDBG economic development projects. We believe that similar standards to encourage the stretching of Federal funds could apply to proposals for CDBG rehabilitation projects as well. According to area office officials we interviewed, there currently is no directive or requirement that they give more weight to community rehabilitation proposals calling for cost-effective financing techniques than to those calling for outright grants.

Incorporating such incentives in the regulations would clearly put HUD and community officials on notice of HUD's commitment to encourage the use of cost-effective techniques in rehabilitation programs. At the same time, such incentives should not interfere with the "local discretion" principle of the CDBG program, since communities would still be free to decide for themselves whether to seek the incentive.

HUD officials, in commenting on the need to establish performance standards and management data to gauge the extent of progress being made in encouraging communities to adopt more cost-effective financing techniques, acknowledged that they currently lack sufficient data to determine their success and/or how much more needs to be done. They told us that they are currently in the process of accumulating data on financing techniques being used by having their area offices survey entitlement communities using a questionnaire. We were told that a decision was made several years ago, prior to their recent policy change encouraging the greater use of cost-effective financing techniques, to rely on special surveys rather than overburden communities by routinely requiring that such information be reported. In light of their recent policy change and the growing concern over Federal expenditures, HUD officials agreed that this decision should be reconsidered.

RECOMMENDATIONS TO THE SECRETARY, HUD

To ensure that HUD's technical assistance efforts are helping local communities use the most cost-effective financing method available in their CDBG housing rehabilitation programs without incurring substantial costs in developing an elaborate, new, monitoring system, the Secretary should:

--Improve HUD's existing monitoring capabilities by revising the application forms for collecting information on the planned uses of block grant funds to require that, in the case of housing rehabilitation activities, local communities indicate the amount of funds they plan to budget for rehabilitation grants versus loans.

--Revise the grantee performance reports to require that information reported on block grant expenditures for housing rehabilitation indicate the amount spent through the use of rehabilitation grants versus loans. HUD should also incorporate this information on expenditures into its computer system as it has done for block grant budgets to enable routine and timely comparisons between planned and actual expenditures.

--Establish performance standards in conjunction with these block grant rehabilitation data systems, stating the Department's goals for using more cost-effective rehabilitation financing methods.

--Use the improved management data and accompanying performance standards to measure the progress area offices and communities are making to reduce their reliance on the use of direct grants in rehabilitating housing. HUD should also consider whether additional actions, such as incentives, are needed to reward communities for stretching block grant funds by adopting financing methods more cost effective than direct grants.

CHAPTER 3

PERFORMANCE STANDARDS AND RELIABLE MANAGEMENT DATA ARE ALSO NEEDED TO ENSURE THAT HUD's CHANGES IN THE SECTION 312 LOAN PROGRAM ARE SUCCESSFULLY IMPLEMENTED

During calendar year 1980, responding to recommendations in our December 1979 report, HUD made several significant policy and procedural changes in the Section 312 Program. These changes, if properly implemented, could save or permit better use of millions of housing rehabilitation dollars annually if the Section 312 Program is continued. The revisions include

--adding new restrictions on refinancing with section 312 funds;

--encouraging the practice of leveraging section 312 loans with conventional financing, establishing variable loan interest rates based on income, and reemphasizing that repayment periods are to realistically reflect a borrower's ability to pay; and

--emphasizing the statutory requirement that section 312 loan priority be given to low- and moderate-income persons.

While these revisions should improve the efficiency and effectiveness of section 312, our followup review showed that HUD needs to improve its existing monitoring capability to ensure that its new policies and procedures are effectively implemented and the cost savings identified in our prior report are fully achieved. We found that HUD's program information on section 312 refinancing was unreliable, thus limiting the effectiveness of HUD's monitoring capabilities. Other information on loan priority for low- and moderate-income borrowers could be better used for monitoring program objectives.

In conjunction with improved data, HUD needs to establish standards or minimum levels of acceptable or desirable performance against which data on actual performance can be compared. As HUD has recognized, monitoring alone is of little value unless standards are established to determine whether actual performance is acceptable.

IMPROVEMENTS MADE TO ENSURE REFINANCING DATA IS ACCURATE BUT PERFORMANCE STANDARDS STILL NEEDED

Our December 1979 report questioned the use of section 312 funds for refinancing home mortgages. We pointed out that HUD was often permitting--in fact encouraging--borrowers to refinance existing home mortgages with low-interest rehabilitation loans, a costly and ineffective practice which was diverting substantial amounts of rehabilitation funds from their intended purpose--repairing houses. Based on HUD data, we reported that since the Section 312 Program began borrowers had used over $76 million, or about 18 percent of the loan amount awarded to owners of single-family properties, to refinance their home mortgages.

HUD agreed that refinancing can be costly and that its financing procedures needed revising. Therefore, HUD notified its field personnel that effective March 1980, refinancing would

--generally be used only as a last resort when other forms of rehabilitation assistance are unaffordable by the borrower;

--generally be permitted only for housing-related debts;

--be considered only when rehabilitation costs represent 30 percent or more of the total loan amount, instead of the former 20 percent; and

--not be permitted for applicants whose incomes exceed 95 percent of the median income for the area, to ensure that benefits are directed to low- and moderate-income persons.

These changes also were included in HUD's new comprehensive program regulations which were scheduled to become effective on February 15, 1981. These regulations, however, were withdrawn before becoming effective and have not been resubmitted, pending final action on the proposal to terminate the Section 312 Loan Program. In addition, Public Law 96-399, enacted October 8, 1980, requires HUD itself to approve each loan involving refinancing by prohibiting HUD from delegating its approval authority to local communities.

In December 1980, to assess the effectiveness of the new restrictions, we requested HUD officials to provide us data on the extent of refinancing before and after the March 1980 policy change. The data HUD officials provided to us, from two regularly generated computerized reports (quarterly and cumulative reports), while inconsistent with each other, showed that refinancing had dramatically increased rather than decreased from the level shown in our prior report. From April through June 1980, for example, one of HUD's computer records showed that refinancing represented nearly 70 percent of all loan funds--a rate almost four times the 18-percent rate we had cited in our prior report. The other report showed about 80 percent. After examining the two reports, it was apparent that they contained errors, but the extent of the errors was unknown.

After we brought the errors to HUD's attention, they provided us with revised computer data again showing dramatically different results. For example, the revised reports not only indicated that the refinancing rate from April through June 1980 was running about 4 percent, rather than 70 or 80 percent, but surprisingly also showed that the aggregate amount of refinancing from the beginning of the program to September 30, 1980, was, for unexplained reasons, $6 million less than the $76 million shown by HUD records for a year and a half earlier.

The extreme variances reflected in these regularly generated computerized reports limit the effectiveness of HUD's program monitoring efforts. In our opinion, data systems designed to provide management with readily available information on program operations are of little value, and a waste of funds, if the data is inaccurate and not used by management for monitoring. In fact, unreliable data could mislead managers into making unwarranted changes in programs performing satisfactorily or, conversely, not making changes when needed.

HUD officials acknowledged that data errors had been a problem in the past and said they would determine why the errors occurred and make the necessary changes to limit the possibility of recurring errors. Subsequently, in March 1981, HUD officials told us that they had corrected the data errors discussed above and provided us with revised reports. The revised reports show that from the beginning of the program through fiscal year 1980, approximately $103 million, or about 16 percent of the section 312 funds lent to single-family owners, were used to refinance their home mortgages. Further, the data showed that refinancing for fiscal year 1980 represented about 9.7 percent of the total loan funds and that the last two quarters of fiscal year 1980 reflected an improvement over the first two quarters of the year, coinciding with HUD's March 1980 administrative policy change to restrict the extent of refinancing.

HUD officials said they believe that refinancing would constitute less than 1 percent of the total amount of section 312 owner-occupied loans made annually once all of the new restrictions on refinancing are fully implemented. However, performance standards have not been established reflecting these expectations.

BETTER USE OF EXISTING DATA AND THE ESTABLISHMENT OF PERFORMANCE STANDARDS ARE NEEDED TO MONITOR THE LOAN PRIORITY FOR LOW- AND MODERATE-INCOME BORROWERS

Although the section 312 legislation and HUD policy require that low- and moderate-income homeowners 1/ receive priority in obtaining rehabilitation loans, our December 1979 report showed that HUD had not specified how, or to what extent, such priority should be given. For fiscal years 1978 and 1979, about 30 and 33 percent, respectively, of section 312 funds were loaned to higher income persons, even though lower income homeowners still had unmet needs.

Many cities we visited in our prior review awarded section 312 loans on a first-come, first-served basis regardless of income, which did not assure that low- and moderate-income homeowners received the priority required by law. Some communities awarded more than 50 percent of the loans we reviewed to higher income households, although officials said that low- and moderate-income homeowners still had a large, unmet need for rehabilitation assistance. We estimated that nationwide over $40 million in section 312 single-family loans could go to higher income families in fiscal year 1980.

Because we believe that section 312's objectives are met best by giving preference to low- and moderate-income homeowners, we concluded that HUD needed to require communities to give priority consistently to low- and moderate-income property owners. Specifically, we recommended that the Secretary of HUD develop section 312 regulations to require that low- and moderate-income single-family loan applicants receive funding priority by restricting loans to higher income homeowners to exceptions to be defined by the Secretary.

In commenting on our prior report, HUD agreed to develop section 312 regulations which provide more explicit standards or criteria for issuing loans to higher income homeowners. Also, HUD stated that in allocating section 312 funds for fiscal year 1980 it would consider a locality's performance in meeting the priority for low- to moderate-income participants.

In its new comprehensive regulations for section 312 that would have become effective in February 1981 but were withdrawn, and in a draft handbook of implementing procedures which would

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1/The term "low- and moderate-income," as defined by 1978 amendments to the Housing and Community Development Act of 1974, means income which does not exceed 95 percent of the area median income. Before October 1978, the term meant income not exceeding 80 percent of the area median income.

accompany the regulations, HUD stated that in processing, recommending, and approving section 312 loans, localities shall give priority, as required by the Housing Act of 1964, to applications of low- and moderate-income owners of single-family, owner-occupied property. The handbook also contained the following restriction:

> "a. Low-Moderate Income Priority. The low- and moderate-income priority * * * is a statutory mandate contained in Section 312(a) of the Housing Act of 1964. Localities shall administer their Section 312 loan programs in keeping with this priority. Lending to owner-occupants above 95% of median income shall generally be done only when necessary to achieve the overall neighborhood revitalization goals of the locality."
> (Second underscoring supplied.)

Also, the draft handbook (1) discusses the concept and acceptability of making loans to homeowners with incomes over 95 percent of the area median, (2) provides examples of appropriate and inappropriate lending to such higher income homeowners (for example, the handbook specifically states that a "first-come, first-served" method of funding applicants, regardless of income, is not an acceptable means of providing assistance to prospective higher income borrowers), and (3) requires the loan-approving official to include a written justification in the borrower's loan file when a loan is made to a higher income homeowner.

Our analysis of HUD's proposed new regulations and its draft handbook indicates that, if effectively implemented by participating communities, loans to higher income participants will likely be fewer and those that are made will be better justified.

Also, an analysis of HUD area offices' funding allocations for fiscal year 1980 indicates that HUD is moving to meet its commitment to adjust a community's annual allocation of section 312 funds based on the community's past performance in giving priority attention to low- and moderate-income participants. Of 368 communities for which fiscal year 1980 fund allocation information was readily available, HUD's records showed that 57 communities (15 percent) were awarded additional section 312 funds, and 32 communities (9 percent) were penalized by a reduced allocation, based on HUD area office evaluations of communities' low-moderate income lending patterns. According to HUD officials, the adjustments for fiscal year 1980 were discretionary on the part of HUD area offices. In fiscal year 1981, when the adjustments become mandatory, they expect a significantly greater percentage of communities to be affected.

Thus, we believe that HUD has taken a number of positive steps to emphasize the statutory requirement for providing preference to low- and moderate-income borrowers. However, additional steps that need to be taken, similar to the previously discussed point on refinancing, concern monitoring results and establishing performance standards. In its program regulations and implementing draft handbook, HUD states that it has chosen not to set a fixed percentage goal of loans to be made or housing units to be rehabilitated for low- and moderate-income persons either nationally or within each locality. HUD believes that such standards may not be responsive to local conditions or administratively feasible at all times.

We recognize that numerical standards, particularly those that are used to reward or penalize communities on performance, are difficult to establish and administer because of the wide array of circumstances that may exist in individual communities or regions. In this case, however, we believe there is merit to numerical standards, or a range of acceptable performance, for monitoring purposes. First, the amount of reward or penalty adjustments made to community budget allocations are largely discretionary on the part of the area offices. Thus, HUD has no assurance that the adjustments reasonably reflect only necessary distinctions between areas or adhere to HUD's overall program objectives.

Second, HUD's reward and penalty adjustments, while made for each community at the beginning of the fiscal year, reflect the community's performance during the prior year--after-the-fact--and thus HUD's performance expectations are unknown to communities until after the year being evaluated is completed. This seems unfair to communities, particularly those that are penalized, which could have altered their loan practices during the prior year to meet HUD's expectations if those expectations had been known.

Third, HUD's data on the extent of community compliance with the low- and moderate-income priority requirement is not a routinely generated computer record, but rather is generated only as a special run--principally so that HUD area offices can make their reward and penalty determinations. By increasing the frequency of these computer runs to "routine" status, HUD and the communities would be in a better position to monitor performance as it occurs and take necessary action to bring performance up to an acceptable level on an ongoing basis. In this regard, HUD officials indicated that they have made some use of these reports for monitoring purposes and cited an April 1980 memorandum to HUD field offices reminding them of the priority.

Thus, to ensure that HUD's efforts to provide loan priority to low- and moderate-income borrowers are successful, HUD needs to produce information that can be used to monitor actual performance on an ongoing basis and, more specifically, notify communities of what it believes to be acceptable levels of performance.

RECOMMENDATIONS TO THE SECRETARY, HUD

To ensure that recent changes made in HUD's proposed regulations to improve the efficiency and effectiveness of the Section

312 Program are fully implemented and potential cost savings are achieved if the program is continued, we are recommending that the Secretary:

--Prepare periodic reports using existing data systems to routinely monitor the HUD objective that communities give loan priority to low- and moderate-income borrowers.

--Establish performance standards to be used with reliable management data on refinancing and loan priority given to low- and moderate-income borrowers, clearly stating HUD's goals for anticipated levels of performance. The performance standards should be communicated to field staffs and communities and used to focus HUD's technical assistance activities.

END

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