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Report to the Chairman, Subcommittee
on Housing and Consumer Interest,
Select Committee on Aging, House of
Representatives

HOUSING FOR THE ELDERLY

HUD Policy Decisions Delay Section 202 Construction Starts



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Resources, Community, and
Economic Development Division

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January 14, 1991

The Honorable Marilyn Lloyd
Chairman, Subcommittee on Housing
and Consumer Interest
Select Committee on Aging
House of Representatives

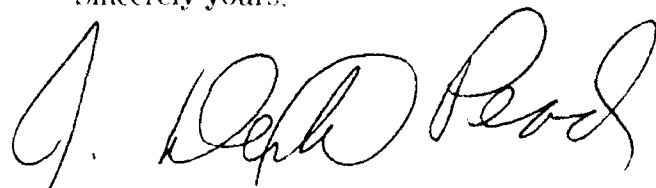
Dear Madam Chairman:

In response to your request, this report addresses the processing time for section 202 projects from fund reservation to construction start. Specifically, the report discusses the increase in processing time that can be caused by limitations placed on fair market rents, additional sponsor contributions because of insufficient fair market rents to cover development costs, inconsistent interpretation of cost containment requirements, and inconsistent administration of the program by the Department of Housing and Urban Development (HUD) field offices. The report addresses these causes and contains a number of recommendations to better ensure the timely completion of section 202 projects.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Secretary, Department of Housing and Urban Development; the Director, Office of Management and Budget; other congressional committees and subcommittees interested in housing matters; and other interested parties. We will make copies available to others upon request.

Our work was conducted under the general direction of John M. Ols, Jr., Director, Housing and Community Development Issues, who can be reached at (202) 275-5525. Other major contributors are listed in appendix VI.

Sincerely yours,


J. Dexter Peach
Assistant Comptroller General

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Executive Summary

Purpose

Nonprofit organizations receive direct loans for constructing or rehabilitating rental housing for the elderly and handicapped under Section 202 of the U.S. Housing Act of 1959 (12 U.S.C. 1701q). As of 1988, the Department of Housing and Urban Development (HUD) had 3-years' worth of projects where construction had not started.

Noting this backlog, the Chairman, Subcommittee on Housing and Consumer Interest, House Select Committee on Aging, asked GAO to examine HUD's project processing. The chairman was concerned that lengthy project processing might be increasing nonprofit organizations' (sponsors') costs and delaying the delivery of housing to the elderly and handicapped. As agreed, this report examines trends in project processing times between 1980 and 1988 and relates sponsors' views on the reasons for delays in processing.

Background

The section 202 program allows HUD to make 50-year direct loans to nonprofit sponsors to construct or rehabilitate rental housing designed specifically for the elderly and handicapped. Over the years, amendments to the 1959 legislation have targeted the section 202 program to lower income (defined by HUD as not exceeding 80 percent of an area's median income) elderly and handicapped and have provided them with rental assistance payments to make this housing affordable.

Project processing involves a series of HUD reviews of project plans which occur between the time HUD reserves funds for a project and the start of construction. HUD reviews are intended to ensure that proposed projects meet program requirements, are well-designed but meet cost containment standards, have sufficient and reasonable construction budgets, and have rents in line with new construction fair market rents. Fair market rents are established annually by HUD for individual housing areas on the basis of rents for comparable units.

Between 1980 and 1989, the Congress authorized \$6.9 billion for 133,851 units of section 202 housing. During this period, HUD returned to the Treasury about \$932 million, or 13 percent, of the total authorized loan authority.

Results in Brief

Over the past 9 years, the time required to process a section 202 project increased. As a result, many low-income elderly and handicapped people

have been delayed in receiving housing assistance. In 1988, only 10 percent of HUD's 51 field offices achieved the program's goal of starting project construction within 18 months after fund reservation.

Three factors stand out as the primary reasons for processing delays. First, HUD has indirectly restricted funds available to finance section 202 projects by establishing fair market rents that are too low in some cases and do not reflect the cost of construction. Second, HUD offices are inconsistent in their cost containment reviews and often change project plans in an effort to lower costs to limits supportable by fair market rents. Third, HUD's administration of the section 202 program varies among field offices because some field offices have developed effective processing procedures and practices, while others have not.

Principal Findings

Processing Time Has Increased

The time required for HUD's processing of section 202 projects has risen an average of 7.5 months from 19.3 months in 1980 to 26.8 months in 1988. As of November 1989, 1,092 projects were under HUD review and awaiting construction. About 45 percent of these projects had been in processing for at least 2 years.

Fair Market Rent Limits Increase Processing Time

Fair market rents determine the income available to cover the operating costs and loan payments for a section 202 project. When fair market rents are too low to cover project costs, HUD often requires sponsors to perform time-consuming and costly redesigns of their projects and file lengthy appeals for increases to the fair market rents.

Fair market rents for section 202 projects are low in certain areas of the country because of two HUD policy decisions aimed at controlling program costs. First, in 1982, HUD headquarters began capping fair market rent increases at predetermined national inflation rates rather than using local rental market surveys conducted by its field offices. If field office rent surveys are higher than HUD's predetermined inflation rate, fair market rents are set at the lower capped amounts. Over time, the impact of capping fair market rents has resulted in wide disparities in certain areas of the country between the lower HUD-allowed rents and the higher market survey rents. Second, in 1986, HUD began limiting

allowable mortgage loans to fair market rents in place at the time of fund reservation.

**Fair Market Rent Limits
Lead to Sponsor
Contribution**

Section 202 legislation allows nonprofit sponsors to finance 100 percent of allowable project development costs. However, even after sponsors redesign their projects to comply with HUD reviews and receive the maximum rents allowable under HUD regulations—120 percent of the area's fair market rent—it still may be insufficient to cover project development costs. In five of the six field offices GAO visited, nonprofit sponsors were required to make monetary contributions ranging from \$600 to \$350,000 to projects in order to begin construction.

**Application of Cost
Containment Increases
Processing Time**

HUD performs cost containment reviews to ensure that section 202 projects are of a modest design and are not excessive in terms of amenities or construction materials. The reviews apply to all projects regardless of fair market rent levels. HUD field offices normally perform these reviews and can approve rents up to 110 percent of the fair market rent. Increases above this percentage, but not exceeding the maximum of 120 percent, require HUD headquarters review and approval.

Cost containment reviews generally do not cause significant processing delays when fair market rents are adequate. They become a problem when HUD offices use cost containment as a means to reduce project costs so they are covered by the fair market rents. Repeated field office and headquarters reviews, coupled with the resulting project redesigns, add a significant amount of time to project processing.

On the basis of GAO's questionnaire to sponsors, GAO found examples of inconsistent interpretations of cost containment requirements. These inconsistent interpretations may be caused by a lack of training and of headquarters oversight. Since 1986, headquarters has provided field office staff two 1-day training sessions on cost containment compliance. Headquarters has also conducted cost containment reviews at only 5 of the 51 field offices that process section 202 projects.

**HUD Program
Administration Causes
Processing Delays**

Two field offices that GAO visited allowed processing delays to routinely occur and provided little guidance to project participants in meeting program requirements. These offices consistently had processing times in excess of HUD's maximum allowable 24-month processing criterion that was in effect at the time of our review. Conversely, GAO also visited two

offices that paid strict attention to timely processing and consistently achieved program processing goals. The offices with timely processing had several management techniques in common. Specifically, these offices required project development teams and HUD field office staff to periodically meet during project processing to discuss time goals, cost containment objectives, program requirements, and regulatory mortgage limits.

HUD headquarters did not monitor the processing performance of field offices. As a result, section 202 project processing receives differing degrees of management attention among field offices. Without adequate monitoring, HUD cannot identify processing techniques that are working well nor be aware of field offices experiencing processing delays that could benefit from these techniques.

Recommendations

To better ensure the timely completion of section 202 projects, the Secretary, HUD, should (1) establish fair market rents for section 202 projects that reflect the cost of modest housing in local rental markets to help reduce processing time and make it more likely that the section 202 program will provide 100 percent of sponsor financing for modestly designed projects and (2) ensure that supervisory visits and reviews are implemented to validate consistent application of cost containment requirements among field offices.

Agency Comments

HUD acknowledged that the factors cited in GAO's draft report had the effect of increasing section 202 project processing time. HUD said that it had developed, or was in the process of developing, actions to deal with these factors. These actions include increasing fair market rents while minimizing the potential budget effects, monitoring cost containment at field offices for consistent application, issuing instructions aimed at establishing project processing timetables and requiring regular communications with project development teams, and monitoring field office processing time and establishing a goal to start project construction within an average of 24 months. HUD's comments on GAO's draft report are included as appendix V of this report.

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Abbreviations

FMRs	fair market rents
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
MIDLIS	Multifamily Insured and Direct Loan Information System

Introduction

Several million households headed by elderly or handicapped persons with limited incomes need government assistance to obtain decent and affordable housing. The Department of Housing and Urban Development's (HUD) section 202 program is the primary means of federal assistance available to provide new housing units to help meet this need.

HUD's Section 202 Elderly Housing Program

Section 202 of the U.S. Housing Act of 1959, as amended (12 U.S.C. 1701q), authorizes HUD to make 50-year direct loans to nonprofit sponsors to construct or rehabilitate rental housing for the elderly or handicapped. Interest rates on the loans are based on the average interest rate on all interest bearing obligations of the United States not to exceed 9.25 percent. The section 202 direct loan is available to cover 100 percent of the cost of land plus the cost to design and construct or rehabilitate a project.

Section 202 projects are designed to provide elderly and/or handicapped residents with an independent living environment that includes provisions for necessary services, such as health, continuing education, welfare, recreation, and transportation. Projects can also include essential service facilities, such as dining facilities and multipurpose community rooms.

The Housing and Community Development Act of 1974 permits HUD to use the section 202 program in conjunction with the section 8 rental housing assistance program. The section 8 program, established by the 1974 act, authorized HUD to make rental assistance payments on behalf of lower income families (households) to enable them to obtain decent and affordable housing. Lower income families are defined as those with incomes not exceeding 80 percent of the median income (adjusted for household size) for their particular area of residence. However, section 8 assistance is now generally targeted to low-income families with incomes that do not exceed 50 percent of the median for the area.

Families eligible for section 8 rental assistance generally are required to pay 30 percent of their adjusted monthly income for rent. The assistance payment covers the difference between the amount the tenant pays and the fair market rent for the unit. Section 202 project rents are limited to the amount necessary to operate and maintain the project and to cover

the amortization of the debt incurred to develop and construct the project.¹ Additionally, project rents cannot exceed 120 percent of the fair market rents (FMRs) established annually by HUD for each housing area on the basis of rents for comparable units. HUD field offices are allowed to approve rents up to 110 percent of the FMRs while the 120-percent ceiling requires headquarters approval.

FMRs serve as a control on the amount of mortgage financing that sponsors can obtain for project construction costs. In authorizing HUD to approve project rents up to 120 percent of FMRs, the Congress anticipated that this authority would be used only in exceptional cases, according to the House and Senate conference committee report on the 1974 act.

The FMRs for new construction include provisions for all utilities except telephone service; ranges and refrigerators; and all maintenance, management, and other services required to obtain privately developed, newly constructed rental housing of a modest (nonluxury) nature. Separate FMRs have been established for units with different numbers of bedrooms, for various building types (e.g., elevator, walkup), and for different housing market areas. FMRs for section 202 projects include an additional 5 percent to cover the special housing needs of the elderly and/or handicapped, such as emergency call systems and grab bars.

The Housing and Community Development Act of 1987 modified the section 202 program by setting new requirements for non-elderly handicapped people. HUD implemented this legislation in May 1989 when it issued a final rule establishing a separate section 202 Direct Loan Program for Housing for Handicapped People. Two major differences between the new non-elderly handicapped program and the elderly program are:

- projects for handicapped persons will no longer compete with applications for the elderly and
- rents for handicapped projects will no longer be based on FMRs but rather will be determined by the reasonable and necessary cost of operating the projects including the debt service on the loan.

The new non-elderly handicapped provisions took effect for the fiscal year 1989 budget period. Because HUD and program sponsors had no

¹FMRs for section 202 are determined under 24 CFR 885.5. These FMRs are established independently from FMRs used under section 8 certificate and voucher programs.

experience with the new non-elderly handicapped program, this report deals with the section 202 elderly or handicapped program as it existed prior to HUD's implementation of the new non-elderly handicapped program.

How the Section 202 Program Works

Before construction of a section 202 housing project can begin, HUD requires sponsors to go through a series of processing stages. These stages include requirements designed to ensure that the proposed project (1) is eligible for a section 202 loan and rent subsidy assistance under section 8, (2) serves programmatic goals, (3) is well-designed but modest, (4) has a sufficient and reasonable construction budget, and (5) has rents that are in line with section 8 rent limits and that are adequate to support project management, maintenance, and debt service. Because of the complexity of the process, most nonprofit sponsors employ consultants to prepare the proposal and oversee development of the project.

The section 202 process begins with an annual appropriation. Using this amount as a base, HUD allocates funding to its 51 field offices that process section 202 loans. This allocation comes in the form of an announcement in the Federal Register called a Notification of Fund Availability. Each field office then publishes a notice in its service area announcing its intent to accept applications for project development from interested nonprofit sponsors. Each field office accepts applications and conducts a rating and ranking for selection.

Applications describe the prospective sponsor, the proposed site, the project layout and design, and the services to be provided to tenants. All accepted applications and their relative rankings are submitted to the appropriate HUD region which evaluates the applications from all field offices in its region and submits a recommendation to the Director, Office of Multifamily Housing Development. Finally, usually on the last working day of the fiscal year, the Assistant Secretary for Housing announces all projects selected for fund reservation. At this point the cognizant field offices notify successful applicants that funds have been reserved for their projects and the processing clock starts.

Under HUD regulations, the nonprofit sponsor must begin construction on a project for which funds were reserved within 18 months. The regulations also authorize the Assistant Secretary for Housing to grant one

extension not to exceed 6 months. Therefore, according to HUD's regulations, the maximum amount of time between fund reservation and construction start can be no more than 24 months.² The regulations state that the field office manager shall cancel any reservations that exceed 18 months unless a 6-month extension is granted. The time period between fund reservation and construction start is known as the project processing "pipeline." Project processing involves two key stages: (1) conditional commitment and (2) firm commitment.

Conditional commitment and firm commitment processing are similar in most respects. A sponsor submits preliminary project plans and specifications to obtain HUD's general approval during the conditional commitment stage and then submits final project plans and specifications to obtain a firm commitment. Thus, conditional commitment and firm commitment can be viewed as two reviews—one general, one specific—of a common set of requirements.

At the field offices, projects undergo five kinds of technical analyses in both stages of processing:

1. Architecture and engineering analysis ensures that projects comply with HUD minimum property standards and design requirements for elderly and handicapped units.
2. Cost analysis establishes estimates of the cost of projects including estimates of costs not attributable to dwelling use.
3. Valuation analysis prepares land appraisals, operating expense estimates, estimated income determinations, the section 202 loan amount allowable based on projects' total development costs, and mortgage amounts serviceable with project's income.
4. Mortgage credit analysis determines the financial capacity of the sponsor and/or the borrower corporation to close the transaction and operate the project after developing estimates of the capital needed to defray cash requirements above the loan amount and immediate operation expenses.

²Our results are based on the 24-month criterion in effect at the time of our review. In April 1990, HUD amended its regulations to allow a maximum of 36 months if the delay was not the borrower's fault.

5. Housing management analysis reviews the management capability of the borrower or the management agent, the adequacy of the operating expenses, and the management plan.

In the final stage of processing—initial loan closing—the borrower escrows the cash requirements established by HUD. HUD then establishes an account from which the sponsor may draw funds needed to begin and complete construction of the project. The initial loan closing is usually completed within several weeks of the completed firm commitment. With the start of construction, the processing time clock stops.²

Objectives, Scope, and Methodology

The Chairman of the Subcommittee on Housing and Consumer Interests, House Select Committee on Aging, asked us to

- determine the average processing time from fund reservation to construction start for section 202 projects that started construction between 1980 and 1988,
- examine whether average processing time has increased or decreased between 1980 and 1988 and whether there were any significant differences in processing times among field offices or because of project type, and
- identify reasons for increases or decreases in processing times.

To accomplish these objectives, we analyzed section 202 program regulations and data obtained from several sources including HUD's New York, Philadelphia, Fort Worth, and Seattle regional offices and the following field offices associated with these regions: Newark, Philadelphia, Pittsburgh, Little Rock, New Orleans, and Portland.

To determine the average processing time from fund reservation to construction start, we analyzed data recorded in HUD's Multifamily Insured and Direct Loan Information System (MIDLIS). Using MIDLIS, we evaluated the processing time—the time between fund reservation and construction start—for all section 202 projects that started construction between 1980 and the end of 1988 regardless of the date of fund reservation. This information was developed on a national, HUD region, and HUD field office basis for all projects and according to occupant type—elderly or handicapped.

²The Cranston-Gonzalez National Affordable Housing Act (P.L. 101-625), dated November 28, 1990, authorizes the Secretary of HUD to take certain actions to expedite the financing and construction of section 202 projects. Because HUD has not yet implemented this authority, its effect on processing section 202 projects is not discussed in this report.

To examine whether average processing time has increased or decreased between 1980 and 1988, we computed this time for every project that began construction during this time period. We compiled this information for each year for comparative purposes. Our analysis identified HUD regions and field offices with below average, average, and above average processing times.

To a limited degree, we verified processing date information in the MIDJIS system at the six field offices we visited. In general, we found this information to be acceptable for our analysis of the time between fund reservation and construction start. However, during our analysis of the MIDJIS information we found that 245 projects, or about 9 percent of the projects which started construction between 1980 and 1988, could not be included in our analysis because they did not have a fund reservation date. This number of projects could significantly affect the average processing time information for 1980 and 1981 since 137 of these 245 projects—56 percent—started construction in these 2 years.

To determine reasons for changes in processing times and variations among field offices, we performed case file reviews in each of the six HUD field offices we visited. The six field offices were selected for geographical dispersion and variations in average processing times. Through the case file reviews at these offices and discussions with HUD staff and sponsors and consultants associated with these and other projects, we identified 18 factors contributing to increased processing time.

We developed a questionnaire using these 18 factors to solicit the views of national sponsors and national and local consultants to determine which factors had the greatest impact on processing time. Appendix I provides a description of the methodologies used to develop our questionnaire and sample respondents. Because our selections of sponsors and consultants were judgmental, we cannot apply the results of our questionnaire to the section 202 program in total. However, in making these judgmental selections we considered sponsors' and consultants' processing experience and geographical locations. The projects of the selected sponsors and consultants represented about one-third of the 3,268 projects funded between 1980 and 1988.

We performed our work at HUD headquarters, regional, and field offices from January through December 1989. We contacted sponsors and consultants between July and September 1989. Our review was performed in accordance with generally accepted government auditing standards.

In addition to asking us to examine project processing time and reasons for changes, the requester's office, in February 1990, asked us to obtain information on the use of section 202 loan funding. HUD's budget division, Office of Financial Management, provided us with information on funds available for section 202 loans, fund reservations, and unused and recaptured loan funding for fiscal years 1980-89. We did not verify the figures provided. This information is contained in appendix II.

Section 202 Project Processing Time Has Increased

There is a backlog of 1,092 section 202 projects and 35,103 units for which HUD has approved funding but for which construction has not yet started.¹ The backlog of projects is commonly referred to as the processing pipeline. About 45 percent of the units in the pipeline have been in HUD processing for at least 2 years.

According to our analysis, processing time increased by an average of 7.5 months from 1980 through 1988. Furthermore, in 1980 33 percent of the section 202 projects took longer than 24 months to process, and in 1988, 58 percent took longer than 24 months. HUD had not enforced its regulatory requirement that projects will be terminated and fund reservations will be cancelled unless construction starts within 24 months of fund reservation. Our analysis shows significant variations in processing time among HUD regions and field offices. Also, on average, handicapped projects take longer to process than elderly projects with a difference of about 2 months in 1988.

The Section 202 Pipeline

Our analysis of HUD's MIDLIS information, as of November 9, 1989, shows that 1,092 projects representing 35,103 units were in the processing pipeline. Table 2.1 shows the status of these projects and units by months in process.

Table 2.1: Section 202 Project Processing Pipeline

Year of funding approval	Months in process	Projects in pipeline	Units in pipeline
1983	72	3	134
1984	60	16	680
1985	48	53	1,914
1986	36	128	5,274
1987	24	209	7,712
1988	12	387	10,951
1989	0	296	8,438
Total		1,092	35,103

Source: HUD MIDLIS data as of November 9, 1989

As shown in table 2.1, 72 projects reserved in 1983, 1984, and 1985, representing 2,728 units, have been in the HUD processing pipeline for at least 48 months, or twice the maximum allowed by HUD regulations. In total, 409 projects representing 15,714 units have been in the pipeline

¹The 1,092 projects represent about 31 percent of all section 202 projects funded between 1980 and 1989.

for at least 24 months. Adherence to HUD's regulations in effect when these projects entered the pipeline would have require that all 409 projects in the pipeline beyond 24 months be terminated. Even with HUD's revised 36 month criteria, at least 200 projects should be considered for termination. Our concern with this new criterion is discussed in chapter 3.

According to HUD's director of assisted elderly and handicapped housing division, HUD is reluctant to terminate projects for being in process for excessive periods of time because funds for the projects cannot be reused and, therefore, the projects would be lost for elderly and handicapped housing. Project terminations that do occur are usually the result of sponsors deciding to stop project processing. Appendix III shows the number of pipeline projects as of November 9, 1989, by HUD region and processing field office and the length of time these projects have been in the pipeline.

Average Processing Time for Section 202 Projects Has Increased

The average processing time for projects starting construction has been increasing. Projects starting construction in 1980 averaged 19.3 months in the pipeline while projects starting in 1988 averaged 26.8 months—an increase of 7.5 months. As shown in table 2.2, of the 246 projects starting construction in 1980, 33 percent were in the pipeline longer than 24 months. However, of the 295 projects starting construction in 1988, 58 percent exceeded 24 months in processing time.

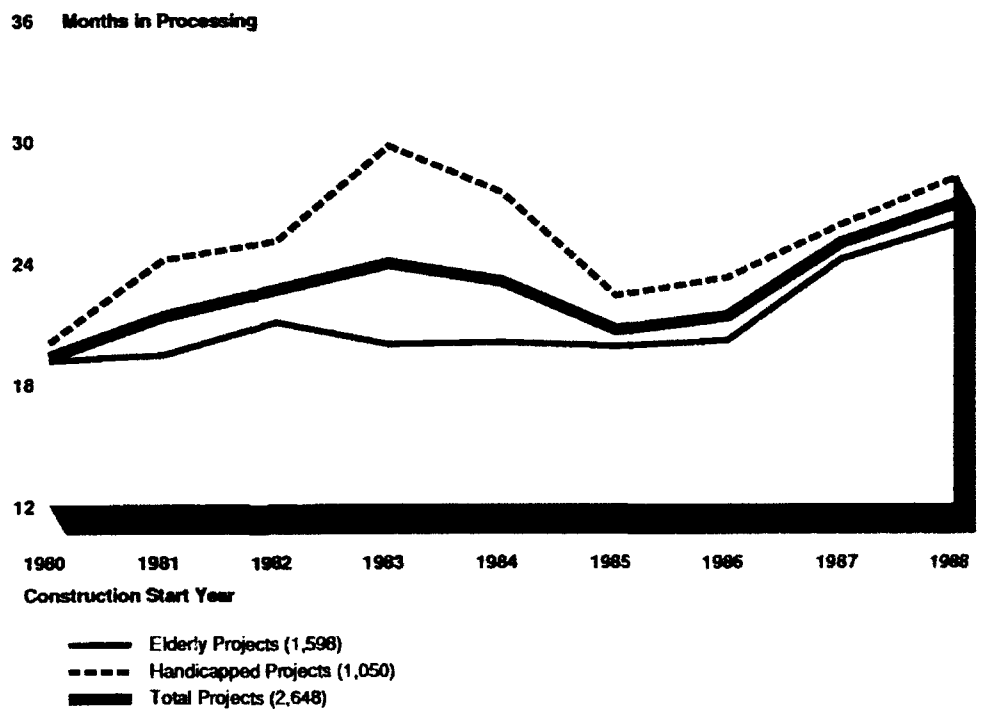
Table 2.2: Projects Starting Construction That Exceeded 24 Months in Processing

Year of funding approval	Projects starting construction	Projects exceeding 24 months	Percent exceeding 24 months
1980	246	82	33
1981	318	140	44
1982	353	165	47
1983	321	141	44
1984	280	98	35
1985	312	96	31
1986	256	89	35
1987	267	141	53
1988	295	170	58
Total	2,648	1,122	42

Source: HUD MIDLIS data as of November 9, 1989.

We also examined processing time by occupant type—elderly and handicapped. Processing time differences between these two categories varied from year to year with a difference of only 2.3 months in 1988. In 1980, 181 elderly projects started construction in an average of 19.1 months, while the 65 handicapped projects averaged 20 months in the pipeline. In 1988, 159 elderly projects started construction in an average of 25.8 months while the 136 handicapped projects started construction in an average of 28.1 months. Figure 2.1 shows the trend in processing time for all projects starting construction from 1980 through 1988 and also the trends for elderly and handicapped projects separately.

Figure 2.1: Average Processing Time for Section 202 Projects

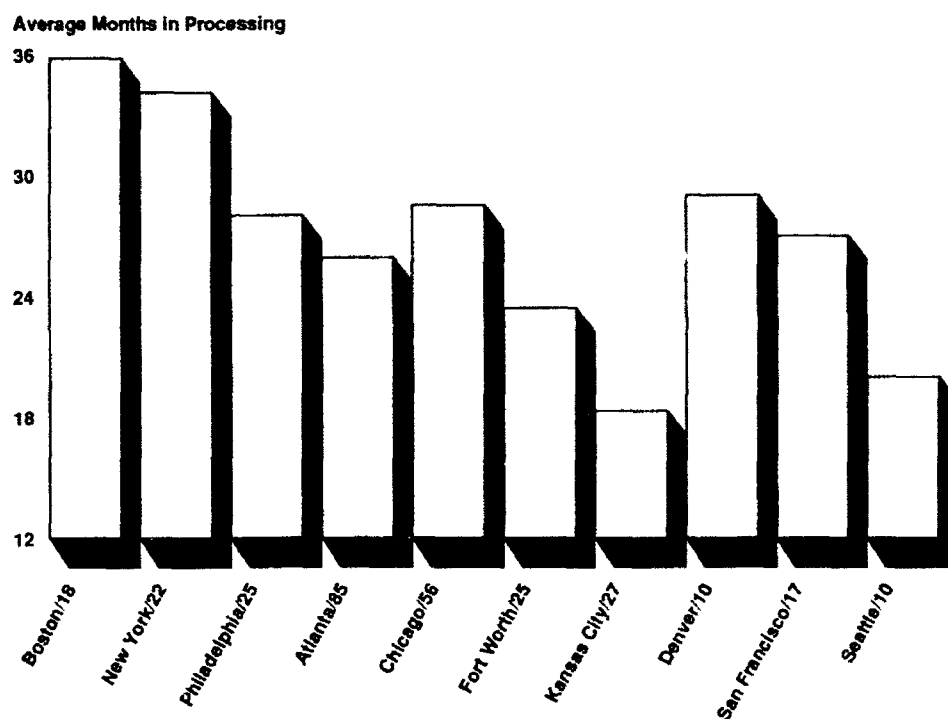


Source: HUD MIDLIS data as of November 9, 1989.

Processing Time Varies Among HUD Regions and Field Offices

Processing time for section 202 projects differs significantly among the HUD field offices. As figure 2.2 shows, the combined field office average processing time in only 3 of the 10 HUD regions was less than 24 months for projects starting construction in 1988. The average processing time ranged from 18.3 months for field offices in the Kansas City region to 35.8 months for the field offices in the Boston region.

Figure 2.2: Section 202 Project
Processing Time in 1988 by HUD Region



HUD Regional Offices/Number of Projects in 1988

Source: HUD MIDLIS data as of November 9, 1989

Even wider disparities in average processing time exist among HUD field offices. For example, for projects starting construction in 1988, the Providence field office took 50.8 months to process one project while the Fort Worth field office took 15.1 months to process one project. These were the only projects starting construction in these field offices in 1988. Table 2.3 shows the success in processing within the 24-month criterion for the 49 HUD field offices which processed section 202 projects in 1988.

Chapter 2
Section 202 Project Processing Time
Has Increased

Table 2.3: HUD Field Offices' Success in Meeting Project Processing Criteria in 1988

Category	Number of field offices ^a	Percentage of field offices
Construction starts averaging over 24 months	26	53
Construction starts averaging 18.1 - 24 months	18	37
Construction starts averaging 18 months or less	5	10
Total	49	100

^aTwo field offices had no construction starts in 1988

As table 2.3 shows, only five field offices—10 percent—met HUD's regulatory goal of starting construction within 18 months. Further, 26 field offices—53 percent—exceeded HUD's maximum regulatory time limit of 24 months between fund reservation and start of construction. Appendix IV shows the 1988 average processing times for projects starting construction and the number requiring processing times of 18 months or less, 18.1 to 24 months, and more than 24 months for each HUD region and field office. Reasons for these differences are discussed in chapter 3.

Reasons Why Section 202 Processing Time Has Increased

As noted in chapter 2, the time between reserving funds and starting construction for new section 202 projects is increasing. Our reviews of project files and discussions with sponsors and consultants of section 202 projects revealed that while various factors taken together can delay construction starts, the following three factors were the most frequently cited reasons for project delays:

- Fair market rents. In efforts to control program costs, HUD has suppressed FMRs to levels that in many cases can not support section 202 project development leading to project redesigns and appeals for increased FMRs. While HUD's efforts have reduced section 202 costs, the reductions have come at the expense of nonprofit sponsors who have needed to delay construction while raising funds to cover costs not provided by the FMRs. Sponsor contributions are necessary despite the legislative authority for the program to provide loan funds to cover 100 percent of a project's development costs.
- Cost containment. Faced with inadequate FMRs for section 202 projects, HUD offices repeatedly attempt to reduce costs by requiring sponsors to make project changes and redesigns. Sponsors also expressed concern about inconsistent cost containment reviews among HUD offices.
- HUD administration. The degree of management attention given the section 202 program varies among HUD field offices. While three of the six HUD offices we visited establish agreements on processing time goals through meetings between their technical staffs and the sponsors' design teams, the other three offices appear to provide sponsors little guidance.

While sponsors and consultants cited FMRs, cost containment, and HUD administration as factors greatly increasing processing time on their projects, they also identified several other factors as being somewhat important in increasing processing time. Appendix I discusses these other factors.

Fair Market Rents

Of the 30 sponsors and consultants with projects exceeding 24 months in processing, 22 responded to our questionnaire that processing time is greatly increased because of fair market rents. More specifically, several sponsors and consultants stated that HUD is setting section 202 FMRs too low in many areas of the country. Furthermore, they indicated that, as a result, allowable rents do not cover all of a project's development and operating costs. Insufficient funds cause processing delays because sponsors must either find ways to cut costs through time-consuming

project redesign, filing lengthy appeals to HUD for higher FMRs, or raising money to cover funding shortfalls.

The 22 sponsors and consultants attributed inadequate section 202 FMRs to one or two HUD policy decisions. In 1982 and 1986, respectively, HUD decided to control costs in the section 202 program by (1) capping annual FMR determinations to a predetermined inflation rate adjustment instead of using actual HUD field office surveys of local market rent levels and (2) limiting FMRs to the rents in effect at the time of fund reservation.

Our reviews of project files in five of the six field offices we visited disclosed that cases existed where projects

- were designed according to HUD's cost containment specifications,
- received the maximum allowable FMRs, and
- still required sponsor contributions to bring the mortgage down to a level supportable by the FMRs.

Requiring sponsors to make large monetary contributions in order to make project construction feasible conflicts with the legislative authority to provide direct loans to qualified nonprofit sponsors at 100 percent of allowable project development costs.

HUD recognizes that inadequate section 202 FMRs delay construction starts. On December 20, 1989, the Secretary of HUD reported to the Chairman, Subcommittee on Housing and Urban Affairs, Senate Committee on Banking, Housing and Urban Affairs, on actions HUD is taking to expedite section 202 processing. The Secretary said that since August 1989 HUD has allowed projects that have been in the pipeline for over 2 years to use 1987 FMRs in place of FMRs in effect at the time of fund reservation. The Secretary stated that the use of 1987 FMRs and a reduced interest rate has improved processing, in that 1,000 units started construction in October 1989 an increase of 45 percent over the number of starts a year earlier.

FMRs Determine Most Project Loan Amounts

Under HUD regulations, a project's section 202 loan is based on the lowest of two amounts: (1) A section 202 per-unit-cost limit which may be adjusted for the market area where the project is to be built. This estimate is made by the cognizant HUD field office at the time of fund reservation. (2) An estimate of a project's land and construction costs. This estimate, or cost valuation, is made by HUD field office staff based

on project plans and specifications submitted by the sponsor at conditional and firm commitment. Notwithstanding these regulations, HUD's processing manual for section 202 projects also stipulates that the loan cannot exceed the amount supportable by the FMRs after considering project operating expenses.

Because of different data sources used in calculating the three estimates, there can be wide variations in allowable loan amounts under the three methods. For example, a national consultant stated that in one case HUD's fund reservation amount for a 100-unit project in Texas was about \$2.8 million; the field office's valuation of the project at firm commitment was \$2.1 million; however, the maximum mortgage amount supportable by the FMRs was \$1.7 million. The maximum section 202 loans allowable for projects we reviewed were usually based on FMR determinations.

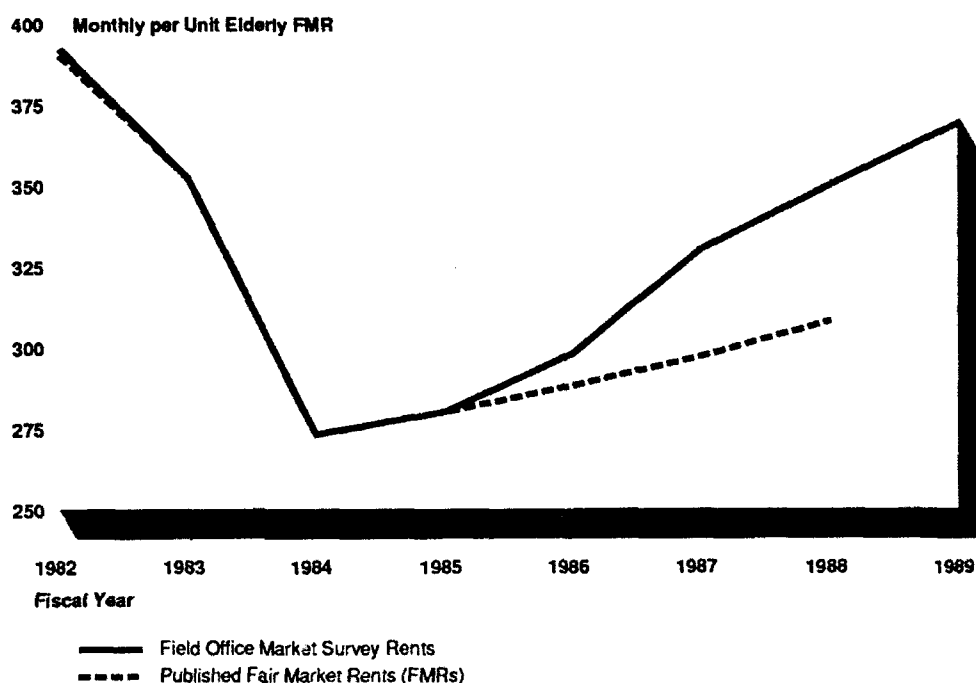
A section 202 project in the Portland, Oregon, area illustrates the effect inadequate FMRs had on project processing.

Inadequate FMRs Are Delaying a Portland Field Office Project

For a number of years in the early 1980s, market rents in the areas served by the Portland field office were declining due to a depressed local economy. According to the Portland field office's director of housing development, rent surveys prepared by the field office reflected this local market recession, and fair market rents for section 202 projects declined. However, in the mid-1980s, the Portland area economy experienced an upturn and rent levels increased substantially. During the period 1986 through 1988, HUD capped fair market rents to an inflation factor averaging about 3 percent while actual rents were increasing at about 8 percent. Consequently, market rents soon exceeded HUD's allowable fair market rents.

According to field office staff, the disparity between actual and allowable rent levels in the Portland area has effectively precluded sponsors from building section 202 projects in many areas of the Portland market. Figure 3.1 shows a comparison of new construction rents as determined by Portland field office rent surveys compared to HUD published new construction FMRs for 1-bedroom units in a 2- to 4- story building with an elevator in the Coos Bay, Oregon, market area.

Figure 3.1: Comparison of Field Office Rent Surveys and Published Fair Market Rents for the Coos Bay, Oregon, Market Area



1-Based on Elderly FMRs for 1-Bedroom Units in a 2- to 4- story building with an elevator.

2-FMRs for Fiscal Year 1988 were not published until December 1, 1989, but were effective retroactively to September 15, 1988.

3-FMRs for fiscal year 1989 have not been published.

Note: Data based on elderly FMRs for 1-bedroom units in a 2- to 4-story building with an elevator. FMRs for fiscal year 1988 were not published until December 1, 1989 but were effective retroactively to September 15, 1988. FMRs for fiscal year 1989 have not been published.

As illustrated in figure 3.1, new construction survey rents and published rents were nearly identical from 1982 through 1985 when rents were decreasing. The rents corresponded because HUD uses survey rents to adjust FMRs downward. However, beginning in 1986, survey rents increased at a more rapid pace than inflation adjusted rents approved by HUD. By fiscal year 1988, survey rents were \$350 per month while published rents were \$308 per month, a differential of 14 percent.

A project located in the Coos Bay market area illustrates the dual effect of HUD capping FMRs and also limiting FMRs to those in effect at the time of fund reservation. The sponsor of this project was notified in September 1986 that HUD reserved \$1,097,800 based on the section 202 per-unit-cost limit adjusted for the Portland market area.

In July 1987, about 9 months after fund reservation, the Portland field office issued a conditional commitment for the project. At this time, the field office valued the project at \$750,487. It also authorized FMRs to be raised to 110 percent, or \$316 per month. With these FMRs, the project could support a development cost of \$617,700, or \$132,787 less than the valuation estimate.

The sponsor began developing drawings and specifications of the project for HUD's firm commitment review prior to obtaining construction bids. In December 1987, the sponsor provided detailed drawings and specifications to the Portland field office architectural, engineering, and cost branch for a firm commitment review. The Portland staff responded in 15 days with 11 cost containment suggestions such as reducing the number of parking places, minimizing landscaping, and asking local authorities to waive permit charges. The sponsor agreed to these changes and in January 1988 resubmitted the revised project plans. In March 1988, the Portland field office sent the sponsor the results of its firm commitment processing. The field office found the project to be cost contained and, based on the detailed project specifications, estimated the project's valuation cost at \$837,615.

On April 26, 1988, the field office requested HUD headquarters approval to use 120 percent of FMRs for this project. The Assistant Secretary agreed that the project met the objectives of cost containment and approved the project for a 120-percent FMR exception rent, based on the FMRs at the time of fund reservation. At the 120-percent of FMR level, or \$345 per month for 1-bedroom units, HUD headquarters found that the project's maximum allowable mortgage could not exceed \$723,400. Thus, although the project met HUD's cost containment objectives, the mortgage supportable by the 1986 FMRs was still \$114,215 below the valuation cost estimate. Following the Assistant Secretary's approval of 120 percent of FMRs, Portland issued the firm commitment in June 1988—20 months after fund reservation.

Upon receiving the firm commitment, the sponsor obtained construction bids. Construction bids were higher than the valuation estimated by the field office in March 1988. Based on the construction bids, the field office valued the project's estimated cost at \$862,120. Since the maximum direct loan supportable by the FMRs was only \$723,400, the project had a cash shortfall of \$138,720.

On December 1, 1989, HUD published 1988 fair market rents, which for Coos Bay were \$308 for 1-bedroom units. HUD permitted the Coos Bay

project to use the 1988 FMRs escalated to the 120-percent exception level, or \$369 per month. In addition, the project was able to take advantage of a lower interest rate, which declined from 9.25 percent in 1988 to 8.375 percent on September 19, 1989. Even with the 1988 FMRs and a lower interest rate, the Coos Bay project still could only support a mortgage of \$828,500. This is still \$33,620 below the estimated project development costs. A rent of \$374 per month would be needed to cover this difference and meet 100 percent of the project's development costs.

We note that if HUD had accepted the field office survey rents for fiscal year 1988, FMRs would have been \$350 per month. With this rent, the field office could have approved a 7-percent increase to the FMRs without central office approval and the project could have been 100 percent financed. Nevertheless, as of April 16, 1990, the nonprofit sponsor was unable to provide \$33,620 to cover the estimated shortfall and the project remained stalled in HUD's processing pipeline.

If FMRs were set so that this project did not require a sponsor contribution, HUD's costs would increase in two ways. First, the section 202 loan would increase by \$33,620. However, since the project has unused loan reservation funds of \$269,300—the difference between the fund reservation amount and the maximum allowable mortgage—the increase in section 202 loan authority would be covered. In addition, section 8 subsidy costs would increase by \$3,161 per year, or \$63,220 over a 20-year period.

From 1980-89, HUD did not use or recapture \$932 million (13 percent) of the \$6.9 billion section 202 loan authority established through appropriations. The \$932 million includes \$490.8 million in funds that were not used because project loan funds were less than project reservation amounts. However, because HUD's accounting systems do not track the amount of sponsor contributions, it is not possible without a project-by-project review to determine the overall effect that increasing FMRs would have on total program costs. Appendix II presents section 202 funding and project processing information for 1980 through 1989.

Additional Examples of Inadequate FMRs

In four other HUD offices we found examples of sponsors receiving the maximum allowable FMRs—the projects met cost containment objectives—but still needing to make contributions for allowable project development costs. The required sponsor contributions ranged in amount from \$600 to \$350,000.

According to HUD staff in each of these field offices, local rent surveys showed actual rents to be higher than the FMRs ultimately approved by HUD. The staff stated that had project rents been based on these surveys, sponsor contributions would have been eliminated or greatly reduced. Little Rock, Arkansas, was the only location that we visited in which FMRs were not identified as a problem by HUD field office staff and section 202 consultants. In Little Rock, the survey rents and the published FMRs were the same from 1986 to 1988. In 1988, the Little Rock office processed section 202 projects in an average of 16.3 months, whereas the nationwide average was 26.8 months.

Cost Containment Reviews

Of the 30 sponsors and consultants with projects exceeding 24 months in processing, 23 cited cost containment reviews as greatly increasing processing time in response to our questionnaire. Eighteen of the 23 agreed that cost containment was a necessary HUD function to assure modest project designs. However, they stated that the policy is subject to interpretation and often driven by the levels of the section 202 FMRs rather than by design and construction considerations.

HUD's cost containment policy is intended to prevent projects from being excessive in terms of amenities and cost of materials, thereby ensuring a proposed project is of modest design. The policy states that cost containment applies to all projects regardless of FMR level. Items specifically prohibited from section 202 projects include swimming pools, saunas, balconies, atriums, dishwashers, and individual trash compactors. HUD also reviews whether the project design is cost-efficient in terms of site use, structure type, and common spaces and amenities.

Eighteen of the 23 sponsors and consultants stating that cost containment greatly increased processing time expressed frustration with the implementation of cost containment because they perceive the reviews being applied differently depending on the adequacy of the section 202 FMRs to support total development costs. When FMRs are adequate to support development costs, cost containment is usually not a problem according to these sponsors and consultants. However, they stated that cost containment becomes a problem when FMRs are too low to support project development costs.

According to these sponsors and consultants, HUD applies repetitive and inconsistent cost containment reviews in an attempt to reduce these costs when FMRs are too low. They added that each review finds another problem with the design or construction material—sometimes requiring

changes to be made to items already changed in response to a previous review. When HUD disallows design or construction materials, the sponsor must either redesign the project or contribute funds to cover the nonallowable costs. HUD regional office administrators in Fort Worth and Philadelphia agreed with sponsors' comments that HUD will search for ways to cut project costs to the level that allowable rents will support.

HUD oversees the way its field offices implement cost containment but only to a limited degree. Since 1986, cost containment training has consisted of two 1-day training sessions given in 1988 and 1990 to field office staff. According to HUD's technical support division director, on-site compliance reviews are the superior method of assuring consistent field office treatment of cost containment. She said, however, that limited resources do not allow for more than 10 on-site visits each year. However, only six on-site cost containment compliance reviews have been made in the past 3 years to the 51 processing field offices, according to the architectural and engineering branch chief in the technical support division.¹

HUD's December 20, 1989, report on expediting section 202 processing cited cost containment as a factor contributing to processing delays. The Secretary reported that HUD is continuing to study this issue.

The following example illustrates the processing delays that additional cost containment reviews have caused a nonprofit sponsor in starting construction of a section 202 project in the Philadelphia, Pennsylvania, field office.

Example of a Project Affected by Additional Cost Containment Reviews

Cost containment reviews have been a problem for a 59-unit project being processed by the Philadelphia field office. At fund reservation in September 1986, HUD reserved \$3,419,500 for this project. However, as of February 1990, firm commitment still had not been issued, mainly because of differences in cost containment interpretations between the field office and headquarters.

During its June 1987 cost containment review at conditional commitment, the Philadelphia HUD field office recommended several design changes. At conditional commitment, the field office also approved a 110-percent exception to the Philadelphia area's published section 202

¹While six on-site cost containment reviews have been conducted since 1986, only five field offices were involved. The Greensboro, North Carolina, field office was reviewed twice.

FMRs. The published rent for a 1-bedroom unit was \$705 per month, and the rent at a 110-percent exception level was \$775 per month. The exception level rent would support a mortgage amount of \$3,374,500 while the field office valued the project at \$3,375,900. In July 1987, the consultant informed the field office that the project would be redesigned to make the field office cost containment changes. The sponsor made the changes, and the field office issued conditional commitment in February 1988.

The consultant submitted the project's firm commitment application including the project's detailed plans and specifications in August 1988. The field office also performed another cost containment review and, in October 1988, informed the consultant of six additional cost containment measures, including eliminating several ornate design features, such as bricked archways, and eliminating a dishwasher, trash compactor, and microwave oven in the community room. In November 1988, the sponsor accepted three of the additional changes, but agreed to provide \$33,408 at initial closing to retain the other design features. Finally, in April 1989, the field office valued the project at \$3,940,800.

In May 1989, the field office accepted the project as cost contained. However, because rents were limited to \$775 per month, HUD's maximum allowable mortgage of \$3,374,500 would not support project costs. Since project costs exceeded 110 percent of FMRs, the sponsor asked HUD headquarters for a 120-percent FMR exception rent. At the 120-percent level, FMRs would increase to \$846 per month and would support a mortgage of \$3,814,300. This amount is less than the project valuation and would require an additional sponsor contribution of \$93,100. Since this amount was greater than the original fund reservation, the sponsor was required to seek an amendment to the original reservation amount from HUD headquarters. As part of the approval process, HUD headquarters conducted a cost containment review.

In July 1989, the field office sent the sponsor the results of the headquarters cost containment review. On the basis of its interpretation of cost containment requirements, headquarters listed 10 items that needed to be eliminated or redesigned to meet cost containment objectives. According to the headquarters review, the most effective way to address most of these items would be a complete redesign of the project from a 6-story to a 5-story structure. The field office told the sponsor he had two choices. He could either (1) redesign the project as suggested or (2) pay for the nonallowable costs, estimated at \$147,000.

In July 1989, the consultant appealed the headquarters decision. The consultant's appeal pointed out that after several design changes the field office determined the project was cost contained and that making the redesign envisioned by headquarters would add nearly one year of processing time and increase project costs by \$478,000. In December 1989, HUD headquarters informally notified the field office that the headquarters June 1989 cost containment review was HUD's official position. As of March 1990, the project was stalled in the processing pipeline because the sponsor did not have the money to redesign the project or pay for the unallowed costs.

Other Problems With Cost Containment Reviews

Sponsors and consultants of projects in several geographic locations provided examples of differing interpretations among offices on cost containment requirements. For example, on one project, which received firm commitment in November 1989, the Greensboro, North Carolina, field office determined that the project design was not in compliance with cost containment objectives. The office required the consultant to redesign the project from an 8-unit row structure to an 8-unit block structure with 4 units back to back. According to the consultant the Greensboro office had previously certified the same 8-unit row structure three times previously, when FMRs covered project costs. However, in the most recent project, FMRs did not cover estimated project costs. Meanwhile, on another project, which received firm commitment in March 1990, the Columbia, South Carolina, field office approved the consultant's same 8-unit row structure design as meeting cost containment objectives. South Carolina's elderly FMRs were adequate to cover estimated project costs according to the consultant.

Several sponsors and consultants we contacted also expressed concern about HUD changes that result in higher operating costs or higher life-time project costs. For example, one HUD field office required a project to be built with electric heat for all units because electric heating units are cheaper to install than gas heating units. However, electric heat often results in higher utility costs for the life of the project. Other examples given were potentially higher heating costs in cases where insulation was reduced and additional costs for pest extermination in cases where window screens were eliminated.

HUD Administration

When responding to our questionnaire, 22 of the 30 sponsors and consultants with projects exceeding 24 months in processing indicated that HUD review time greatly increased processing time. In addition, 20 of the

30 also indicated that HUD staff actions greatly increased processing time. We combined these responses into an overall category of HUD administration. According to nine respondents, section 202 housing was not a high priority program in HUD, and HUD staff allowed processing delays to occur and provided little assistance to sponsors in meeting processing requirements. Although 16 respondents were critical of HUD's administration of the program, 9 sponsors and consultants also commented that HUD employees are hardworking and simply overburdened with the volume of paperwork involved in section 202 processing.

Other than responding to a congressional directive to determine the reasons for section 202 processing delays, HUD headquarters did not monitor its regional or field office processing performance. In practice, field offices differed significantly in the degree of management attention given to the program.

For example, the Newark and New Orleans HUD field offices routinely experienced processing delays beyond 24 months. These offices did not provide program participants the same degree of assistance as other field offices in executing processing requirements. Conversely, the Pittsburgh and Little Rock field offices processed most projects in less than 24 months, and they had several management techniques in common.

Although HUD regulations do not provide time goals for issuing firm commitment, each office established such goals. Also, each office required the field office's technical staffs—architecture and engineering, cost, valuation, mortgage credit, and housing management—to meet with project development teams during the conditional and firm commitment stages of processing. The meetings were meant to ensure that the development teams understood and accepted HUD's cost containment objectives, program requirements, and regulatory mortgage limits.

HUD's section 202 processing requirements provide target dates for certain processing steps that account for 8 to 9 months of the total 18-month processing goal. HUD's notification to selected sponsors that their section 202 project applications were selected for funding includes a statement that construction shall start within 18 months unless extensions are granted. These requirements include:

- the sponsor's submission of a conditional commitment application within 60 days—90 days for a complex proposal—of the notification of fund reservation.

- HUD's review and issuance of the conditional commitment within 60 days of receipt of a complete application, and
- the sponsor's submission of a firm commitment application within 120 days of issuance of conditional commitment.

HUD has not established any additional target dates for reviewing and issuing the firm commitment. Moreover, HUD does not require its field offices to meet with the sponsor to discuss cost containment objectives and allowable mortgage limits during this processing stage. Firm commitment is a critical processing stage in which the project's design and materials are finalized for HUD review.

The following example illustrates the differences in administration of the section 202 program in the Little Rock and New Orleans HUD offices.

Example of Differences in HUD Administration of the Section 202 Program in Two Field Offices

HUD's MIDLIS system shows that 98 percent of the section 202 projects funded during 1980 to 1986, in the Little Rock office, started construction within 24 months. In contrast, only 29 percent of the section 202 projects funded during this period in the New Orleans office started construction within 24 months.

Field office officials in Little Rock attributed their consistently timely performance in meeting section 202 goals to two factors. First, project size was limited to a maximum of 20 units beginning in 1983. This decision accelerated project starts by moving sites to rural areas where site selection problems were minimized. Second, HUD officials and project development teams met at project funding and during conditional and firm commitment processing to establish mutually agreed upon times and costs and precluded potential future delays by eliminating misunderstandings. Little Rock officials added that they believed FMRs were adequate for section 202 projects and that, as part of their meetings with project development teams, it was specifically stated that no waivers of the FMR limits would be allowed.

New Orleans field office officials attributed frequent processing delays to cost containment, inadequate FMRs, site control problems, and to a low priority given the section 202 program within the field office. According to the field office manager, the processing of elderly and handicapped housing is a low priority because the field office is insufficiently staffed for timely performance on all HUD programs. Unlike the Little Rock Office, the New Orleans office did not conduct meetings at the firm commitment stage between field office review staff and the sponsor's design

team. Local consultants who dealt with the New Orleans office confirmed that aside from limited management attention, cost containment and inadequate FMRs were also reasons for delays in New Orleans.

The Fort Worth regional administrator and the director, Office of Housing, agreed that cost containment, FMR limitations, and site selection were all problems contributing to processing delays in New Orleans. However, they did not concur with the New Orleans office's contention of being understaffed. The regional administrator said that the New Orleans office was better staffed than other HUD field offices in the region. Furthermore, the Little Rock office was able to avoid processing delays because of adequate FMRs and by building small projects in nonmetropolitan areas according to these officials.

The management styles of the two offices have greatly contributed to the processing time differences according to a national consultant who deals with both offices. Specifically, the consultant noted that the Little Rock office requires each project's development team (architect, consultant, attorney, etc.) to work with HUD in establishing budgets and designs within cost containment limits and FMRs. Conversely, the New Orleans office provides little guidance to program participants and does not collaborate with the sponsor's design team at firm commitment which leads to lengthy delays when FMR limits are exceeded or when cost containment is an issue.

Conclusions

We believe that HUD has a responsibility to assure that its fair market rent levels represent fair caps on the rents that nonprofit sponsors can charge in section 202 projects. Low FMRs have helped create backlogs of section 202 projects not starting construction, precluded certain areas of the country from participating in the section 202 program, and required significant nonprofit sponsor contributions that the program's legislation did not intend.

HUD offices have been inconsistent in their application of cost containment. In locations where HUD sets section 202 FMRs too low, HUD offices repeatedly review and change project design plans in attempts to lower costs to amounts that can be supported by the lower rents. Low FMRs followed by duplicative cost containment reviews often result in time-consuming redesigns of projects. Sponsors and consultants of section 202 projects also told us that HUD offices are inconsistent in determining what are acceptable project costs. This may be due to HUD providing limited training and oversight of cost containment implementation.

We also noted there were sharp differences in the degree of attention paid to timely section 202 processing at the HUD field offices we visited. Some HUD offices paid strict attention to timely section 202 processing, while other offices allowed processing delays to occur and provided little assistance to sponsors in meeting processing requirements. The field offices with timely section 202 processing established procedures beyond those in HUD's processing requirements. Specifically, these offices establish time goals to issue firm commitments. HUD processing requirements do not include target dates for this activity. In addition, at firm commitment, these offices require their technical staffs—architecture and engineering, cost, valuation, mortgage credit, and housing management—to meet with project development teams to ensure that sponsors understand and accept cost containment objectives and allowable mortgage limits.

Moreover, other than responding to a congressional directive to determine the reasons for section 202 processing delays, HUD has not adequately monitored its regional or field office section 202 processing performance.

Recommendations

To better facilitate the timely completion of section 202 projects, we recommend that the Secretary of HUD:

- Establish fair market rents for section 202 projects at levels that reflect local rental markets to help improve processing time and also make it more likely that the section 202 program will provide 100 percent sponsor financing for modestly designed housing.
- Ensure that supervisory visits and reviews by HUD headquarters and regional offices are implemented to validate consistent application of cost containment requirements among field offices.

Agency Comments and Our Evaluation

In commenting on a draft of this report (see app. V), HUD agreed with our conclusion that inadequate section 202 project fair market rents have contributed to delays in processing section 202 projects because they do not always accurately reflect local market rents in a given area. However, HUD pointed out that using actual market rents could increase program costs beyond an acceptable level. HUD went on to comment that it is endeavoring to develop an approach to increasing the FMRs that would support the market rents while also minimizing the budget impact as much as possible. We agree that there would be a budgetary impact if FMRs are increased. However, in terms of funding section 202 projects,

HUD needs to take into account Congress' intent that development costs for these projects are authorized to be provided at 100 percent.

In regard to applying cost containment guidelines consistently, HUD said that all field offices were provided training in 1988 and 1990. Because HUD believes that these training sessions have increased field offices' awareness and understanding of cost containment objectives, application of cost containment guidelines are being decentralized to the field offices. HUD plans to monitor field office compliance with cost containment through random project reviews and field office visits. We agree with HUD's approach of decentralizing cost containment to the field offices provided that HUD headquarters and regional office monitoring is adequate to ensure the consistent application of cost containment objectives.

HUD has taken action in response to a proposal in our draft report that processing time goals be established. In June 1990, HUD issued a notice to all field offices requiring them to develop timetables for processing section 202 projects. This notice also requires field office staff to ensure regular communications between the sponsor's development team and the HUD field office staff during all phases of processing.

In accordance with the final proposal in our draft report, HUD said that both headquarters and regional offices are now monitoring field office processing time. HUD also said that it plans to establish, in fiscal year 1991, a goal to process section 202 projects in an average of 24 months or less with a maximum allowable time of 36 months. HUD recently amended its regulations to codify that intent. Given HUD's planned actions to correct the factors causing delays, we do not believe increasing the processing time goals to 36 months was warranted. By adjusting section 202 FMRs, improving communications between the field office staff and borrowers' development team, training staff, and increasing field office reviews, HUD should be able to meet its original processing goals of 18 to 24 months. In fact, in field offices where corrective action by HUD is not needed, 21 projects were processed within an average of 20 months in 1988.

Questionnaire Methodology and Results

Questionnaire Methodology

To determine the reasons for processing delays among HUD field offices, we identified 18 possible factors through reviews of HUD project files and discussions with both HUD staff and consultants. We conducted computer-assisted telephone interviews with 40 judgmentally selected sponsors and consultants and asked them how these 18 factors may have affected their projects' processing times.¹ As a group, these sponsors and consultants had processing experience covering 1,098 projects in 48 of HUD's 51 processing field offices and all 10 HUD regions. The interviews, ranging from 1 to 2 hours in duration, focused on determining the degree to which various factors affected processing times on specific section 202 projects.

We interviewed 4 national sponsors out of 18 that we identified in HUD's MIDLIS computer system. We selected all national sponsors who had at least 25 projects, did business with more than two HUD regions, and had projects funded in at least two different funding years. The four sponsors whom we identified represented 236 projects.

We interviewed 9 national consultants out of 14 that we identified through discussions with HUD officials and consultants. We selected all national consultants who had at least 25 projects, experience in at least two HUD regions, and had projects funded in at least two different funding years. The nine national consultants whom we identified represented 573 projects.

We interviewed 27 local consultants out of 108 whom HUD field office staff identified as having projects funded in the six HUD field offices chosen for our review. We selected local consultants who had worked on at least three projects in two different funding years. The 27 local consultants represented 289 projects.

The sponsors and consultants we interviewed represented about one-third of all section 202 projects funded between 1980 and 1988. However, since our selection of HUD field offices and survey participants was judgmental, the results of our analysis is not applicable to the section 202 program in total. In addition, each respondent was asked to discuss any additional factors affecting processing times on their projects that may not have been included in the list of 18 items. The respondents were also asked to provide documentation regarding the major factors they identified as greatly increasing processing times on their projects.

¹Sponsors are nonprofit organizations who apply for section 202 loans. Consultants for nonprofit sponsors help them conform to HUD requirements and also select the project's development team.

Questionnaire Responses

Of the 40 selected sponsors and consultants, 30 had projects that exceeded 24 months in processing. Since 24 months is supposed to be the maximum processing time, we concentrated our efforts on establishing those factors that caused project processing to exceed this limit. Therefore, the remaining information is based on 30 responses.

The combined responses of the 30 sponsors and consultants with projects that exceeded 24 months in processing showed that they most frequently indicated (1) cost containment (23 of 30), (2) fair market rents (both capping (22 of 30) and maintaining (17 of 30) FMR levels), and (3) HUD administration (review time (22 of 30), and HUD staff (20 of 30)) as the major factors greatly increasing processing time. Since more than 50 percent of these respondents indicated that these factors greatly increased processing time, we designated these factors as being of major importance.

More than 50 percent of the 30 respondents also indicated that an additional five factors either greatly or somewhat increased processing time on their projects exceeding 24 months in processing.² However, since these factors were not indicated as greatly increasing processing time by a majority of the 30 respondents, we designated these factors as being of some importance rather than major importance.

Table I. 1 shows survey participant responses to each of the 18 factors included in our questionnaire for the 30 sponsors and consultants with projects exceeding 24 months in processing. The results indicate the percentage reporting the factors as either greatly or somewhat increasing processing time on their projects. While sponsors and consultants also identified several additional factors as causes for delays on section 202 projects, these additional factors were not mentioned frequently and were applicable to delays on specific projects.

²The five additional factors that increased processing time included (1) operating expenses, (2) local regulations, (3) information required by HUD, (4) competitive bid, and (5) cost containment versus local design.

**Appendix I
Questionnaire Methodology and Results**

Table I.1: Analysis of Factors for Processing Delays According to National Sponsors and Consultants and Local Consultants (For Projects Exceeding 24 Months in Process)

Factor title	Description	Effect on processing time ^a	
		Greatly increased	Somewhat increased
Of major importance			
Cost containment	Requirement that the building is not excessive in terms of amenities and cost of materials.	76.7	13.3
Limited FMRs	Cap of FMRs at certain inflation limits beginning in 1982.	75.9	10.3
Maintained FMRs	Maintenance of FMRs to those in effect at the time of fund reservation beginning in 1986.	58.6	10.3
HUD review time	Amount of time required by HUD to review material submitted for processing.	73.3	16.7
HUD staff	HUD staff assigned to oversee processing	66.7	10.0
Of some importance			
Operating expenses	Since FMRs must cover both debt service and operating expenses, every dollar of income assigned to operating expenses reduces the amount of income available to cover debt service. This reduces the maximum loan amount supportable by FMRs and increases the potential for sponsor contributions.	46.7	20.0
Information required by HUD	Financial statement disclosures and identity of interest statements at all stages of processing.	26.7	33.3
Local regulations	Obtaining local zoning permits.	30.0	30.0
Competitive bid	Competitive bidding is mandatory when projects exceed 110 percent of FMRs or the mortgage amount exceeds \$2 million.	31.3	25.0
Cost containment versus local design	Cost containment may disallow costs for local code requirements increasing sponsor contributions.	23.3	30.0
Other factors			
Local opposition	Community opposition to the project can delay processing or require the selection of a different site.	30.0	13.3
Field office changes	Processing procedures that differ from other field office.	23.3	6.7
No elderly site control	Lack of site control requirement prior to fund reservation for elderly project funded in 1986.	12.5	31.3
Architect experience	Architect's experience with section 202 requirements can affect processing time.	10.0	23.3
Handicapped support	HUD requires support services to assist the less mobile, handicapped persons to be contracted for at firm commitment.	8.3	12.5
Contractor experience	Contractor's experience with section 202 requirements can affect processing time.	3.3	13.3

(continued)

Appendix I
Questionnaire Methodology and Results

Factor title	Description	Effect on processing time ^a	
		Greatly increased	Somewhat increased
Sponsor experience	Sponsor's experience with section 202 requirements can affect processing time	31	63
Consultant experience	Consultant's experience with section 202 requirements can affect processing time	00	00

^aListed by percentage of 30 respondents having projects exceeding 24 months in processing. The percentages do not total to 100. For the remaining percentages, the respondents indicated that the factor decreased or had little or no effect on processing time or the respondent was either unsure of the effect on processing time or found it not applicable.

Source: GAO analysis of questionnaire responses.

Section 202 Program Activity

During fiscal years 1980 through 1989, HUD had authority to issue \$6.9 billion in section 202 loans to finance the construction of 133,851 units of new elderly and handicapped rental housing. While most of the authorized housing units were built or are in the processing pipeline, a substantial amount of appropriated funds were unused. During the 10-year period, HUD financed the construction or has in process 96 percent of the authorized units, while only 4 percent, or 5,424 units, were terminated after approval. However, of the \$6.9 billion appropriated for the program, about \$932 million, or 13 percent, was initially unused or recaptured. Recaptured funds are funds reserved in prior fiscal years for specific section 202 projects, but not used. Table II.1 shows the loan amounts available for the program, and the unused and recaptured loan authority, for fiscal years 1980 through 1989.

Table II.1: Section 202 Amounts Appropriated, Unused, and Recaptured for Fiscal Years 1980 Through 1989

Dollars in thousands

Fiscal year	Loan limitation approved	Unused loan funds	Reservation amounts recaptured	Total unused or recaptured
1980	\$1,053,560 ^a	\$121,045	\$55,998	\$177,043
1981	895,848 ^b	23,271	46,979	70,250
1982	830,848	12,025	58,705	70,730
1983	634,200	862	108,193	109,055
1984	666,400	564	105,101	105,665
1985	600,000	3,050	73,819	76,869
1986	603,899	48,058	59,643	107,701
1987	592,661	18,612	61,388	80,000
1988	565,776	742	61,047	61,789
1989	480,106	2,384	70,827	73,211
Total	\$6,923,298	\$230,613	\$701,700	\$932,313

^aIn fiscal year 1980, the section 202 program was authorized to reuse all funding available from prior fiscal years. This amounted to \$223.6 million.

^bIn fiscal year 1981, the section 202 program was authorized to reuse \$65 million of recaptured reservations from prior years.

The unused loan funds shown in table II.1, or \$230.6 million, are funds that were not reserved in the year appropriated. Since fiscal year 1981, these funds have not been available for use in the section 202 program in succeeding fiscal years and, therefore, revert back to the Treasury. The reservation amount recaptured, or \$702 million, includes \$210.9 million that was reserved for projects funded during fiscal years 1980 through 1989, but the projects were terminated in years after fund reservations were made, and \$490.1 million in funds that were not used.

Appendix II
Section 202 Program Activity

because project loan funds were less than project reservation amounts. Recaptured funds from prior year appropriations cannot be reused and are, therefore, not available for section 202 projects.

The numbers of new section 202 units starting construction have been declining in the last several years. The reasons for the decline have been both decreasing funding for the program as well as increasing project processing time. Table II.2 shows that while decreasing numbers of projects have started construction, the section 202 pipeline—projects reserved but not starting construction—has continued to grow.

Table II.2: Section 202 Projects Starting Construction and in the Pipeline—1980-1989

Calendar year	Starting Construction		In the Pipeline	
	Projects	Units	Projects	Units
1980	246	16,760	656	32,909
1981	318	17,437	604	29,227
1982	353	18,217	560	26,404
1983	321	15,615	551	24,270
1984	280	12,093	655	25,585
1985	312	13,044	703	24,955
1986	256	9,396	774	26,642
1987	267	8,496	875	30,381
1988	295	9,678	974	31,807
1989	178	5,142	1,092	35,103
Total	2,826	125,878		

Source: HUD MIDLIS data as of November 9, 1989

Section 202 Pipeline Status by HUD Region and Processing Field Office as of November 9, 1989

Months

	Projects in Pipeline					Total projects
	0-11	12-23	24-35	36-47	48 or more	
HUD Region I-Boston						
Providence, RI	3	0	2	3	1	9
Hartford, CT	4	4	2	1	3	14
Boston, MA	11	10	7	3	6	37
Manchester, NH	3	5	0	1	0	9
Total	21	19	11	8	10	69
HUD Region II-New York						
New York, NY	10	15	16	11	9	61
Buffalo, NY	11	15	5	3	2	36
Newark, NJ	5	8	7	6	3	29
San Juan, PR	1	4	6	3	2	16
Total	27	42	34	23	16	142
HUD Region III-Philadelphia						
Washington, DC	2	5	2	4	0	13
Pittsburgh, PA	9	8	0	1	0	18
Philadelphia, PA	9	9	4	7	7	36
Charleston, WV	3	4	5	2	0	14
Richmond, VA	9	8	4	3	1	25
Baltimore, MD	4	4	5	1	2	16
Total	36	38	20	18	10	122
HUD Region IV-Atlanta						
Greensboro, NC	26	25	5	1	0	57
Columbia, SC	4	8	7	2	0	21
Atlanta, GA	3	11	4	6	2	26
Birmingham, AL	6	11	5	1	0	23
Jacksonville, FL	15	16	16	12	3	62
Jackson, MS	6	7	4	1	2	20
Louisville, KY	0	8	1	0	0	9
Nashville, TN	2	8	5	0	3	18
Knoxville, TN	3	3	3	1	0	10
Total	65	97	50	24	10	246

(continued)

Appendix III
Section 202 Pipeline Status by HUD Region
and Processing Field Office as of November
9, 1989

	Projects in Pipeline					Total projects
	0-11	12-23	24-35	36-47	48 or more	
HUD Region V- Chicago						
Cleveland, OH	4	7	7	6	2	26
Columbus, OH	1	0	8	1	10	20
Detroit, MI	3	6	2	1	1	13
Cincinnati, OH	0	6	5	0	0	11
Grand Rapids, MI	0	4	4	1	0	9
Chicago, IL	15	18	12	9	12	66
Indianapolis, IN	10	5	6	2	2	25
Milwaukee, WI	8	11	2	0	0	21
Minneapolis, MN	6	8	2	0	0	16
Total	56	73	41	20	17	207
HUD Region VI-Fort Worth						
New Orleans, LA	5	2	5	4	1	17
Little Rock, AR	13	10	1	0	0	24
Fort Worth, TX	0	7	5	8	2	22
Houston, TX	3	3	1	0	0	7
San Antonio, TX	4	2	1	0	0	7
Oklahoma City, OK	2	6	4	2	0	14
Total	27	30	17	14	3	91
HUD Region VII- Kansas City						
Des Moines, IA	5	7	1	0	0	13
Kansas City, MO	10	10	3	0	0	23
St. Louis, MO	6	8	3	0	0	17
Omaha, NE	4	4	0	0	0	8
Total	25	29	7	0	0	61
HUD Region VIII- Denver						
Denver, CO	4	7	1	2	0	14
Total	4	7	1	2	0	14

(continued)

Appendix III
Section 202 Pipeline Status by HUD Region
and Processing Field Office as of November
9, 1989

	Projects in Pipeline					Total projects
	0-11	12-23	24-35	36-47	48 or more	
HUD Region IX-San Francisco						
San Francisco, CA	8	11	10	7	3	39
Los Angeles, CA	14	17	9	6	3	49
Phoenix, AZ	2	4	3	1	0	10
Sacramento, CA	2	2	2	2	0	8
Honolulu, HI	0	4	1	0	0	5
Total	26	38	25	16	6	111
HUD Region X-Seattle						
Anchorage, AK	0	0	0	0	0	0
Portland, OR	4	7	2	1	0	14
Seattle, WA	5	7	1	2	0	15
Total	9	14	3	3	0	29
HUD National Total	296	387	209	128	72	1,092

Source: HUD MIDLIS data as of November 9, 1989

Section 202 Average Processing Time by HUD Region and Processing Field Office

Months				
	1988 average processing time (months)	Projects Starting Construction in 1988		
		0 - 18	18.1 - 24	More than 24
HUD Region I-Boston				
Providence, RI	50.8	0	0	1
Hartford, CT	36.3	0	2	4
Boston, MA	28.9	0	1	4
Manchester, NH	38.6	0	0	6
Total	35.8	0	3	15
HUD Region II-New York				
New York, NY	36.0	0	0	9
Buffalo, NY	27.4	1	0	6
Newark, NJ	41.1	0	0	5
San Juan, PR	27.8	0	0	1
Total	34.1	1	0	21
HUD Region III-Philadelphia				
Washington, D.C.	33.2	0	0	1
Pittsburgh, PA	19.8	2	3	2
Philadelphia, PA	35.5	1	1	5
Charleston, WV	a			
Richmond, VA	27.7	1	0	5
Baltimore, MD	28.4	0	0	4
Total	28.0	4	4	17
HUD Region IV-Atlanta				
Greensboro, NC	22.5	5	17	12
Columbia, SC	23.4	0	1	0
Atlanta, GA	38.9	0	0	4
Birmingham, AL	19.4	2	2	1
Jacksonville, FL	30.0	1	2	10
Jackson, MS	32.5	1	1	7
Louisville, KY	17.2	1	3	0
Nashville, TN	28.5	2	0	4
Knoxville, TN	26.1	2	3	4
Total	25.9	14	29	42

(continued)

Appendix IV
Section 202 Average Processing Time by HUD
Region and Processing Field Office

	1988 average processing time (months)	Projects Starting Construction in 1988		
		0 - 18	18.1 - 24	More than 24
HUD Region V-Chicago				
Cleveland, OH	29.4	0	1	4
Columbus, OH	20.9	2	1	2
Detroit, MI	36.4	0	1	7
Cincinnati, OH	22.8	1	0	4
Grand Rapids, MI	19.5	0	3	0
Chicago, IL	38.5	0	1	10
Indianapolis, IN	27.9	0	2	4
Milwaukee, WI	23.4	1	2	6
Minneapolis, MN	20.3	1	1	2
Total	28.5	5	12	39
HUD Region VI-Fort Worth				
New Orleans, LA	40.9	0	0	5
Little Rock, AR	16.3	4	3	1
Fort Worth, TX	15.1	1	0	0
Houston, TX	22.1	0	4	2
San Antonio, TX	19.9	0	1	0
Oklahoma City, OK	20.3	1	2	1
Total	23.4	6	10	9
HUD Region VII-Kansas City				
Des Moines, IA	20.5	3	3	1
Kansas City, MO	17.6	7	2	3
St. Louis, MO	20.0	1	1	1
Omaha, NE	16.0	2	3	0
Total	18.3	13	9	5
HUD Region VIII-Denver				
Denver, CO	29.0	1	2	7
Total	29.0	1	2	7

(continued)

Appendix IV
Section 202 Average Processing Time by HUD
Region and Processing Field Office

	1988 average processing time (months)	Projects Starting Construction in 1988		
		0 - 18	18.1 - 24	More than 24
HUD Region IX-San Francisco				
San Francisco, CA	29.2	0	1	7
Los Angeles, CA	27.2	0	2	2
Phoenix, AZ	20.1	0	2	0
Sacramento, CA	28.1	0	0	1
Honolulu, HI	23.6	0	1	1
Total	27.0	0	6	11
HUD Region X-Seattle				
Anchorage, AK	^a			
Portland, OR	19.7	2	1	3
Seattle, WA	20.5	1	2	1
Total	20.0	3	3	4
1988 HUD National Total	26.8	47	78	170

^aNot applicable because the Anchorage, Alaska, and Charleston, West Virginia offices did not have any projects starting construction in 1988.

Source: HUD MIDLIS data as of November 9, 1989.

Comments From the Department of Housing and Urban Development



THE UNDER SECRETARY OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

August 24, 1990

Mr. John M. Ols, Jr.
Director, Community and Economic
Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Ols:

Your letter of July 13, 1990, addressed to the Secretary of Housing and Urban Development transmitting a proposed report to the Congress entitled: "Housing for the Elderly and Handicapped: HUD Policy Decisions Delay Section 202 Construction Starts (GAO/RCED-90-187)," has been referred to me for reply.

I will answer the recommendations in the order that they are presented in the report.

Recommendation No 1: The Secretary of HUD should establish fair market rents that accurately reflect the cost of modest housing in local rental markets to help reduce processing time and also making it more likely that the section 202 program will provide 100 percent of sponsor financing for modestly designed projects.

Reply: The Department recognizes that the capping process, while affording short term benefits as related to budget impact, has, in many instances, resulted in increased costs in the long-run and has inhibited our ability to provide this housing for the intended occupants within a reasonable timeframe. For these reasons, the Department is currently assessing various options in connection with the publication of the FY 1989 FMRs. For the past eight years, increases in FMRs have been limited to the lesser of the FMRs submitted by Field Offices which reflect local market conditions, or the previous year's FMRs increased by a percentage determined by Headquarters (capped rent). This process has led, in some areas, to a widening gap between the market-based rent and the published FMRs, and has contributed, in some cases, to the clogging of the Section 202 pipeline. Simply deciding to publish FMRs based on market data may appear to be the easy solution. However, the budget impact in terms of additional Section 8 contract and budget authority needed to support the higher, uncapped rents may render this alternative unacceptable. The Department is endeavoring to develop an approach to increasing the FMRs that would support the market rents proposed by our Field Offices while minimizing the budget impact as much as possible. Other options involve a cap which may be established in different ways.

Recommendation No 2: The Secretary of HUD should ensure more consistent application of cost containment reviews among field offices either by increased training or supervisory visits.

**Appendix V
Comments From the Department of Housing
and Urban Development**

Reply: Considerable training on cost containment has already occurred. Three two-day training sessions were conducted in 1986, two one-day sessions in 1988, and three one-day sessions in 1990. All field offices were covered in this training. During the last year, the field office staff has demonstrated increased awareness and understanding of the Department's cost containment objectives. As a result of improved field performance, Headquarters is decentralizing the cost containment review process to the field offices. Headquarters and the regional offices will monitor field office performance through random reviews of projects and through field office visits.

Recommendation No 3: The Secretary of HUD should establish processing time goals, such as those currently employed in offices who have had success with sponsor and field office staff meetings for this purpose.

Reply: The Department has issued instructions to the field offices that address this recommendation. On June 30, 1990, the Department issued Notice H 90-37 entitled, "Revised Section 202 Fund Reservation Extension and Cancellation Policy". This Notice requires field offices to meet with borrowers and develop a schedule to start of construction. It requires the field office staff to take initiative in making sure that the borrower's development team and the HUD field staff are in regular communication during all phases of the development process. It requires justification for any delays experienced during the development process, and sets up a monitoring process whereby Headquarters will monitor each region's and each field office's performance by rank ordering the ten regions and each field office within a region based on the average time lapsed between the issuance of the fund reservation and the start of construction. The Department intends to take additional actions as well. For example, the Department intends to ask for reuse of recaptured Section 202 loan authority. If the Department succeeds in getting reuse of recapture, instructions will be sent to each regional office authorizing them to reuse such recapture for amendments to projects in the pipeline, giving priority to the field office from which the recaptured authority came. The Department is also including pipeline goals in the FY 1991 Regional Management Plan, which will require that a certain percentage of the projects reserved in a given fiscal year be started. The Department is also scheduled to conduct Section 202 program training which will include participants from all field offices.

Appendix V
Comments From the Department of Housing
and Urban Development

Recommendation No 4: The Secretary of HUD should require headquarters and regional office monitoring of field office processing time.

Reply: The Department is now monitoring field office processing time. Unfortunately, field office processing time will look even worse than the GAO report shows if the field offices succeed in bringing to start of construction those cases approved in FY 1987 and prior fiscal years. In order to avoid penalizing the field for getting these cases started, the Department will include in its FY 1991 Regional Management Plan a goal for each region to start all cases with fund reservations received in FY 1988 or subsequent fiscal years in an average of 24 months or less. This goal will be monitored through the Multifamily Insured and Direct Loan Information System, and field offices that perform poorly will receive field reviews by Headquarters or regional staff.

Sincerely yours,


Alfred A. DelliBovi
Under Secretary

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