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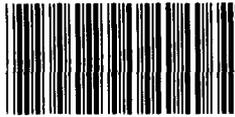
United States General Accounting Office

GAO

Transition Series

December 1992

# Housing and Community Development Issues



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GAO/OCG-93-22TR





United States  
General Accounting Office  
Washington, D.C. 20548

Comptroller General  
of the United States

December 1992

The Speaker of the House of Representatives  
The Majority Leader of the Senate

In response to your request, this transition series report discusses major policy, management, and program issues facing the Congress and the new administration in the area of housing and community development. The issues include (1) providing affordable housing for the nation's poor, (2) strengthening the Department of Housing and Urban Development's management, (3) controlling housing loan and lead-based paint cost exposure, (4) promoting community development, and (5) reexamining strategies for responding to disasters.

The GAO products upon which this report is based are listed at the end of the report.

We are also sending copies of this report to the President-elect, the Republican leadership of the Congress, the appropriate congressional committees, and the designated heads of the appropriate agencies.

A handwritten signature in cursive script that reads 'Charles A. Bowsher'.

Charles A. Bowsher

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# Housing and Community Development Issues

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Three conditions frame today's debate on housing and community development issues. These conditions are (1) the increasing gap between the demand for and the available supply of decent and affordable rental housing for low-income families, (2) the increasing need for investment in our communities, and (3) the shrinking federal resources for dealing with these problems.

For decades, federal legislation has reaffirmed a commitment to decent, safe, and affordable housing for every American family. However, as we reported in 1988, federal housing efforts have not met the needs of many Americans. Today, the supply of affordable rental housing for low-income people continues to decline while the need for such housing continues to grow. Rising costs, declining real wages, and a decreasing number of affordable homes have put a decent place to live beyond the reach of millions of families.

At the same time, the federal government is facing large real and potential cost exposure in several areas. For example, the nation's public housing stock, valued at over \$70 billion, has fallen into serious disrepair. The cost to meet existing needs is estimated at over \$20 billion, and modernization needs

continue to accrue. Moreover, the cost to renew expiring contracts that provide rental subsidies to lower-income families is expected to more than double over the next 5 years—rising from an estimated \$7.5 billion in fiscal year 1993 to about \$17.1 billion in fiscal year 1997.

Regarding potential cost exposure, the Federal Housing Administration's (FHA) single-family home ownership insurance program has lost an average of almost \$900 million a year from fiscal years 1979 to 1990 and has an economic value of negative \$2.7 billion. If these losses continue, the Treasury may be called upon to fund the program for the first time in FHA's 50-year history. Finally, the federal government faces billions of dollars in costs to clean up lead-based paint from its housing inventories, such as public housing. Estimates of these costs range from \$6 billion to \$16 billion. Resolving these issues will likely require significant funds at a time when federal budget choices are becoming increasingly limited.

Finally, other economic and social problems are putting tremendous strains on communities. Opportunities to provide additional funds are sharply constrained

because of the federal budget deficit and the relatively limited capacity of federal, state, and local governments for dealing with these problems. Under these circumstances, reinvigorating our communities will require careful leveraging of our investments in both the physical and human resources that communities provide. New partnerships and creative solutions will be needed.

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# Providing Affordable Housing for the Nation's Poor

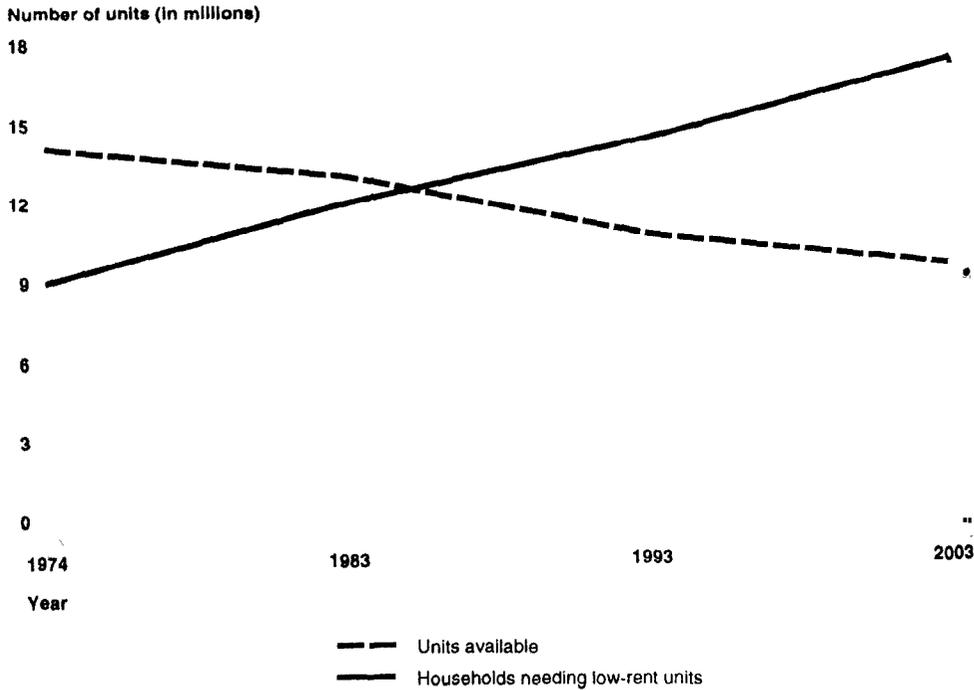
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The federal government has invested tens of billions of dollars in rental housing assistance to provide decent and affordable housing for low-income families. Nevertheless, an increasing share of our poor families are living in inadequate and unaffordable housing. In addition, much of the past federal investment is in danger of being lost—a condition that will only worsen an already dismal situation.

The gap is widening between the number of decent, affordable rental units and the demand for these units. In the early 1980s, demand and supply were in relative equilibrium. Since then, demand has been outstripping supply (see fig. 1). The gap is expected to grow over the next 10 years, when nearly one of every two low-income families may not be able to find affordable rental housing. Furthermore, it should be emphasized that this analysis understates the housing problems of low-income families, since the analysis is not adjusted for factors such as the location of available housing and household size.

**Providing Affordable Housing for the Nation's Poor**

**Figure 1: Number of Low-Rent Housing Units Available and Households Needing These Units, 1974-2003**



Source: Neighborhood Reinvestment Corporation, At Risk of Loss: The Endangered Future of Low-Income Rental Housing Resources.

To address the growing housing shortage,  
we will need to preserve private sector

low-income units, modernize the public housing stock, obtain sufficient permanent financing for affordable multifamily units, and continue to provide rent subsidies to poor families in private housing.

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**Preserving  
Private  
Low-Income  
Housing**

During the 1960s and 1970s, the federal government provided mortgage insurance, loans at below-market rates, and direct subsidies to stimulate the private sector's production of low-income housing. Within the coming 5 years, about 3,000 properties containing over 350,000 units could be withdrawn from the low-income rental market as restrictions limiting their use to low-income rental expire. The National Affordable Housing Act of 1990 provides financial incentives from the federal government, such as rent subsidies, to retain this inventory as a low-income housing resource. However, providing these incentives to preserve this stock for low-income use could cost the federal government hundreds of millions of dollars a year.

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**Modernizing  
Public Housing**

Too much of the public housing stock, particularly in urban areas, has fallen into serious disrepair. Home to many of the

nation's poorest households, the public housing stock consists of approximately 1.4 million units whose value exceeds \$70 billion. Modernization costs to meet existing capital improvement needs are estimated at over \$20 billion. These needs, coupled with new repair needs, would require annual appropriations over the next 20 years estimated at \$3.4 billion—about \$600 million per year more than the average annual appropriation of \$2.8 billion for this purpose in fiscal years 1991 to 1993.

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**Stimulating  
Investment  
Through  
Mortgage Credit  
Enhancements**

Changes in government policies and regulations during the 1980s, along with the poor performance of inadequately managed multifamily housing loans insured by FHA and other loans purchased by the Federal Home Loan Mortgage Corporation, led to a steep decline in mortgage funds available for affordable rental housing. A variety of participants representing a cross section of the financial market believe that significant barriers exist in accessing capital for rental housing targeted to low-income and very low-income rental households.

In this climate, the secondary market for multifamily housing mortgages (buyers and sellers of mortgage loans) has taken on

increased importance. However, such a market has not evolved for several reasons, including the risk—both real and perceived—associated with affordable housing and the reluctance of FHA and key secondary market institutions to expand their support for financing this housing as they attempt to balance support for affordable housing with the safety and soundness of their operations. New forms of federal credit enhancement—such as insurance on individual loans and pools of loans—recently authorized by the Congress can help to address this problem if the enhancements get support from FHA and the secondary market institutions charged with carrying out the new law. We expect to issue a comprehensive report discussing these issues in spring 1993.

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**Rent Subsidies  
Becoming  
Increasingly  
Costly**

Rent subsidies—provided through certificates, vouchers, and project-based assistance—are a mainstay in federal efforts to enable low-income families to live in decent and affordable privately owned rental housing. Currently, about 2.7 million families receive this assistance through HUD's contracts with private owners and local housing agencies, such as public housing agencies. Yet contracts covering assistance

to an estimated 1.6 million families are expected to expire in the next 5 years, and the cost to renew these contracts will grow, in current dollars, from an estimated \$7.5 billion in fiscal year 1993 to an estimated \$17.1 billion in fiscal year 1997.

This increase is due primarily to the larger number of contracts expected to expire in the next few years than in the recent past. The Congress and HUD have pursued a policy of renewing all expiring contracts so that low-income families can continue to live in affordable and decent housing. Yet the cost to continue this policy will more than double within the next 5 years, creating increasing pressures on an already strained federal budget.

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# Strengthening HUD's Management

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Since the publicizing of scandals at HUD in 1989, a great deal of attention and energy has focused on improving the Department's management. However, while HUD has undertaken a series of reform measures, many fundamental management problems remain unresolved. Solutions are needed so that HUD can shift more of its attention to program results.

In April 1989, a series of major, well-publicized problems began unfolding at HUD, involving widespread fraud, waste, abuse, and mismanagement. The full array of problems became widely known as the "HUD scandal." Some of these problems were departmentwide; others were confined to individual programs. Some of the most notable problems included influence-peddling, theft by private real estate agents of millions of dollars in HUD funds, inadequate enforcement of requirements designed to minimize defaults on HUD-backed mortgages, and poorly designed programs and controls that made it relatively easy for developers and lenders to exploit the program—at billions of dollars in costs to the government.

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**HUD  
Management  
Deficiencies  
Unresolved**

Although the Congress and HUD made major efforts to address these management and program design problems, the underlying causes of HUD's long-standing management deficiencies remain largely unresolved. These deficiencies include inadequate information and financial management systems, weak internal controls, an inappropriate organizational structure leading to ill-defined responsibilities and authority, and insufficient staff resources to perform necessary functions, such as monitoring and enforcing program requirements. These problems leave HUD's multibillion-dollar programs open to fraud, waste, abuse, and mismanagement. In fact, a recent report by the HUD Office of Inspector General cautioned that unless the Department acquires sufficient resources, another HUD scandal is a distinct possibility.

Although HUD has implemented many program-specific corrective actions, it is only beginning to resolve the underlying, departmentwide deficiencies. Until corrective actions for these departmentwide problems are implemented, actions focused on individual programs, no matter how extensive, cannot fully guarantee that the earlier abuses will not recur.

For these reasons, it is important to continue to review HUD's progress to ensure that HUD sustains its efforts to rectify problems, that corrective actions become an integral part of program operations, and that actions have a lasting effect. Only continued support and oversight can assure the public that HUD's resources are being efficiently used to serve the intended beneficiaries.

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# Controlling Increasing Cost Exposure

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Substantial losses from federal insurance programs and costs to be incurred to abate lead-based paint in the government's housing inventory have substantially increased the federal government's cost exposure.

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## Limiting FHA's Insurance Losses

FHA's home ownership assistance program is the largest source of mortgage financing for low- and moderate-income Americans. As of the end of fiscal year 1990, \$303 billion in federally insured mortgage loans were outstanding under the program, which encourages home ownership by providing more liberal credit terms than private sector lenders would offer. Unlike private sector mortgage lending, FHA's program is to strike a balance among certain social and financial goals—to help relatively risky borrowers with mortgage financing while remaining actuarially sound. As such, FHA's program is inherently more risky than private sector programs.

Over the past 12 years, the economic value of FHA's largest program—the single-family home ownership program—has been decreasing by an average of about \$891 million a year, dropping from \$8 billion in fiscal year 1979 to a negative \$2.7 billion in fiscal year 1990. This has occurred because

of rising foreclosures in economically stressed regions during the 1980s, particularly the Rocky Mountain and Southwest regions of the country, poor HUD management, and lax HUD monitoring. More recently, the economic recession and the slower-than-expected recovery have increased claims. If these conditions continue to play out, the Treasury may be called upon to fund the program for the first time in FHA's 50-year history. While there is no way to predict how much this remedy could cost, it could be substantial. In dealing with this issue, policymakers must balance the desire to assist home buyers against the federal government's potential financial risk and the possible need for assistance from the Treasury.

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**Facing  
Lead-Based Paint  
Abatement  
Liability**

The federal government also faces billions of dollars in costs to clean up lead-based paint from its housing inventories. Lead poisoning—mostly caused by lead-based paint—is, according to the Centers for Disease Control, the most common and socially devastating environmental disease of young children. Estimates of the cost to abate lead-based paint in public housing units range from \$6 billion to \$16 billion. In addition, federal agencies that sell

foreclosed residential housing to the public—HUD, the Farmers Home Administration, and the Department of Veterans Affairs—must comply with certain testing and abatement requirements that will probably cost the government hundreds of millions of dollars. The federal government's exposure to these large costs could result in substantial outlays.

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# Promoting Community Development

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How best to revitalize our communities is a question central to today's public policy debates. While much of this question has focused, appropriately, on the problems of inner cities, other important economic and community development issues warrant increased attention, such as the effectiveness of federal efforts to develop small businesses, particularly for minority groups.

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## Curing Urban Ills

For decades the nation has attempted to address the problems of inner-city, urban America. However, the recent unrest in Los Angeles has demonstrated that we have made only slight progress at best. Residents of low-income neighborhoods commonly face difficulties finding jobs and attaining a reasonable standard of living. Similarly, neighborhood businesses confront a variety of barriers in creating and expanding job opportunities for inner-city residents.

Federal efforts have been limited to formulating and designing programs to address specific problems. Overall, these efforts have been piecemeal, and more attention has been paid to symptoms than to the underlying need to develop human resources. The price the country pays for

these continuing urban problems is tremendous—both in social and economic terms.

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**Impact of Small  
Business Loans  
Unclear**

A critical element in developing and maintaining the economic well-being of communities—rural, urban, and suburban—is small business. There are over 20 million businesses in the United States. All but about 200,000 of them are small businesses. Within the federal government, the Small Business Administration (SBA) is charged with developing and nurturing small business by providing financial, technical, and other assistance, giving particular attention to small minority businesses. SBA is to provide this support while protecting the taxpayers' interests.

There has been no recent assessment of what sector of small business, if any, would receive financial assistance if SBA did not exist. Nor has there been a recent assessment of the economic impact that has resulted from the billions of dollars in federal guarantees that SBA has provided to small businesses. Yet in fiscal year 1992, SBA almost doubled the value of the business loans that it guaranteed—from \$3.8 billion in fiscal year 1991 to \$6.4 billion in fiscal year

1992. Our work has shown that SBA's loss rate is greater than that of private lenders and that SBA has not adequately overseen the operations of lenders receiving government loan guarantees. Without adequate resources to oversee its existing loan portfolio, SBA cannot ensure the quality of the new loans that it guarantees and protect the government against loan losses. SBA's impact on stimulating small business development also needs to be determined.

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**Minority Business  
Development  
Problems**

Our work and that of others has shown that SBA has been ineffective in developing minority firms into viable, independent businesses. As far back as 1975, we reported that SBA's success at helping minority firms become self-sufficient and competitive was minimal. In the 1980s, SBA's Office of Inspector General, the National Academy of Public Administration, the Senate Small Business Committee, and we found that SBA's management of the program fell far short of requirements and expressed grave concerns about the lack of progress in making the program a true business development program. Most recently, we reported in 1992 that SBA has made little progress in implementing the Congress' third major attempt to improve the program's

effectiveness. In addition, a 1992 Presidential Commission on Minority Business Development reported that the federal government—specifically SBA—has failed to develop the talents and creativity of minority businesses. Our work on this program over the years, as well as the work of others, raises serious concerns about SBA's overall commitment to the goals of the program. Until problems with the minority business development program are corrected, federal funds will continue to be spent ineffectively, and community development will be hindered.

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# Reexamining Strategies for Responding to Disasters

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Recent experience has called into question how well federal efforts assist communities suffering the effects of natural disasters. Since 1989, when the country experienced the back-to-back disasters of Hurricane Hugo in South Carolina and the Loma Prieta earthquake in California, dissatisfaction with the federal government's responsiveness to these kinds of devastating occurrences has grown. Hurricane Andrew reinforced these concerns and raised them to an even higher level on the Congress' agenda.

Basic questions are now being raised about whether the federal government is properly organized to respond to major disasters. In this context, the roles of the Department of Defense, Federal Emergency Management Agency, and federal and state governments in responding to disasters are being reexamined.

Our work clearly indicates that substantial policy, organizational, and operational changes are needed. We are continuing to study these issues and plan to identify and report on a series of options for dealing with them by spring 1993.

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## Related GAO Products

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### Low-Income Housing

Public Housing: Housing Persons With  
Mental Disabilities With the Elderly  
(GAO/RCED-92-81, Aug. 12, 1992).

Mortgage Credit Enhancements: Options for  
FHA in Meeting the Need for Affordable  
Multifamily Housing (GAO/T-RCED-92-52, Apr. 3,  
1992).

Homelessness: Transitional Housing Shows  
Initial Success but Long-term Effects  
Unknown (GAO/RCED-91-200, July 15, 1991).

Rental Housing: Implementing the New  
Federal Incentives to Deter Prepayments of  
HUD Mortgages (GAO/PEMD-91-2, Apr. 30, 1991).

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### Managing HUD

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

HUD Reforms: Limited Progress Made Since  
the HUD Scandals (GAO/T-RCED-91-62, June 12,  
1991).

Increasing the Department of Housing and  
Urban Development's Effectiveness Through  
Improved Management (GAO/RCED-84-9,  
Jan. 10, 1984).

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Increasing  
Exposure to  
Costs

Home Ownership: Loan Policy Changes  
Made to Strengthen FHA's Mortgage  
Insurance Program (GAO/RCED-91-61, Mar. 1,  
1991).

Impact of FHA Loan Policy Changes on  
Financial Losses and Homebuyers  
(GAO/T-RCED-90-95, July 10, 1990).

Impact of FHA Loan Policy Changes on Its  
Cash Position (GAO/T-RCED-90-70, June 6, 1990).

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Economic  
Support and  
Developing  
Communities

Industrial Development Bonds Are Generally  
Not Targeted and Benefits Unclear  
(GAO/RCED-92-247R, July 24, 1992).

Small Business: Problems in Restructuring  
SBA's Minority Business Development  
Program (GAO/RCED-92-68, Jan. 31, 1992).

Small Business: Financial Condition of SBA's  
Business Loan Portfolio Is Improving  
(GAO/RCED-92-49, Dec. 3, 1991).

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Disaster  
Assistance

Earthquake Recovery: Staffing and Other  
Improvements Made Following Loma Prieta  
Earthquake, (GAO/RCED-92-141, July 30, 1992).

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**Related GAO Products**

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**Disaster Assistance: Federal, State, and  
Local Responses to Natural Disasters Need  
Improvement** (GAO/RCED-91-43, Mar. 6, 1991).

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**General**

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**Housing and Urban Development Issues**  
(GAO/OCG-89-22TR).

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# Transition Series

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## Management

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## Program Areas

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National Security Issues (GAO/OCG-93-9TR).

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(GAO/OCG-93-10TR).

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(GAO/OCG-93-17TR).

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(GAO/OCG-93-20TR).

Veterans Affairs Issues (GAO/OCG-93-21TR).

Housing and Community Development  
Issues (GAO/OCG-93-22TR).

Justice Issues (GAO/OCG-93-23TR).

Internal Revenue Service Issues  
(GAO/OCG-93-24TR).

Foreign Economic Assistance Issues  
(GAO/OCG-93-25TR).

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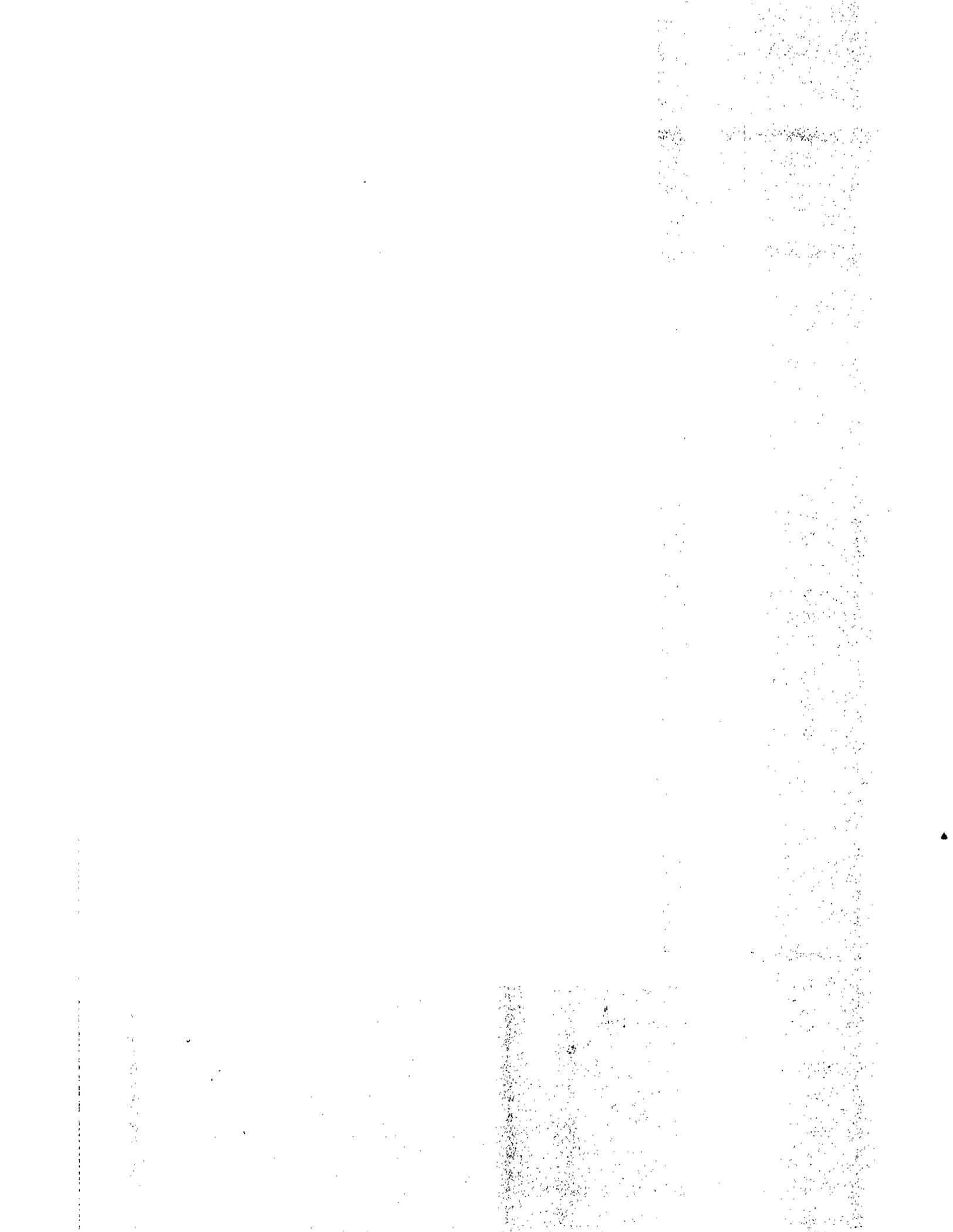
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