SAVING TAXPAYER MONEY THROUGH SOUND FINANCIAL MANAGEMENT

HEARING

BEFORE THE

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OVERSIGHT AND INVESTIGATIONS

OF THE

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CONTENTS

SAVING TAXPAYER MONEY THROUGH SOUND FINANCIAL MANAGEMENT

Wednesday, June 25, 2003

U.S. House of Representatives,
Subcommittee on Oversight and Investigation,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to call, at 2:13 p.m., in Room 2128, Rayburn House Office Building, Hon. Sue Kelly [chairman of the subcommittee] presiding.

Present: Representatives Kelly, Green, Inslee, Crowley and Matheson.

Chairwoman Kelly. [Presiding.] This hearing on the Subcommittee on Oversight and Investigations will come to order.

Without objections, all members' opening statements are going to be made part of the record.

Far too often, we in Washington see much reckless and wasteful spending without regard for American taxpayers. I believe we have to carefully examine every penny the federal government spends to ensure that hardworking American families are getting the most for their tax dollars.

The budget resolution passed by the House for the next fiscal year includes a pledge to search for and eliminate waste, fraud or misuse in federal spending. This pledge represents a commitment to all Americans that this Congress will not take their hard-earned dollars for granted. The subcommittee is meeting today to discuss how to fulfill this promise immediately.

With the committee's encouragement, senior managers at the Department of Housing and Urban Development and the Rural Housing Service, an agency within the Agriculture Department, are scouring decade-old accounts and contracts under their control. I would like to commend both of these agencies for working diligently with this subcommittee to identify funds that are available to reduce spending needs in future years.

After careful investigation, I am pleased to be able to announce that we have discovered, they have discovered for us, over $1 billion that were appropriated and obligated for a specific grant or subsidy, but for a variety of reasons the money was never spent and the money is no longer needed for its original purpose. To date, we have officially found a total of $1.7 billion in unspent funds at HUD that can be used to reduce future spending. We have also located an additional $737 million in unspent funds at the Rural Housing Service, which the Agriculture Department is still investigating. To assist in these efforts to protect taxpayers, I would like to announce our request for a GAO study to determine how much of these funds can be recaptured.

Today, we have with us senior officials from both agencies to discuss their findings and what they hope to do with the funds they have found. We have asked for and received a statement from the Inspector General of HUD, Kenneth Donohue, on his office's initiatives to halt waste, fraud and abuse. These include work to recover improper payments for housing assistance and a new initiative to detect and prosecute fraud in the Section 8 program in collaboration with HUD management.

The subcommittee applauds these steps. By eliminating waste in important housing programs, Secretary Martinez and Inspector General Donohue are ensuring that vital program funds are spent to help the beneficiaries as Congress intended. I ask the subcommittee's unanimous consent to insert this statement into the record.

I really thank the witnesses for appearing before the subcommittee today. I look forward to your testimony.

I will turn now to my fellow New Yorker.

Mr. CROWLEY. I thank the chairwoman. And I would like to read an opening statement.

I would like to thank her for holding this hearing today in the Oversight and Investigations Subcommittee regarding the Republican directive inserted into the budget resolution for each committee to identify and weed waste, fraud and abuse out of mandatory spending. Let me begin by stating that I opposed the Republican budget resolution as it was, and as I believe it to be a sham document that cuts vital spending programs, including mandatory veterans benefits and discretionary housing accounts.

But today we are not here to discuss the overall budget, again a budget that will produce well over $1 trillion in new deficits over the next several years, further eroding our nation's economy, an erosion which began in the winter of 2002 after 8 straight years of growth and prosperity. We are here to discuss a specific section of that document, Section 301 of Title III which pertains to the weeding out of waste, fraud and abuse. This is one thing that should be bipartisan, with Democrats and Republicans working together. We are all taxpayers here and no one likes to see any of our taxpayer dollars wasted.

But the gist of this hearing is off, in my opinion, as Section 301 pertains to mandatory spending programs only, not discretionary programs as the chairwoman is highlighting in the hearing today. In fact, both Section 8 and the rural housing programs are discretionary programs, not mandatory programs. So when my colleagues talk of eliminating waste, fraud and abuse in mandatory programs, what are they actually referring to? I believe they are referring to federal employee benefits, something I will be interested in getting the take of our two witnesses here today as they are both federal employees. The Republican Caucus I believe is referring to Medicare, veterans's benefits and Social Security. These are mandatory programs.

In fact, with respect to the housing programs Chairwoman Kelly wants to have a discussion on today, I will quote budget chief Jim Nussle who stated that the Budget Committee, "wants to put the same discipline that the appropriators put into their disciplinary spending process into the mandatory side," meaning we should be looking at only mandatory spending, not the discretionary programs that we will be discussing here today. In fact, Mr. DeLay says that these mandatory cuts will save the government over $10 billion a year, but again, what are the mandatory cuts? Veterans, Medicare, Social Security, they are not the HUD programs in question today as they are discretionary, as opposed to mandatory in nature.

While I welcome the opportunity for the other side to finally come clean in their ultimate goal which I believe is to gut key social service programs like veterans's benefits, we must be 100 percent honest in this debate. Let us remember that the head of the Disabled American Veterans himself wrote to Speaker Hastert and called the Republican budget shameless as it cut disabled veterans's services and benefits. Let us also not forget the Administration recently moved to cut benefits for 164,000 veterans citing the same waste, fraud and abuse claims being made here today.

These are the mandatory spending programs threatened by Mr. DeLay on the other side of the aisle, and this pursuit of destroying veterans's benefits or Medicare will not be a bipartisan issue.

Moving on to the claims of waste, fraud and abuse at HUD, the other side cites the unobligated balances in the Section 8, 236, and 521 programs. But these are not caused by waste, fraud and abuse on the part of local housing authorities, low-income tenants or assisted housing landlords. Such balances only come about through contracts entered into where all of the obligated funds are not needed once the long-term contract expires or is canceled due to prepayment. The funds are not wasted. Eventually, they are routinely rescinded, recaptured or reallocated, meaning the government takes them back and uses them again, either for housing or for some other purpose. In fact, unobligated funds are routinely used as a piggy bank so to speak to fund non-housing programs in supplemental spending bills.

According to preliminary data provided by CBO, the Congress rescinded $6.8 billion in Section 8 budget authority in supplemental spending bills from fiscal year 1997 through fiscal year 2002, the overwhelming majority of which were used to fund non-housing expenditures, meaning the money was spent, not wasted as they would have many believe here today.

More recently, Congress rescinded $300 million in Section 236 balances in the fiscal year 2002 supplemental spending bill, and $100 million in fiscal year 2003 appropriations bills. These funds were previously earmarked by authorizing statute for rehabilitation of low-income housing units. Again, the funds went elsewhere and did not disappear into thin air. In fact, the rescission of unobligated Section 8 balances would leave a gaping hole in the HUD budget, which would require as much as $1 billion in additional cuts to housing program on top of the cuts recommended by the president's budget. This is as the Administration proposed to use 100 percent of the estimated $1 billion in unobligated Section 8 balances in fiscal year 2004 to help cover the cost of Section 8 renewals, again seeing the money go back into other programs and again not wasted.

The only real issue of accountability is whether HUD and RHS are properly accounting for and reporting to Congress the accurate level of balances in these accounts. This waste, fraud and abuse issue I believe is a red herring to justify further cuts in important housing programs.

With that, Madam Chair, I yield back.

Chairwoman KELLY. Thank you.

Just to set the record straight, Mr. Crowley, the budget which was passed included $63.8 billion for veterans, which is more than they have ever allocated for the veterans issues.

Mr. Green?

Mr. GREEN. Madam Chair, thank you for adding that point of clarification.

I appreciate your holding this hearing today. This hearing is an opportunity for good news, ways that we can make the taxpayer dollar go further. The opening statement from the gentleman from the other side did not seem to focus on that. Instead, tossed the usual partisan rhetoric about gutted programs and so on and so forth. I look forward to a hearing in which we find ways to make things work and find ways to make those dollars go further and further.

Thank you, Madam Chair.

Chairwoman KELLY. Thank you, Mr. Green.

There are no more opening statements, so I will introduce our witnesses.

We have with us the Honorable Angela Antonelli, who is the Chief Financial Officer of the Department of Housing and Urban Development; the Honorable Thomas Dorr is the Under Secretary for Rural Development at the Department of Agriculture. He is accompanied by David Grahn, the Associate General Counsel for Rural Development.

We thank you very much for testifying before us today. I welcome you on behalf of the entire committee. Without objection, your written statements and any attachments that you have will be made part of the record. You will be recognized for a five-minute summary of your testimony. The lights in the box on the table will indicate, it is green when you have the full five minutes; within one minute of the time your time is ended at the end of four minutes, the yellow light will go on; when your time is up, the red light will go on. I want to warn you that I tend to keep on time because I think other people need to be heard. With that, we start with you, Ms. Antonelli. It is a great pleasure to have you here. I look forward to your testimony.

STATEMENT OF HON. ANGELA M. ANTONELLI, CHIEF FINANCIAL OFFICER, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Ms. ANTONELLI. Thank you very much.

Chairwoman Kelly and other distinguished members of the House Subcommittee on Oversight and Investigations, on behalf of HUD Secretary Martinez, thank you for inviting the department to testify on the status of unexpended balances that remain from funds that were previously appropriated by the Congress for HUD programs.

I believe that HUD's leadership has worked diligently and successfully to reduce unexpended balances and to ensure that funds reach their anticipated beneficiaries as quickly as possible. After all, the benefits of federal programs that are authorized and funded by the Congress are not realized until the funds are actually put to use providing assistance to low-and moderate-income families.

There are many who criticize HUD for what are perceived as very high unexpended funds balances with large savings potentials. At first glance, this is not an unreasonable criticism or reaction. At the end of May of this year, HUD had $108 billion in unexpended appropriated funds. However, these balances do not represent either an inability of HUD's leadership to award and obligate funds or an opportunity to recapture these funds and use them for other purposes because the program recipients no longer need them.

Let me begin by trying to put the total unexpended balance of $108 billion in perspective. First, of the total balance, $34 billion has yet to be awarded and obligated by HUD. The vast majority of the funds are not obligated because Congress only enacted the fiscal year 2003 Appropriations Act in February. And because several of HUD's programs are in fact competitive grant programs, and given the time required to run a competitive funding program, those funds are often not obligated until late in the fiscal year or in some cases until the next year. This leaves a total of $74 billion in obligated balances yet to spend out.

I would like to break this into two groups; first, the balances for terminated programs. Congress enacted long-term low-income assistance programs in the 1970s and 1980s, many of which no longer receive annual funding for new project activity. However, these long-term programs were either fully funded at their inception or sufficient funds were provided to obviate the need for additional appropriations for many years in the future. All of these funds are obligated against the projects and have steadily been spending out for the past two decades and will continue to do so for many years to come. In total, over $34 billion in obligated funds remain for a variety of programs such as the Section 236 interest rate reduction program, project-based Section 8 contracts, and other smaller programs. Although many of these programs were terminated, the contracts and therefore obligations have not expired and will continue to be expended over time.

Should the Congress determine that these balances should be reduced and be used for other purposes, it must be aware that future appropriations will be required to complete the contractual obligations into which the government has entered. Hence, the Administration does not necessarily see these funds as excess and available for recapture. However, please understand that once these contracts do expire or for other reasons project owners or grantees opt out or the contract is terminated, HUD moves to recapture any funds that remain.

One example is the 236 IRP program from which HUD recently recaptured approximately $700 million. We are now completing a reevaluation of the original estimate of need throughout the remaining active life of each contract. The president's budget assumes that $300 million of the $700 million recaptured will be available to offset the overall cost of HUD's program in fiscal year 2004.

Of the balance that remains in terms of obligated balances in current programs, there is about $40 billion. In the case of the Section 8 housing choice voucher program, there are about $8 billion in obligated balances. However, of this amount, $6 billion are obligations for fiscal year 2002 and 2003 appropriations, reflecting the fact that public housing agency recipients have different fiscal years than the federal fiscal year, and there is a lag in the receipt of funds.

These balances do not necessarily reflect a failure by PHAs to expend the funds properly, since they are current-year contracts that have not yet expired. Over the past few years, HUD has moved to recapture all unused tenant-based Section 8 funds from all expired contracts with a long-term project base or annual tenant-based contracts. In fiscal year 2004, the president's budget assumes approximately $1.4 billion in fiscal year 2002 and prior year unused Section 8 funds will be made available to offset the costs of this program.

HUD is working as hard as possible to ensure that it annually sweeps both the project-based and tenant-based programs and makes funds to offset the costs of the program. Thus, combined with the budget reforms enacted in 2003, we will ensure that future obligated balances will always be the lowest possible. This reform represents one of the most significant management improvements since the start of the Administration.

In the case of the public housing capital fund, of the $4.4 billion in obligated funds for modernization appropriated from 1997 to 2002, PHAs have four years to spend the funds once they are obligated. HUD is working closely with Congress to enforce the new law that requires PHAs to spend these funds within that time frame or if not, Congress requires that HUD recapture the funds.

We have already seen a dramatic drop in obligated balances, particularly for funds that are more than two years old. In the case of our special populations program, there are $4.4 billion in unexpended obligations in the case of our elderly and disabled housing program. Seeing such a large amount of funds yet to be expended may make people think that the department is not using its funds in a timely manner. However, the majority of the funds, about $2.5 billion, are associated with the elderly 20-year and 5-year project rental assistance contracts for support of completed and occupied projects.

A recent GAO report on the elderly stated that at the end of September 30, 2002, only about $700 million represented funding for projects that remained in the pipeline. The $700 million represents funds for some of the most difficult projects to bring to closure because of unanticipated issues with the site or litigation. However, we have made it a priority to clear the pipeline and have significantly reduced the number of projects in that pipeline.

In conclusion, I hope that I have been able to give you a different perspective on what many believe are these excessive unexpended balances in HUD programs. I hope that I have been able to demonstrate that where the real excess balances do exist, HUD has been aggressive in recapturing those funds and using them to offset the costs of HUD programs or for other uses.

In fiscal year 2004 alone, HUD's budget assumes that over $1.7 billion in recaptured balances will be used to reduce the overall budgetary requirements of the department. I want to emphasize that while it is important to recapture funds, our first goal at HUD is to ensure that our grantees or other intermediaries expend the funds as fast as possible, consistent with the rules Congress has enacted, so that low-income families and communities across the country can enjoy the benefits that are intended by Congress. The real success story at HUD is the tremendous effort that is now going into reducing these unexpended obligations through improved program performance, rather than recaptures.

Thank you very much. I would be happy to answer any questions.

[The prepared statement of Hon. Angela M. Antonelli can be found on page 18 in the appendix.]

Chairwoman KELLY. Thank you very much.

Mr. Dorr?

STATEMENT OF THOMAS DORR, UNDER SECRETARY FOR RURAL DEVELOPMENT, DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY DAVID GRAHN, ASSOCIATE GENERAL COUNSEL FOR RURAL DEVELOPMENT

Mr. DORR. Thank you, Chairwoman Kelly, members of the committee. Thank you for this opportunity to testify on the multi-family housing Section 521 rental assistance program. The rental assistance program currently helps 264,000 rural households maintain their rental residence by providing a subsidy to pay the difference between the basic rent for the apartment and up to 30 percent of an eligible tenant's income. Section 515 multi-family housing borrowers operate the rental assistance program under contract with USDA. These contracts consist of a commitment from the borrower to operate an affordable housing property to the life of the mortgage and a commitment from the United States Government to provide funds to help residents make rent payments.

At the start of the rental assistance program in 1978 until 1982, contracts were executed for 20 years for new construction projects, and five-year contracts were executed for existing properties. Contracts executed after that period are all five-year contracts. All contracts continue until the obligated rental assistance funds are depleted. The General Accounting Office is reviewing the Section 521 rental assistance program and has raised concerns about the unliquidated balances on the 20-year contracts and five-year contracts on which rental assistance payments continue to be paid on units beyond the original terms.

Rural Development has determined that there is $737 million approximately outstanding on these active contracts that were obligated between 1978 and 1998. This obligated amount remains outstanding for several reasons. First, the 1978 to 1982 contracts were vastly overestimated, mostly due to the newness of the program. Second, lower than projected rental assistance usage occurs as tenant income goes up and the gap narrows between 30 percent of income and the basic rent. As a result, less rental assistance is needed.

Third, lower usage is also experienced when vacancies at the property are higher than expected. This reduces the number of occupied units and may reduce the amount of rental assistance used by the property. And fourth, rental assistance units exist in our program in perpetuity. If a property no longer needs rental assistance on several units, the rental assistance on those units is transferred to another property to provide rental assistance for rent-overburdened tenants. The usage on these units is subject to adjustment due to changes in tenant income and property occupancy conditions.

Of the outstanding $737 million, and this is as of March 11, 2003, $525 million represents unlimited authority through the U.S. Treasury to fund the 20-year contracts made between 1978 through 1982. The outstanding obligations are termed “unliquidated obligations,” which means unused authority to fund contractual obligations for that period. These are not dollars that rural development can access to spend to fund RA for new construction. These RA funds are only available for the current contracts or may be transferred to other units on existing contracts.

Unliquidated obligations are not unique to the rental assistance program. Every program has obligations to be paid in the future by the government. The contract executed by Section 515 borrowers identifies a specific amount of rental assistance obligations. Changes in use would require these contracts to be renegotiated with the borrowers and legislation would be needed to provide more flexibility in the use of these funds. This would allow funds set aside for RA payments in the distant future to be used to fund more rental assistance units today.

We are willing to work with your committee and the Appropriations Committee, General Accounting Office and Office of Management and Budget to explore more flexibility in using this funding source, provided that this can be done without increasing the government’s exposure to future unmet funding needs.

The committee has inquired about the inactive contracts in our portfolio. Those contracts fall into three categories. First, contracts that have not yet started paying out because the contract they are replacing had not yet exhausted all funds. Secondly, we have contracts that have not yet started paying out because a new construction project has not been completed and started operations. And thirdly, for any property whose debt has been accelerated or is in foreclosure, rental assistance is held in abeyance until those legal actions are completed. On completion of these servicing actions, the rental assistance will begin flowing at that property or another that needs rental assistance. In each case, these inactive contracts will be started or re-started.

Rural Development has taken steps to become more accurate in our projections of rental assistance, including automation initiatives, rental assistance review, management control review, and the implementation of our Regulation 3560 proposed changes. Rural Development will continue to work with the committee and other interested parties in reviewing the unliquidated obligations.

Madam Chairwoman, this concludes my testimony. I would like to thank you for allowing me the opportunity to testify today and I would answer any questions you may have or the committee members may have.

[The prepared statement of Hon. Thomas C. Dorr can be found on page 24 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Dorr. Actually, I do have a couple of questions.

Of the total rental assistance contracts, what percentage are inactive? I didn't get that number.

Mr. DORR. What percentage of them?

Chairwoman KELLY. Yes, what percentage of the rental assistance projects that you now have are inactive?

Mr. DORR. Of the contracts themselves, we have about 3.5 percent that are inactive. Of the total dollar value of obligations, it amounts to about 7 percent.

Chairwoman KELLY. About 7 percent and 3.5 percent. The reason for the inactivity again is?

Mr. DORR. Well, it is three-fold. Essentially, we have new construction or renewal contracts. The new construction contracts are contracts that have been obligated. The properties are not yet functioning and therefore they are not authorized to draw on the rental assistance. Of that 7 percent, about half of them are contracts that will run out of rental assistance this year, and we are obligating another five-year contract, but that has not been activated at this point. Then we have a third category which involves the servicing and transferring of certain contracts including those that have various legal actions pending or are in some other minor form of transition that is not easy to categorize. That is a small number of the total inactivity.

Chairwoman KELLY. Mr. Dorr, you said in your testimony that changes in the use of the unliquidated obligations would require the renegotiation of the contracts. That is really what we are asking GAO to resolve with you. For the record, can you please specifically describe the language in the contracts that is at issue?

Mr. DORR. I would not have specific language for you today, but we will get that to you.

Chairwoman KELLY. Does Mr. Grahn have that?

Mr. DORR. Mr. Grahn, would you care to comment? Go ahead.

Mr. GRAHN. Madam Chairwoman, the Rural Development Administration, and particularly at that time the Farmers Home Administration, entered into a series of amendments in the early 1990s with these contracts. If you take a look at Section 8(a) of the amendment, it talks about the terms of the contract expiring upon the total disbursement or credit at the borrower's account. At the bottom of the amendment, it indicates how much money that is. So we have interpreted that contract to mean that the contract will run until the dollars are expended.

Chairwoman KELLY. I wonder if you could provide a good copy of the kind of contract that is at issue here for our records, and a legal opinion about your interpretation. I think we would find that to be very helpful in understanding the questions about the contract. Would you do that for us please?

Mr. GRAHN. Yes.

Chairwoman KELLY. Thank you.

Ms. Antonelli, I really want to compliment Secretary Martinez and Deputy Secretary Jackson and you and the other HUD officials for your leadership in identifying and attempting to recapture these funds. I urge you to continue.

For instance, you testified that the obligated balances in the public housing authorities have dropped from $3.4 billion in 2001 to $700 million as of this March 31. Would you please very briefly describe the specific procedures that you put into place when you arrived at HUD to try to ferret out and recapture unspent funds?

Ms. ANTONELLI. Much of what we have done within the department since the beginning of this Administration has really been very generally focused on the entire department and all programs, to focus on the level of unspent balances. Obviously, that includes the PIH programs as well. Again, you are referring specifically to the comment in the testimony regarding the public housing capital fund. There have been efforts that have been put in place in terms of those programs, as well as other programs, to expedite the expenditure of funds and to streamline the processes by which those funds would be expended by the public housing authorities.

I am also being told that part of the reason that we have been able to see the drop in the level of funding that has been out there is because of efforts to work with the appropriators to try to speed the ability to get the money out towards the modernization projects. So we have worked very closely, again, with the appropriators as well to address some of these issues, particularly in the area of public housing.

Chairwoman KELLY. Thank you very much. I am out of time.

Mr. Crowley?

Mr. CROWLEY. Thank you, Madam Chair. When HUD rescinds, recaptures or reallocates funds from Section 8 programs, for example, are they lost; do these funds just disappear; or are they reused for other purposes, whether it be for housing or other governmental purposes?

Ms. ANTONELLI. Most of the time, the money that is recaptured from tenant-based Section 8 is often put back and is used for Section 8. For example in the case of the president's fiscal year 2004 budget, as you know, there is $1 billion in offsets anticipated to contribute to reducing the level of appropriations for the Section 8 tenant-based program going forward.

Mr. CROWLEY. Would you describe that as fraud or waste or abuse?

Ms. ANTONELLI. Absolutely not. Obviously in terms of the discussion of the Section 8 program, the tenant-based program, there have been efforts to try to improve the utilization of funds within the program; the fact that every year the department annually recaptures a significant amount of funds from the tenant-based program. It is something that we have been working very, very hard to resolve. In the context of the 2003 Appropriations Act, for example, we had worked very closely with the appropriators to make modifications that would allow us to begin to drop the level of recaptures over time that we would see in this program.

It is certainly not waste, fraud and abuse. It reflects issues with regards to the management of the program and we need to work to improve the management of the program and have begun to do that in the context of 2003 with these management improvements to try and reduce the level of recaptures that we have so that the money in fact is flowing out to the public housing authorities and those who need them.

Mr. CROWLEY. Thank you. I have a limited time for questions, but I appreciate your answer.

Just let me take it one step further. The Inspector General is not here today. Kenneth Donohue has submitted testimony that will be the basis of some of my questions as well. He talked about contract excesses, as well as what I mentioned before in terms of what is rescinded or recaptured or what is reallocated funds. Is the same true about contract excesses in Section 8 programs? Are they also recaptured or are they spent or are they lost?

Ms. ANTONELLI. Again, as I mentioned, we don't necessarily see the funds as excess per se because, again, we have contractual obligations that we are legally required to uphold. In the case of project-based Section 8, for example, if you look at the funds that are there and that have not yet been spent, these are dollars that are attached to projects. Again, if those monies were to be rescinded, then ultimately it is entirely possible that we would have to seek additional appropriations in fact to meet those legal obligations. That is just one example of, again, we would not necessarily see these as excess funds.

They are in fact funds that when these programs were initially created, the money was provided up front. It spends out over a long period of time. And again, to the extent that those funds would be removed, ultimately somewhere down the road the money would have to be appropriated again to uphold those legal obligations, contractual obligations.

Mr. CROWLEY. Let me ask you and Mr. Dorr, if you can. If you could answer these questions with just one word yes or no answers to the first two parts of the questions. Does Congress allocate an annual appropriation for Section 8 and Section 238 housing programs, as well as Section 521 of the rural housing programs? Does Congress make an annual allocation through the appropriations process towards those programs?

Mr. DORR. Yes, we get an annual appropriation.

Mr. CROWLEY. Thank you.

And the same would be said for HUD?

Ms. ANTONELLI. Not for 236.

Mr. CROWLEY. Okay, 238? Section 8?

Ms. ANTONELLI. Section 8, we do have annual appropriations, yes.

Mr. CROWLEY. Okay. Does Congress allocate an annual appropriation for Social Security or Medicare? To your knowledge, I know it is not your field, but to your knowledge, does Congress allocate an annual appropriation for Social Security or Medicare?

Ms. ANTONELLI. These are mandatory programs.

Mr. CROWLEY. Right. We don't allocate them, do we? We don't make appropriations for them, do we?

Ms. ANTONELLI. You have to meet the need.

Mr. CROWLEY. Right.

The HUD programs in question are discretionary.

Ms. ANTONELLI. That is correct.

Mr. CROWLEY. As opposed to mandatory spending, which veterans' benefits, Social Security and Medicare are. I am holding up a copy of the Section 301 of the budget resolution where it stipulates that the committee needs to look into mandatory spending. None of the programs we are talking about here today are mandatory spending. They are all discretionary spending. Is that correct?

Ms. ANTONELLI. I should just point out, we do have about $27 billion in mandatory obligated balances, but those are reserves that are in our FHA fund.

Mr. CROWLEY. Is Section 8 a mandatory program or is it a discretionary program?

Ms. ANTONELLI. No, sir, it is not. It is a discretionary program.

Mr. CROWLEY. My feeling is here that the hearing is taking place. I think it is a red herring. I will say it again, because I think this is an attempt to make cuts in the Section 8 program which would have a very serious effect on my city and my district particularly. I think it is wrong to be doing this. Clearly, the excess monies that are recaptured are spent again, either in HUD in Section 8 programs or in other programs. Actually, it is used by Congress for defense spending and other emergency spending that comes up. I think it is wrong to hold in the cloud of trying to find out waste, fraud and abuse, to have members on this side of the aisle vote against any cutting of Section 8, and declare that we are against waste, fraud and abuse. I think it is wrong to do that, and I yield back the balance of my time.

Chairwoman KELLY. Mr. Crowley, I really need to remind you that when the budget passed, embedded in the budget was the mandate that every chairman of every committee who controlled the budget of any executive agency attempt to work with that agency to cut at least 1 percent out of the budget. The committee chairmen all accepted that challenge. These are not cuts that we are talking about. What we are talking about is streamlining things here in the effort to recapture money. That does not necessarily revolve around waste, fraud and abuse, but management problems, as Ms. Antonelli said, and if it is appropriate, the idea is if we need to make legislation available to these agencies to free up funds and allow flexibility so that money that is residing in those agencies can be used now and appropriately, rather than being held in accounts for 20 years because they are held up and that money will probably never be used, then it is important that we do what we can to provide flexibility and free-up these funds so that they are available.

Too many programs, especially in these two areas, with rural housing and with HUD, don't have as much money available to them because there are funds frozen in various ways. That is exactly what I am applauding HUD about because I think the HUD officials have worked very hard to identify and ferret out and recapture these unspent funds that have been frozen in the agencies. So I applaud them for this and I think it is important that we make clear what is happening here. We are not worried about cuts. We are worried about making available the money that is there.

Mr. Green?

Mr. GREEN. Thank you, Madam Chair.

I have listened carefully to the testimony and I will read the written testimony in great detail later on. I would like to step back and just ask a couple of general questions. First off, if each of you could simply bottom-line your testimony for us, if there is one message that you would like us to take from your testimony, what would it be?

Ms. ANTONELLI. I am sorry, Congressman. I apologize.

Mr. GREEN. No, not a problem. We have talked a lot about details and specifics. I would like to step back a second. What is the bottom line of your testimony? Can you summarize as best you can if there is one message that you would like us to hear with respect to the discussion points, what would it be?

Ms. ANTONELLI. I think the most important message that we would like to convey from the Department of Housing and Urban Development is just how seriously we take our responsibilities in terms of being good stewards of the taxpayer dollar and improving the financial management of the department. As the IG has outlined and has the responsibility annually in terms of doing an audit of our financial statements, they have highlighted areas where we can and should be doing better.

I think the department has already done a great deal in the past and will continue to do what we have been doing in terms of keeping track of and very carefully reviewing the level of unexpended funds program by program within this department. To the extent that we can, we will recapture those funds where we know that we are able to do that, and not have an impact on our programmatic needs. We have been very successful in doing that.

In the context of the 2002 audit, there were some things that the Inspector General had highlighted in a couple of our programs. We are happy to work with them. We continue to work with them. As a result of their work, we have very detailed corrective action plans in place that will allow us to continue to do an even better job in the issue of the review of unliquidated obligations. So that, again, we are making the most effective and efficient use of the taxpayer dollars as Congress has allocated them to the Department of Housing and Urban Development.

Mr. GREEN. Mr. Dorr?

Mr. DORR. Yes, Congressman Green, I would first of all generally echo what Ms. Antonelli has expressed. But in addition to being good stewards, I would clearly point out that we are very sensitive to our responsibility to provide housing for those elderly and single and others in rural areas who have diminished resources and need access to this program. If there is one thing that I would like you to come away with from this is that, first of all, we need management flexibility. In the long run, what we need is flexibility to administer these programs in a way that allows us to steward these resources effectively, as is what I think is the intent of this committee.

In our case, we are fully engaged in an automation review so that our rental assistance budget forecasting mechanism is going to be much improved. I feel comfortable in saying that. We also have initiated a very aggressive internal agency review to find out why these obligated unliquidated balances have accrued; what is the cause of them. I think we are very close to determining that.

We are also putting in place some management control review processes that we hope will become much more effective, particularly as we implement our new multi-family housing rules.

In conjunction with everything that Ms. Antonelli said, management flexibility is clearly the one thing that would help us the most.

Mr. GREEN. I guess you anticipated my next question. What are the most significant financial management challenges that you are facing right now? And what steps are you taking to address them? I suspect you have partially answered that question already.

Mr. DORR. The four things that I have outlined are clearly steps that we are taking to address them. Counselor Grahn indicated that he was going to get to you some contract language that I think you are interested in that may cast some additional light on this. And finally, I think collaboratively and collectively we need to review what it takes to essentially make a three-legged stool out of this, which involves more effective management, looking at our internal processes, as well as developing management flexibility. We generally know where we have to go, but I think it takes a little work to flesh it out in ways that make it clear and sensible to everyone involved.

Mr. GREEN. Ms. Antonelli, my time is running out, but if you could address that question as well?

Ms. ANTONELLI. We face a number of financial management challenges at the department and we are very determined to overcome them. Some of the management challenges that we face deal basically with people and systems. We have a very strong financial management team, first of all. That was a priority put in place, get some excellent people in here who could help us address some of our problems. Some of the priorities that I focused on, again, have related to our financial statements and, again, the proper accounting for our funds and making sure that we get clean audits.

We have updated our funds control policies and procedures for the first time in 20 years in the department, and we have detailed funds control plans for every single program now in the department. These are annual funds control plans, and within those plans all of our programs have to tell us what they will be doing in terms of the review of their obligated balances so we can determine again in looking at unexpended funds and what we should be doing there.

With respect to the financial audit, the Department of Housing and Urban Development has three material weaknesses and 10 reportable conditions. So again, we have significant challenges that we have to address. We have worked very closely with our IG and have a very good relationship, and have worked with them to develop corrective action plans for the first time. That puts the department on a path to eliminating these major material weaknesses that relate to our financial systems and many of our reportable conditions, one of them being addressing the issue of the review of obligation balances.

So we have challenges in many respects that we need to address. We are up to that challenge. We have detailed plans of actions. We are committed over the longer term by 2006 to significantly overhaul our financial systems. That will help us significantly improve the job that we are doing, to do it even more effectively, more efficiently, and provide better information in a more timely manner for Congress.

Mr. GREEN. Thank you. Thank you very much. Thank you, Madam Chair.

Chairwoman KELLY. Thank you.

I would like both of you to know that I am interested in whether there is an unnecessary duplication in housing subsidy programs. I am interested in redundancy. I am interested in overlap, because these are also areas where we can perhaps recapture funds, and if we can eliminate anything that might be a turf battle out there, so much the better, because our desire here is to get federal funds to the people who truly need to get housing from these programs.

Do either of you want to address that issue today, because I am probably going to pursue this a little bit further at some other venue, but if you would like to talk about that, if you feel prepared to do that, I would like to hear an answer.

Mr. DORR. Specifically with regard to the multi-family issues, I can honestly say that we have not pursued as aggressive a working relationship with HUD to tap into their resources or vice versa, as we have in our single-family programs. But I will tell you that Dr. John Weicher, the Commissioner for their FHA programs, and I have developed a very good relationship. They have been very cooperative in helping us to utilize some of their resources that enable us to automate some of our systems more cost-effectively and more quickly.

There is willingness, at least on our part, I know, and I believe at HUD, to work and collaborate on issues that specifically impact us in ways that reduce or eliminate redundancy. There is clearly a delivery mechanism in rural areas that is different from HUD programs in urban areas. I am fairly new at this, but my sense is that some of those delivery mechanisms are unique to rural areas versus the urban area delivery mechanism. There are some things that I think are unique that we effectively deal with. But we are definitely not opposed to collaborating, cooperating and looking for ways to ferret out redundancy and have in fact done this already in our single-family area.

Chairwoman KELLY. Good.

Ms. Antonelli?

Ms. ANTONELLI. I would just echo much of what Under Secretary Dorr has just said. The Department of Housing and Urban Development has and is more than happy and will continue to look at opportunities and work with the Department of Agriculture with respect to our programs, and again look at areas where we can work together more effectively, to the extent that that has not already been happening.

Mr. DORR. Madam Chairwoman, I would also like to point out that we just executed a memorandum of understanding between the U.S. Department of Agriculture and HUD with regard to collaborative working relationships on programs in the southwest border Colonias region. That was something that has been very effective. And we at USDA also executed an MOU with the National Association of Credit Unions to enhance our ability to finance housing and bring these opportunities more effectively to folks in those areas that need them.

Chairwoman KELLY. That is wonderful news. We appreciate that.

I note that some members, this is a busy day for a lot of people, and some members may have questions for this panel that they may submit in writing. So without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

We thank you very much for your time. We appreciate your testimony. This panel is excused with our great, deep appreciation. I want to briefly thank the members and staff for their assistance in making the hearing possible.

The hearing is adjourned.

[Whereupon, at 3:00 p.m., the subcommittee was adjourned.]

A P P E N D I X

July 8, 2003

OPENING STATEMENT OF REP. SUE KELLY

CHAIRWOMAN

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

"Saving Taxpayer Money Through Sound Financial Management"

June 25, 2003

Far too often, we in Washington see too much reckless and wasteful spending without regard for American taxpayers. I believe we must carefully examine every penny the federal government spends to ensure that hardworking American families are getting the most for their tax dollars.

The budget resolution passed by the House for the next fiscal year includes a pledge to search for and eliminate waste, fraud, or misuse in federal spending. This pledge represents a commitment to all Americans that this Congress will not take their hard-earned dollars for granted. The Subcommittee is meeting today to discuss how to fulfill this promise immediately.

With the Committee's encouragement, senior managers at the Departments of Housing and Urban Development and the Rural Housing Service, an agency within the Agriculture Department, are scouring decade-old accounts and contracts under their control. I would like to commend the two agencies for working diligently with this Subcommittee to identify funds that are available to reduce spending needs for future years.

After careful investigation, I am pleased to be able to announce that we have discovered over a billion dollars that were appropriated and obligated for a specific grant or subsidy but, for a variety of reasons, were never spent and are no longer needed for their original purpose. To date, we have officially found a total of $1.7 billion in unspent funds at HUD that can be used to reduce future spending. We have also located an additional $737 million in unspent funds at the Rural Housing Service, which the Agriculture Department is still investigating. To assist in these efforts to protect taxpayers, I would like to announce our request for a GAO study to determine how much of these funds can be recaptured.

Today, we have with us senior officials from both agencies to discuss their findings and what they hope to do with the funds they have found. We have also asked for, and received, a statement from the Inspector General of HUD, Kenneth Donohue, on his office's initiatives to halt waste, fraud, and abuse. These include work to recover improper payments for housing assistance and a new initiative to detect and prosecute fraud in the Section 8 program in collaboration with HUD management. The Subcommittee applauds these steps. By eliminating waste in these important housing programs, Secretary Martinez and Inspector General Donohue are ensuring that vital program funds are spent to help the beneficiaries as Congress intended. I ask the Subcommittee's unanimous consent to insert this statement in to the record.

I would like to thank the witnesses for appearing before the Subcommittee today. I look forward to your testimony.

STATEMENT OF ANGELA M. ANTONELLI

CHIEF FINANCIAL OFFICER

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

BEFORE THE
UNITED STATES HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
COMMITTEE ON FINANCIAL SERVICES

ON
"SAVING TAXPAYER MONEY
THROUGH SOUND FINANCIAL MANAGEMENT"

June 25, 2003

**"SAVING TAXPAYER MONEY
THROUGH SOUND FINANCIAL MANAGEMENT"**

Chairwoman Kelly, Ranking Member Gutierrez, and other distinguished Members of the House Subcommittee on Oversight and Investigations, on behalf of Secretary Mel Martinez, thank you for inviting the Department to testify on the status of unexpended balances that remain from funds that were previously appropriated by the Congress for HUD programs. I believe that HUD's leadership has worked diligently and successfully to reduce unexpended balances and to ensure that funds reach their anticipated beneficiaries as quickly as possible. After all, the benefits of Federal programs that are authorized and funded by the Congress are not realized until the funds are actually put to use providing assistance to low and moderate income families.

There are many who criticize HUD for what are perceived as very high, unexpended funds balances with large savings potential. At first glance, this is not an unreasonable criticism or reaction. As of the end of May this year, HUD had $108 billion dollars in unexpended appropriated funds, more than three times its requested appropriation for FY 2004. However, as this testimony will demonstrate, these balances do not represent either an inability of HUD's leadership to award and obligate funds or an opportunity to recapture these funds and use them for other purposes because the program recipients no longer need the funds.

Let me begin by trying to put the total unexpended balance of $108 billion in perspective. First, of these total balances $34 billion has yet to be awarded and obligated by HUD. The vast majority ($32 billion) of funds are not yet obligated because Congress only enacted the FY 2003 Appropriations Act in February and because several of HUD's programs are competitive grant programs. Given the time required to run a competition, funding for these programs are not obligated until late in each fiscal year or, like the Homeless programs, are not obligated until the next fiscal year.

This leaves a total of $74 billion in obligated balances that have yet to spend out. I would like to break this balance into two groups of programs.

Obligated Balances for Terminated Programs

First, as many of you are aware, Congress enacted long-term low-income assistance programs in the 1970s and the 1980s, many of which no longer receive annual funding for new project activity. However, these long-term programs were either fully funded at their inception or sufficient funds were provided to obviate the need for additional appropriations for many years to come. All of these funds are obligated against the projects, have been steadily spending out for the past two decades and will continue to do so for many years to come, until 2020 in some cases.

In total, over $34 billion in obligated funds remain for a variety of programs such as the Section 236 Interest Rate Reduction (IRP) program, Elderly Direct Loan program, Rental

Supplement and Rental Assistance Payments programs, Project-based Section 8 contracts and other smaller programs such as the Nehemiah and College Housing programs. Although many of these programs were terminated, the contracts, and therefore the obligations, have not expired and will continue to be expended over time. Of the $34 billion, $28 billion is obligated for Project-based Section 8 and debt service on the construction of public housing in the 1970s and early 1980s.

Should the Congress determine that these balances should be reduced and used for other purposes today, it must also be aware that future appropriations will be required to complete the contractual obligations into which the government has entered. Hence the Administration does not believe that these funds are appropriately considered "excess" and are available for recapture. However, once these contracts do expire, or for other reasons the project owner or grantee opts out or is terminated, HUD moves to recapture any funds that remain on a project.

By and large, experience has shown that recapturing funds from programs with long-term contracts can be difficult to calculate and risky. Projections of excess funds based on estimates of the remaining needs of these programs are extremely sensitive to projections of such economic dynamics as inflation and tenant income or wage rates. Even tiny changes in these variables will greatly change future estimates of need and recapturing the "excess" estimated today may lead to large additional appropriations in the future when these assumptions are not borne out and the government needs to fulfill its contractual obligations.

The one exception is the Section 236 IRP program, from which HUD recently recaptured approximately $700 million in what were believed to be excess funds. In this instance, HUD is completing a re-evaluation of the original estimate of need throughout the remaining active life of each contract. Many of these contracts have, for example, undergone restructuring under the Mark to Market program and others have either opted out or terminated their participation in the program. The President's budget assumes that $300 million of those funds will be available to offset the overall costs of HUD's programs in FY 2004. The remainder was used to fulfill Congressional mandates in FY 2002 and FY 2003.

Obligated Balances for Current Programs

What remains then is the roughly $40 billion in obligated balances from current programs, that is, those programs that are funded annually for new award activity by the Congress. These are the balances on which HUD leadership has been working so hard to reduce. Let me explain what some of the major balances are and what we are doing to keep them to a minimum.

Section 8 Housing Vouchers. In total, the Section 8 program has about $8 billion in obligated balances. However, of this amount, $6 billion are obligations from FY 2002 and 2003 appropriations reflecting the fact that Public Housing Agency (PHA) recipients have different fiscal years than the Federal fiscal year and there is a lag in their receipt of funds. These balances do not necessarily reflect a failure by PHAs to expend the funds properly since they are current year contracts that have not yet expired.

Over the past few years, HUD has moved to recapture all unused tenant-based Section 8 funds from all expired contracts, whether long-term project-based or annual tenant-based contracts. Since 1997, HUD has recaptured over $21 billion in unused Section 8 funds and has made the funds available for both Section 8 and non-section 8 activities as determined by the Congress.

In FY 2004, the President's budget assumes that approximately $1.4 billion in FY 2002 and prior year unused Section 8 funds will be made available to offset the costs of the program. HUD is working as hard as possible to ensure that annually it sweeps both the project based and tenant based programs and makes the funds available to offset the costs of the program. This, when combined with the Budget reforms enacted in the 2003 Appropriations Act, will ensure that future obligated balances will always be the lowest possible. This reform represents one of the most significant management improvements accomplished since the start of the Administration.

Public Housing Capital Fund. About $4.4 billion in obligated funds for modernization remain from funds appropriated from appropriations enacted from 1997 to 2002. PHAs have four years to spend the funds once they are obligated.

HUD is working closely with the Congress to enforce new laws that now require that PHAs must spend obligated Capital funds within four years and, if not, the Congress requires that HUD recapture the funds. The Department is also authorized to provide a $444 million bonus in FY 2003 to those PHAs that obligate and spend their Capital funds within the four year timeframe. We have already seen a dramatic drop in obligated balances, particularly for funds that are more than two years old. Since December 2001, total PHA funds not committed to specific local modernization projects have fallen from $3.4 billion to $700 million as of March 31, 2003, meaning that the funds are being used faster on modernization projects than ever before.

Special Populations. Currently, there are $4.4 billion in unexpended obligations for the Elderly and Disabled Housing programs. Seeing such a large amount of funds yet to be expended may make people think that the Department is not using its funding in a timely manner. However, the majority of the funds -- about $2.5 billion -- are associated with elderly 20-year and 5-year Project Rental Assistance Contracts (PRAC) for support of completed and occupied projects. A recent GAO report on the elderly stated that at the end of September 30, 2002, only about $700 million represented funding for projects that remained in the construction pipeline. The $700 million represents funds for some of the more difficult projects to bring to closure. For the most part, there are either unanticipated issues with the site, or the projects are involved in litigation. This Administration is very concerned that the funds provided for housing for the elderly and disabled are put to use as quickly as possible. We have made it a priority to clear the aged pipeline and have reduced the number of projects in that pipeline from 48 to just 7, and we expect to close on 6 of those during the remaining quarter of this year.

Community Development Block Grants (CDBG). Currently, $9.4 billion in unexpended obligations exists for the CDBG program. This total reflects $5.9 billion from last year's appropriation that also included special disaster supplemental funding for New York City. The remaining balance includes lesser amounts from prior year appropriations reflecting that CDBG funding of housing, infrastructure and other key program categories requires a multi-year spend-out to plan, design, construct and complete projects. Nevertheless, the Department has increased the efficiency of the program in meeting the current regulatory requirement that recipients not exceed an unexpended funding balance of 1.5 times the value of their most recent grant. In 1999, there were 309 communities that exceeded the requirement and through strict enforcement this number was dramatically reduced to fewer than 50 grantees currently, with the number expected to be reduced even further in the near term.

Conclusion

Ms. Chairwoman, I hope that I have been able to put a fresh perspective on what many believe are excessive unexpended balances in HUD programs. In the vast majority of cases, these unexpended funds are either fully committed to long-term projects and will be spending out normally for many years to come, or are obligations from relatively recent appropriations and could not reasonably be expected to have been expended at this time.

I also hope that I have been able to demonstrate that where real excess balances do exist, HUD has been aggressive in recapturing those funds and using them to offset the costs of HUD programs or for other uses specified by the Congress. In FY 2004 alone, HUD's budget assumes that over $1.7 billion in recaptured excess balances will be used to reduce the overall budgetary requirements for the Department.

Finally, I want to emphasize that while it is important to recapture real excess funds, our ultimate goal at HUD is to ensure that our grantees or other intermediaries expend the funds as fast as possible consistent with the rules Congress has enacted so that the low income families and communities across the country can enjoy the benefits that are intended by the Congress. Hence the real success story at HUD is the tremendous effort that is going into reducing unexpended obligations through improved program performance rather than recaptures.

For release only by the
House Committee on Financial Services
June 25, 2003
Room 2128 Rayburn House Office Building
2 p.m.

U.S. DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT

Statement of Thomas C. Dorr, Under Secretary, Rural Development, before the House Subcommittee on Financial Services.

Mr. Chairman and members of the Committee, thank you for this opportunity to testify on the Multi-Family Housing Section 521 Rental Assistance (RA) Program. The RA Program currently helps 264,000 households maintain their rental residence by providing a subsidy to pay the difference between the basic rent for the apartment and up to 30 percent of an eligible tenant's income.

Section 515 multifamily housing borrowers operate the RA program under contract with USDA. These contracts consist of a commitment from the borrower to operate an affordable housing property for the life of the mortgage and a commitment from the United States Government to provide funds to help residents make rent payments. At the start of the RA Program in 1978 until 1982, contracts were executed for 20-year (for new construction) and 5-year (for existing properties) terms. Contracts executed after that period are all 5-year contracts. All contracts continue until the obligated RA funds are depleted.

The General Accounting Office is reviewing the Section 521 Rental Assistance Program and has raised concerns about the unliquidated balances on the 20-year contracts and 5-year contracts on which rental assistance payments continue to be paid on units beyond the original terms. Rural Development has determined that there is $737,000,000 outstanding on these active contracts that were obligated between 1978 and 1998. This obligated amount remains outstanding for several reasons:

1) The 1978-1982 contracts were vastly overestimated mostly due to newness of the program;

2) Lower than projected rental assistance usage occurs as tenant income goes up and the gap narrows between 30 percent of income and the basic rent. As a result, less RA is needed;
3) Low usage is also experienced when vacancies at the property are higher than expected. This reduces the number of occupied units and may reduce the amount of rental assistance used by the property; and
4) Rental assistance units exist in perpetuity. If a property no longer needs RA on several units, the RA on those units is transferred to another property to provide RA for rent overburdened tenants. The usage on these units is subject to adjustment due to changes in tenant income and property occupancy conditions.

Of the outstanding $737,000,000, $525,000,000 (as of March 11, 2003) represents unlimited authority through the U.S. Treasury to fund the 20-year contracts made between 1978 through 1982. The outstanding obligations are termed "unliquidated obligations," which means unused authority to fund contractual obligations for that period. These are not dollars that Rural Development can access to spend to fund RA for new construction. These RA funds are only available for the current contracts or may be transferred to other units on existing contracts.

Unliquidated obligations are not unique to the rental assistance program; every program has obligations to be paid in the future by the Government.

The contract executed by Section 515 borrowers identifies a specific amount of rental assistance obligation. Changes in use would require these contracts to be renegotiated with the borrowers and legislation would be needed to provide more flexibility in the use of these funds. This would allow funds set aside for RA payments in the distant future to be used to fund more RA units today. We are willing to work with your Committee and the Appropriation Committee, General Accounting Office, and Office of Management and Budget to explore more flexibility in using this funding source, provided that this can be done without increasing the Government's exposure to future unmet funding needs.

The Committee has inquired about the inactive contracts in our portfolio. Those contracts fall into three categories:

1) Contracts that have not yet started paying out because the contract they are replacing has not yet exhausted all funds;
2) Contracts that have not yet started paying out because a new construction project has not been completed and started operations; and
3) Any property whose debt has been accelerated or is in foreclosure and RA is being held in abeyance until those legal actions are completed. Upon completion of these servicing action, the RA will begin flowing again at that property or another that needs the RA. In each case, these "inactive" contracts will be started or re-started.

Rural Development has taken steps to become more accurate in our projections of RA, including automation initiatives, RA review, Management Control Review, and Regulation 3560 proposed changes. Rural Development will continue to work with the Committee and other interested parties in reviewing the unliquidated obligations

Mr. Chairman, this concludes my testimony. Thank you for allowing me the opportunity to testify today. I hope I have clearly illustrated for you the status of the Rental Assistance unliquidated obligations. With your continued support, Rural Housing Service looks forward to continuing to work with Congress to provide decent, affordable housing to very low, low, and moderate income rural Americans.

Enclosure

Questions Submitted to Ms. Antonelli from Congresswoman Sue Kelly

1. **As recently as 1999 HUD could not timely close its books and complete a financial statement audit by the Federal deadline. Now there is a government-wide push by this administration to accelerate the preparation and audit of agency financial statements. Is HUD up to that challenge?**

   HUD is up to this challenge. We received an unqualified audit opinion on our consolidated financial statements for the last three consecutive years, an indicator of financial management stability. Completion of the most recent audit was accelerated by one month, from the end of February 2003 to the end of January 2003, and plans are in place and progressing for a further acceleration to mid-December this year and November 15th each year thereafter. The discipline of the preparation of interim financial statements throughout the year has enabled us to improve the timeliness of the year-end closeout process. Furthermore, we have worked closely with our independent auditors in the Office of the Inspector General (OIG) to conduct the audit process over the course of the year and to work with program offices to assure that information needed for the audit is provided to the OIG in a timely manner.

2. **The HUD Community Development Block Grant Program – or CDBG – is a popular program with States and localities. Ms. Antonelli, what is the situation with unexpended balances in this program area?**

   There are currently $14.4 billion in unexpended balances for the CDBG program. Of this amount, $5.0 billion is unobligated and $9.4 billion is obligated but not yet disbursed. With respect to unobligated balances, please note that nearly $800 million is associated with the post 9/11 disaster relief for New York and $4.05 billion of the unobligated amount is associated with the recently enacted FY 2003 appropriation.

   With respect to the obligated balances, $2.1 billion is associated with the New York disaster relief, and $4.1 billion in FY 2002 funds and $1.7 billion in 2001 appropriations are in the pipeline to spend out.

   Of the balances that remain, those that are associated with New York were given no expenditure time limit by the Congress and will expend out only as needed. The enacted appropriations expected that these funds would not be spent out this soon, given the kinds of activities involved, including the emphasis on capital projects.

   The Department has addressed a matter where CDBG funds were being obligated but not expended in a timely fashion. A significant number of CDBG grantees were exceeding the regulatory requirement that they not maintain a balance of 1.5 times their normal distribution of funds. The Department worked closely with these communities to work through this issue and ultimately informed them that funds might be taken back. As a result of the Department's efforts, the number of communities that exceeded this regulatory standard was reduced from 309 in 1999 to fewer than 50 grantees currently and we plan to further reduce the number to a de minimus level in the near future.

Enclosure

3. **What steps have you taken to minimize miscalculations in rental subsidy payments, as discussed in the HUD Inspector General's statement and reported by GAO with respect to both agencies?**

Secretary Martinez initiated the Rental Housing Integrity Improvement Project (RHIIP) to reduce improper payments in HUD's rental housing assistance programs. The comprehensive RHIIP strategy is designed to address the root causes of improper payments, through efforts to:

- Develop and implement statutory and/or regulatory program simplification proposals;
- Increase the sharing of available tenant income data from federal and/or state data sources, for upfront use in making correct rent and subsidy determinations;
- Provide a rent calculation software tool to better support the processing of rent and subsidy determinations by HUD's program intermediaries, as well as an automated subsidy payment validation process;
- Establish a periodic error measurement process;
- Design and implement a comprehensive Quality Control Program over the rent and subsidy determination and payment processes;
- Enhance program incentives and sanctions for tenants and administrative intermediaries,
- Update written program guidance; and
- Provide increased program training and education to tenants, administrative intermediaries and HUD monitoring staff.

4. **This administration inherited two violations of the federal Anti-Deficiency Act for spending more than the appropriations limit. What has been done to strengthen funds control to reduce the risk of future violations?**

In December 2002, HUD strengthened funds control policies and procedures by issuing the first update of HUD's Administrative Control of Funds Handbook in nearly 20 years.

The new Handbook requires funds control training for HUD staff that process funding actions. In October 2002, all HUD Allotment Holders were briefed on their role and responsibilities for maintaining an adequate system of funds control. In the past year, we arranged for the GAO to provide its Principles of Appropriations Law (PAL) course to over 250 HUD staff, and further training is scheduled.

The new Handbook also requires that all HUD Allotment Holders prepare and submit funds control plans for approval by the Chief Financial Officer (CFO).

Enclosure

FY 2003 is a phase-in year for implementing the Handbook and developing funds control plans for all allotments of funds. Annual submission of an approved funds control plan will be a condition of receiving new funding allotments beginning in FY 2004 and each year thereafter. The process of documenting funds control plans is proving very beneficial in terms of both: 1) clarifying and communicating actual processes that move within and between HUD's organizational cylinders to reduce the risk of error; and 2) providing a basis for assessing opportunities for short- and long-range systemic improvements.

In March 2003, an Appropriations Law Division was established in the Office of the CFO to advise and review the development of funds control processes and assist in the investigation and reporting of any future potential violations of the Anti-Deficiency Act. Also the Office of the Assistant Chief Financial Officer for Financial Management is overseeing funds control activity, including the performance of cyclical compliance reviews on adherence to funds control plan processes. As required by HUD's FY 2003 Appropriations Act, we submitted a spending plan to our Appropriations Committees for funds control and financial management systems improvements, which includes the conduct of cyclical compliance reviews, additional funds control training activities, and both short-range and long-range systems improvements.

5. **There have been numerous articles in the press recently concerning long waiting list periods for benefits under the rental subsidy programs. How do you reconcile this problem with the surplus in unliquidated obligations you have just outlined?**

Surplus unliquidated obligations, which may have possibly contributed to long waiting lists, exist for several reasons. In past years, the voucher program has suffered from tight rental markets that cause landlords to view rental subsidies as cumbersome and unnecessary. Additionally, some PHAs, as a result of complications and poor planning and management, failed to anticipate the number of vouchers it had to issue to spend the funds they were provided. In the past six years, the Department recaptured $15 billion from the tenant-based Section 8 program.

In the past several years, the Department and the Congress have taken a number of steps to improve utilization rates and reduce unexpended balances. These include: 1) merger of the certificate and voucher programs; 2) reforms to make the voucher program more attractive to landlords, such as expanded flexibility for PHAs to raise voucher payment standards to respond to changes and variations in local market conditions; 3) a requirement that recipients of new incremental vouchers have utilization rates of 97 percent or more; and 4) the changes in the methodology for providing renewal funding enacted in the FY 2003 appropriations act. Finally, the Department has changed the manner in which it budgets for the Section 8 program, shifting from providing funding for all contracted units, to only requesting funding for those units actually under lease or expected to be under lease during the fiscal year. The combination of these reforms will lead to decreases both in rental assistance waiting lists and unliquidated balances.

Enclosure

6. **The HUD Inspector General's statement discusses a massive mortgage fraud case that his office prosecuted in Charlotte North Carolina. His Office told us that the defendants have been convicted and for one defendant forfeited $8 million in property. Ms. Antonelli, can you tell us what efforts are being made to ensure us that this kind of fraudulent activity will be stopped before $30 million in false mortgages can be obtained? And Mr. Dorr, can you tell us what steps you are taking to minimize the risk of criminal fraud?**

Government National Mortgage Association (Ginnie Mae) has been working with the Federal Housing Administration (FHA) to setup an on-going automated process whereby groups of loans that back Ginnie Mae Mortgage Backed Securities are verified as having FHA insurance or are in the FHA process of getting insured. Ginnie Mae will require its insurers to buy out loans that are questionable from the Mortgage Backed Securities (MBS). Ginnie Mae will identify within 2 or 3 months of the MBS, loans that are not FHA insured. Ginnie Mae expects to have this process implemented by the end of calendar year 2003.

7. **I understand that in the voucher programs for tenant based housing you are unable to verify income statements electronically, but must rely on spot checks and initial screening of applicants. I also understand that a source for some of the waste and fraud in this program can be traced to those who by virtue of income do not qualify. Is there anything we can do to help in this area.**

Nearly two-thirds of HUD's estimated erroneous rental housing assistance payments are attributed to tenant income issues. Congress can assist HUD in substantially reducing the level of erroneous payments by providing the statutory authority needed to perform computer matching with available Federal sources of income data for verification of program participant income to correctly calculate benefit levels. That authority must extend the data sharing to HUD's third party program administrators who actually determine the housing subsidy benefits.

HUD developed a legislative proposal in conjunction with the Department of Health and Human Services (HHS) that would give HUD authority to conduct controlled computer matching with the HHS National Directory of New Hires (NDNH) data base for the purpose of sharing subsidized tenant income data with HUD's third party program administrators to correctly calculate rental housing subsidies. The proposal has been submitted as House Bill HR1030 and a Senate sponsor and enactment is needed. To address privacy concerns, HUD has developed a data sharing systems model that assures that third party administrators can only access income data on subsidized tenants covered by their housing assistance contracts with HUD. In addition, HUD is signing individual State agreements that would allow access to State wage and income data. The process also needs continued support and cooperation from the separate State agencies that hold the data.

House Financial Services Committee – Oversight Subcommittee
June 25, 2003, hearing
Follow-up questions

1. What steps have you taken to minimize miscalculations in rental subsidy payments, as discussed in the HUD Inspector General's statement and reported by GAO with respect to both agencies?

Rural Development has several initiatives underway with regard to Rental Assistance (RA). We have taken steps to improve the RA projections through a number of initiatives:

- Rural Development is currently reviewing all of its more than 17,000 contracts for consistency in contract language and to determine if funds must continue with the contract until fully disbursed.
- An automation initiative is underway to further improve RA forecasting. This initiative will create a process to automatically compute RA based on a 5-year term, with a fixed number of renewal units. RA renewal needs will be projected on a property-by-property basis rather than a state average. The target date for completion is November 1, 2003.
- Rural Development has assigned staff to participate in the development of a forecasting model to improve the accuracy of how RA funding needs should be projected.
- Rural Development is working closely with GAO in its review of unliquidated obligations.
- Rural Development published proposed rule 3560 on June 2, 2003, which will improve efficiency and consistency in administering RA from state to state.

Making changes in the administration of the RA program is one among several of the major innovations that Rural Development has undertaken in its Multi-family Housing Program. There is collaboration between our agency and states that offer a wage and benefit matching program to detect unreported and underreported income. Through wage matching, we can more accurately determine the appropriate subsidy for each tenant.

Additionally, we are updating and automating our web-based subsidy voucher computer program, called Management Interface Connectivity Network (MINC). MINC will enable property owners and managers to input subsidy voucher requests on-line and link directly to our financial management center in St. Louis. Incorporating this update will eliminate most manual entries and insert additional internal controls by providing an automatic payment validation process.

The Agency has issued a proposed regulation 3560 which consolidates, updates, streamlines, and clarifies all Multi-family Housing regulations, including those related to income verification and tenant certification. We also coordinate with other federal agencies to access their income information systems.

2. The HUD Inspector General's statement discusses a massive mortgage fraud case that his office prosecuted in Charlotte, North Carolina. His office told us that the defendants have been convicted and for one defendant forfeited $8 million in property. Ms. Antonelli, can you tell us what efforts are being made to ensure us that this kind of fraudulent activity will be stopped before $30 million in false mortgages can be obtained? And Mr. Dorr, can you tell us what steps you are taking to minimize the risk of criminal fraud?

Because Rural Development provides direct loans through its multifamily programs, we work directly with tenants, community leaders, management agents, and borrowers. This front line involvement has provided meaningful benefits, including experiencing first-hand the issues and problems faced daily by rural Americans, and the economic dynamics of small communities that have an affect on the performance of our loans. The overall benefit is that many potential problems are handled proactively, resulting in a stable and extremely low program delinquency rate of 1.5 percent (as of June 30, 2003).

We recognize the need to provide the field staff with assistance and have established a Compliance and Enforcement Initiative. This initiative will provide us with the ability to handle the more difficult and highly complex MFH financial cases. Field staff will have hands on help in the servicing of special cases, such as, liquidation, receiverships, negotiations with owners of distressed projects, Court actions, and negotiations with government agencies both federal and state to get issues resolved.

Many of the problems addressed by this Initiative are the result of a few abusive program participants. These program participants are borrowers who do not follow the regulations and take money from the properties they own and use it for their own personal use. A staff dedicated to detecting these problems will help guide, and in some cases, take over the negotiations with the difficult borrower to get a resolution to a problem that would be acceptable to the Agency and protect the tenants.

RHS will also continue work with the Office of Inspector General (OIG) to develop systems that can identify delinquent performers, document the case against them, and assist the Department of Justice in prosecuting them.

3. There have been numerous articles in the press recently concerning long waiting list periods for benefits under the rental subsidy programs. How do you reconcile this problem with the surplus in unliquidated obligations you have just outlined?

Rural Development has determined that as of March 11, 2003, there is $737 million in outstanding RA funds on active contracts obligated between 1978 and 1998. Of that amount, $525 million represents 20-year contracts entered into between 1978 and 1982. The outstanding obligations are termed "unliquidated obligations, and represent unused authority to fund contractual obligations entered into during that period.

Annually, Rural Development provides the amount of actual usage to the U.S. Treasury for offset against these contracts. The unused obligations do not represent dollars that Rural Development can access to spend in other ways. These RA funds are only available for the current contracts or may be transferred to other units on existing contracts.

To date, our Office of General Counsel opines that changes in use of unliquidated obligations would require these contracts to be renegotiated with the borrowers. This would allow funds set aside for RA payments in the distant future to be used to fund more RA units today.

We are committed to finding the appropriate method of recapturing unliquidated obligations while ensuring that we meet our contractual obligations to these borrowers. We will be pleased to work with your Committee and the Appropriation Committees, General Accounting Office, and Office of Management and Budget to explore more flexibility in using this funding source, provided that this can be done without increasing the Government's exposure to future unmet funding needs.

STATEMENT OF
KENNETH M. DONOHUE
INSPECTOR GENERAL
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

"SAVING TAXPAYER MONEY THROUGH SOUND FINANCIAL MANAGEMENT"

THE UNITED STATES HOUSE OF REPRESENTATIVES
JUNE 25, 2003

Thank you for inviting me to submit a statement for the record on areas where our audits and investigations have identified cost savings opportunities to the Federal Government. Additionally, we want to discuss other audit and investigative work where we found the Department can do more to detect and deter waste, fraud and abuse. My focus will be on some of our most recent endeavors.

Remaining obligated funds from expired contracts should be promptly identified and used to offset future budgetary needs

Most of HUD's funding obtained through its annual appropriation process are no-year monies. That is, the funding does not automatically expire and it is used to cover the obligations throughout the many years of the contract life.

HUD must recapture any remaining obligated funds when contracts are completed. Our annual financial audit looks for obligated balances no longer needed. At the close of fiscal year 2002, we identified more than $1.1 billion in obligations no longer valid and subject to recapture. This is over and above the $ 2.4 billion in Section 8 recaptures already identified by the Department ($1.1 billion project-based and $1.3 billion tenant-based). HUD's procedures for identifying and de-obligating these funds were ineffective. This internal control weakness has been reported each year in our financial audit since 1998.

Annually, HUD is required to perform a review of unliquidated obligations to determine whether the obligations should be continued, reduced, or canceled. We evaluated HUD's internal controls over this process. This year, as in prior years, we found: (1) some HUD program offices not performing the required reviews or not acting timely on review results, and (2) underlying HUD financial systems not supporting the process for identifying excess budget authority. As a result, funds that could offset future budgetary needs were not being identified in a timely manner.

Section 8 Program. HUD's Section 8 Program provides billions of dollars of rental assistance payments each year to qualified low-income households. HUD administers its Section 8 program in two parts. In general, HUD's Office of Public and Indian Housing (PIH) manages the tenant-based program and the Office of Housing (Housing) manages the project-based program. A contract for Section 8 assistance may cover multiple years and HUD reserves funds to cover the estimated needs. HUD needs to periodically identify excess program reserves from expiring Section 8 contracts. These excesses can be used to offset future budget requirements. Since 1997, HUD has made efforts to identify and recapture excess Section 8 budget authority. However, weaknesses in the review process and the lack of automated system interfaces between the Chief Financial Officer's general ledger and the subsidiary records maintained by the Office of Public and Indian Housing and the Office of Housing continues to hamper HUD's efforts.

Project-based Program. Project-based assistance is linked to specific housing units. Qualified residents in these subsidized units generally pay 30 percent of their income towards rent and HUD pays the difference. The project-based contracts—generally between HUD and the owners of private rental housing—were entered into beginning in the 1970s and 1980s, typically for 15, 20, or 40 year terms. For some of these long-term contracts, actual expenditures have proven to be lower than anticipated. In such cases, HUD can recapture the unneeded funds and use them to help fund other Section 8 contracts with insufficient funding. In addition, the long-term contracts that were entered into during the 1970s and 1980s, began expiring in the early 1990s. Initially contracts were renewed for several years. Currently, expiring contracts are being renewed for one year.

The Office of Housing has been hampered in its attempts to evaluate unexpended Section 8 project-based budget authority balances. The requirement to evaluate data from two payment methods, managed by two HUD accounting systems, has made this process difficult. In fiscal year 2002, HUD recaptured $1.1 billion in unliquidated obligation for expired contracts. There were other excess funds for Section 8 project-based contracts not being recaptured.

A review of the HUD budget estimate of shortfalls and excesses for project-based Section 8 contracts for fiscal year 2003 and outyears showed an estimated $365 million in excess contract authority expected to be realized during fiscal year 2003 related to expiring Section 8 project-based contracts that would be renewed. HUD's fiscal year 2003 budget request, nevertheless, included full funding for Section 8 project-based contract renewals. Housing did not have a process in place to estimate recoveries from expired contract authority associated with this group of contracts. Review of fiscal years 2001 and 2002 contract renewals showed an additional $123 million and $245 million, respectively, in excess contract authority that was rolled over to contract renewals.

In addition, our review of other Section 8 project-based contracts showed 259 contracts that had expired prior to September 30, 2001. These 259 contracts had $34 million in excess funds potentially available for immediate recapture. HUD needs to address data and systems weaknesses to ensure that all contracts are considered in the recapture/shortfall budget process.

Section 8 Moderate Rehabilitation Program. The Section 8 Moderate Rehabilitation Program is another form of project-based housing assistance administered by local housing agencies under contract with HUD. The program was created in 1978 to upgrade assisted rental housing units requiring moderate repair. HUD provides rental subsidies and administrative fees to contracted housing agencies. Housing agencies entered into multi-year Housing Assistance Payments (HAP) contracts with property owners. This program was funded for eleven years. These contracts require owners to rehabilitate their housing units and rent them to eligible families. As of fiscal year 2002, the majority of these assistance contracts had expired and, therefore, many projects had excess Section 8 reserves.

HUD had not reviewed the unexpended obligations in the Section 8 Moderate Rehabilitation Program since fiscal year 2000 when they recaptured $246 million in unexpended funds. As part of our 2002 financial audit, we requested that HUD update their analysis of these contracts through September 30, 2002. HUD identified an additional $217 million in unexpended funds for recapture. As a result, HUD adjusted its 2002 Consolidated Financial Statements for $200 million in excess unexpended funds. In April 2003, HUD recaptured the $200 million.

Tenant-based Program. HUD provides funding to Public and Indian Housing Agencies to administer the Section 8 tenant-based voucher program. Housing authorities make assistance payments to landlords who lease their rental units to Section 8 assisted households with vouchers.

In August 2002, HUD performed an analysis of budget authority for all years related to the Section 8 tenant-based program and estimated that approximately $1.3 billion of the unexpended budget authority was not needed and available for recapture. These funds were recaptured before the close of the fiscal year.

Section 236 Multifamily Mortgage Interest Reduction Program. HUD has been hampered in attempts to determine and account for unexpended Section 236 Interest Reduction Program (IRP) budget authority balances. HUD's reporting of commitments under the insured mortgage component of the Section 236 IRP program was not accurate. There was a difference of approximately $790 million between the subsidiary and general ledgers for the Section 236 program at the end of fiscal year 2002. The cause of the problem was the lack of an aggressive program to identify excess funds and an ineffective accounting system.

The Section 236 program was created in the 1960s and ceased new activity during the 1970s. The mortgage and assistance payments contracts typically run up to 40 years. This program includes making interest reduction payments directly to mortgage companies on behalf of multifamily project owners. Participants were given the right to prepay their subsidized mortgage after 20 years as an incentive to stay in the program.

HUD has historically chosen to estimate the amount of commitments reported in HUD's financial statements due to time needed to review manual records. Our review found the methodology used to make this estimate flawed. Consequently, commitments were overstated by approximately $128 million, and another $487 million in contract authority associated with prepaid mortgages was not identified and recaptured in fiscal year 2002.

As a result of our review, HUD processed an adjustment to the 2002 Consolidated Financial Statements for $705 million in excess unexpended funds. HUD plans to review the computation of estimated 236 subsidy payments using the proper amortization factors. In addition, for the Section 236 program HUD needs to: (1) review and de-obligate, where appropriate, unexpended funds no longer required; (2) strengthen procedures to remove expired contracts in a timely manner; and (3) develop an integrated automated accounting system.

Rent Supplement and Rental Assistance Payments (RAP) Programs. HUD is not recapturing excess undisbursed contract authority from the Rent Supplement and Rental Assistance Payments (RAP) programs in a timely manner. The Rent Supplement program and RAP, operate much like the current project-based Section 8 rental assistance program. Rental assistance is paid directly to multifamily housing owners on behalf of eligible tenants. HUD's subsidiary ledgers show, for each fiscal year, the amount authorized for disbursement and the amount that was disbursed. Funds remain in these accounts until they are paid out or de-obligated by the accounting department. At the end of fiscal year 2002, the general ledger balances for RAP and Rent Supplement totaled $2.18 billion. Our audit projected that at least $46 million in excess funds could be recaptured.

Other Operating Programs. Each program and administrative office was requested to review each outstanding obligation over $200,000. Exclusive of Section 8 (discussed above), $34 billion in obligations were identified. Our audit found that of the $34 billion reviewed; $94.3 million (1,094 program transactions) could be de-obligated. We followed up on whether the balances were actually de-obligated. As of October 11, 2002, 125 of the 1094 transactions with obligation authority of $34 million had not been de-obligated.

Improper Housing Assistance payments

Under the provisions of the U.S. Housing Act of 1937, HUD provides housing assistance funds through various grant and subsidy programs to multifamily project owners and housing authorities. These intermediaries, acting for HUD, provide housing assistance to benefit primarily low-income families and individuals (households) that live in public housing, Section 8 assisted housing, and Native American housing. In fiscal year 2002, HUD spent about $23 billion to provide rent and operating subsidies that benefited over 4 million households. Weaknesses continue to exist in HUD's controls that prevent HUD from assuring that these funds are expended for rent subsidies in accordance with the laws and regulations authorizing the grant and subsidy programs.

The Office of Public and Indian Housing (PIH) provides funding for rent subsidies through its public housing operating subsidies and tenant-based Section 8 rental assistance programs. These programs are administered by housing authorities (HAs) that are to provide housing to low-income households or make assistance payments to private owners who lease their rental units to assisted households.

The Office of Housing (Housing) administers a variety of assisted housing programs including parts of the Section 8 program and the elderly and disabled (Section 202/811) programs. These subsidies are called "project-based" because they are tied to particular properties, therefore tenants who move from such properties may lose their rental assistance. Historically, unlike public housing and tenant-based Section 8, most of these subsidies have been provided through direct contracts with multifamily project owners. HUD has responsibility for processing payments to project owners and ensuring that they provide support only to eligible tenants and that they comply with the contract, program laws and regulations. More recently, HUD has been contracting with "performance based contract administrators" who have begun taking over significant aspects of Section 8 contract administration. However, a sizable number of project owners remain that HUD must monitor.

Legislation authorizing HUD's housing assistance programs includes specific criteria concerning tenant eligibility and providing assistance for housing that meets acceptable physical standards. Moreover, legislation authorizing HUD's programs also establishes minimum performance levels to be achieved. For example, subsidized housing must comply with HUD's housing quality standards.

We continue to report concerns that HUD's intermediaries are incorrectly calculating housing assistance payments. HUD's control structure does not adequately monitor to ensure acceptable levels of performance are achieved. Also, there is an absence of an on-going quality control program that would periodically assess the accuracy of rent determinations by intermediaries. We also found significant control weaknesses in HUD's income verification process. These weaknesses related to tenant income, which is the primary factor affecting eligibility for, and the amount of, housing assistance a family receives, and indirectly, the amount of subsidy HUD pays. Generally, HUD's subsidy payment makes up the difference between 30 percent of a household's adjusted income and the housing unit's actual rent or, under the Section 8 voucher program, a payment standard. The admission of a household to these rental assistance programs and the size of the subsidy the household receives depend directly on its self-reported income.

A significant amount of excess subsidy payments occur as a result of undetected, unreported or underreported income. This year we reported on HUD's measurement of erroneous payments resulting from intermediaries' housing assistance billings for HUD's subsidy payments. HUD identified significant errors in the billings and payments processes, which also results in excess subsidy payments. By overpaying rent subsidies, HUD serves fewer families. The impact of payment errors of this magnitude takes on added significance in light of a HUD estimate that the "worst case housing needs" is around 5.4 million households; that is, unassisted very low-income renters who pay more than half of their income for housing or live in severely substandard housing.

A contract study completed in November 2000, substantiated there was significant risk in HUD's reliance on intermediaries to ensure that rent calculations for assisted households were based on HUD requirements. The study estimated that HUD incorrectly paid $2.3 billion in annual housing subsidies of which about $1.7 billion in subsidies was overpaid on behalf of households paying too little rent, and about $600 million in subsidies was underpaid on behalf of households paying too much rent based on HUD requirements. Last year, HUD revised this estimate to report an additional $978 million in overpayments resulting from underreported and unreported income.

With regard to detection of unreported income, HUD, Housing Authorities and project owners have various legal, technical and administrative obstacles that impede them from ensuring tenants report all income sources during the certification and re-certification process. Since unreported income is difficult to detect, HUD began pursuing statutory authority from Congress to access and use the Department of Health and Human Service's National Directory of New Hires Database to detect such income. In addition, HUD continues to encourage HAs to verify income and to computer match with State wage agencies to detect underreported and unreported income.

In fiscal year 2001, HUD initiated a Rental Housing Integrity Improvement Project (RHIIP). The project plans to address the problems surrounding Housing Authorities and project owners' rental subsidy determinations, underreported income and assistance billings. The Department also continued operations for large-scale income verification and matching involving Social Security (SS) and Supplemental Security Income (SSI) information. This information is made available to Housing Authorities, project owners and administrators of the Office of Housing's rental assistance programs who access the SS and SSI information via a secure Internet facility as a "front-end" way to verify income and annual tenant re-certifications. Our financial audit details the many efforts underway in the Department to improve the accuracy and reliability of subsidy calculations. We are encouraged by the Department's on-going actions.

Investigative initiative to focus on Section 8 Housing Assistance fraud

In concert with the President's Management Agenda, the OIG is announcing a newly focused, prioritized effort to detect and prevent fraud in Housing Assistance Programs. Prior to my tenure, rental subsidy fraud cases were generally assigned a low investigative priority. There had been a somewhat reluctance to investigate these tenant fraud cases because of limited financial payoff; that is, significant recoveries or prosecution were unlikely. We have received input from various Public Housing Executive Directors across the country that a more focused and publicized OIG effort would have a positive effect on accurate reporting. (We have decided to refocus our efforts in this area due to the increasing growth in tenant fraud.)

In an effort to outreach with the Public Housing community, I have addressed conferences of major public interest groups including the National Association of Housing and Redevelopment Officials and the Public Housing Agency Directors Association. It is well understood that HUD serves only a portion of those families needing housing assistance. Consequently, it is important that every dollar be spent for deserving participants with zero tolerance for fraud. Prosecutions will send a message that there are consequences for failing to report income. Persons not entitled to federal benefits will be removed to make way for eligible tenants.

The GAO now lists rental subsidy overpayments as one of the Department's high risk areas. While the amount attributable to fraud is unknown, the Department estimates losses linked to improper housing assistance payments to exceed one billion dollars annually. It is clear that OIG must address this problem using a systemic, multidimensional approach that not only addresses the individual cases referred, but also calls for a partnership with the Department to implement measures that will reduce the overall problem.

This multi-year initiative includes the following steps to assure a comprehensive approach to the problem:

1) **Identify the scope of the problem.** HUD has an automated tenant certification database and the authority to conduct income computer matches with IRS data. OIG will partner with the Department to statistically estimate the extent of rental subsidy fraud. HUD's Office of Policy, Development and Research is already conducting such studies, but this focuses primarily on subsidy miscalculations, not potential fraud. OIG will encourage them to expand their sample to include the fraud rate. By verifying the existence of fraud in the statistical sample, a nationwide fraud baseline can be established. This rate should be recalculated annually or bi-annually in order to measure progress and to determine which detection and prevention techniques are most effective.

2) **Use analytic techniques to extract the most egregious cases.** Income computer matching will be used to identify cases where tenants report little or no income, but wage data indicates significant unreported income. Various U.S. Attorneys offices have already been contacted to coordinate our activities. These cases will provide the basis for a tenant awareness campaign that should serve to deter future crimes.

3) **Identify systemic weaknesses in HUD directives/controls, or in PHA/management agent execution.** Problems often occur because HUD's instructions are not strong enough or program administrators may lack the know-how or will to implement controls effectively. OIG auditors and agents are working with program management staff to develop stronger controls and detection methods. By reviewing entities with high error rates, HUD will have the leverage to correct those administrators who are reluctant to conduct strong tenant screening and verification procedures.

4) **Develop a Rental Fraud training program.** HUD must invest in training new staff by creating certification standards that will continue to provide and enhance a skilled and educated workforce to administer HUD subsidy programs. HUD and its contractors need to teach PHA and management agent staff on ways to prevent, and to detect, fraud and errors. Awareness alerts could also serve as a way to reinforce a strong detection and sanction program, and to signal tenants that HUD will not tolerate fraud in its programs.

5) **Use various computer-matching techniques to test for the most effective methods to reduce crime.** OIG is currently working directly with the Executive Directors of various Housing Authorities in New York, Indiana, Illinois, Virginia, and the District of Columbia. OIG is also working cooperatively with the

Department's Rental Housing Integrity Improvement Program (RHIIP) staff. Presently, HUD is conducting a pilot program with 20 PHAs in Florida, Texas and Ohio to obtain State wage base data. The PHAs will conduct matching programs and will then make referrals to OIG.

OIG Special Agents' in Charge in all ten Regions are making Section 8/ housing assistance fraud an investigative priority, whether committed by a tenant, the Section 8 administrator, the Management Company, or the PHA employee. By announcing this today, it is my hope that our strategy will send a message that this is a high priority for our organization.

Timely and effective communications can go a long way in deterring program fraud

A recent investigative case in Charlotte, North Carolina, involved a major fraud scheme against Ginnie Mae and The Federal Housing Administration (FHA) whereby a mortgage lender placed fraudulent loans in mortgage-backed securities pools. Better communications between the two HUD organizations, FHA and Ginnie Mae, might have prevented this scheme from continuing for more than two and a half years and reduced the nearly $30 million in losses.

FHA insures nearly 1.3 million mortgages each year with an outstanding mortgage insurance portfolio of nearly $600 billion. The secondary market for these FHA loans is under another HUD organization, Ginnie Mae. The vast majority of FHA mortgages are pooled by Ginnie Mae-approved issuers. An issuer will group a pool of mortgages to form a mortgage-backed security. The sale of these securities frees up funds for additional mortgage loans. Approved Ginnie Mae issuers take the FHA monthly mortgage payments for those pooled mortgages and pass the payments through to securities holders. Ginnie Mae guarantees the pass through of these funds.

First Beneficial Mortgage Corporation (FBMC) of North Carolina was an approved FHA direct endorsement lender as well as an approved Ginnie Mae issuer. At the time the fraud was detected, this issuer had a Ginnie Mae mortgage-backed security portfolio worth $45 million. This issuer saw a window of opportunity to originate fraudulent FHA mortgages and then pool them into mortgage-backed securities. By using the investor proceeds from the sale of securities, the issuer was able to continue a "pyramid" scheme by appearing to pass through mortgage proceeds. Over 100 of the pooled mortgages in 11 Ginnie Mae pools were in fact fraudulent. FMBC systematically recruited strawbuyers to sign fraudulent and fictitious mortgage notes for vacant parcels of land. FBMC would then submit these false notes to their registered document custodian as backing for their securities as required by Ginnie Mae.

FBMC, as the issuer, was permitted to sell millions of dollars of Ginnie Mae securities without verification through, or by, FHA that these mortgages were appropriately insured. FBMC was continuing to issue pools using false documents. FHA and Ginnie Mae communications might have detected the fraud earlier. A simple verification by Ginnie Mae that the FHA pooled loans were in fact insured would have raised a red flag. Because of this case, Ginnie Mae has started a process of checking to see that Ginnie Mae pooled mortgages are, in fact, FHA insured. This control should detect improper pools within a few weeks of their origination.

FHA Single-Family mortgage fraud and debt collection activities

Single-Family mortgage fraud continues to be an investigative priority for the OIG. Our investigations of perpetrators of fraud include title companies, loan officers, mortgage companies and brokers, real estate agents, closing attorneys, and appraisers who through a variety of schemes submit fraudulent loan applications, appraisals, and other falsified loan documents and/or utilize straw buyers and other conspirators to effect the schemes.

Our Semiannual Report to Congress for the period ending September 30, 2002 reflected investigative recoveries of $59 million. During the same period, approximately 60% of our cases and 90% of our investigative recoveries was attributed to Single-Family mortgage fraud cases. During the first 6 months of this fiscal year, investigative recoveries are approximately $65 million, a figure which already exceeds our recoveries for all of fiscal year 2002.

Recent statistical information gathered from our ten regional offices shows that investigative efforts expended on these Single-Family cases involve approximately 1400 subjects who have originated more than $1 billion in loans affecting nearly 36,000 FHA-insured properties. These investigations are worked in coordination with 148 Assistant United States Attorneys and with numerous other federal law enforcement agencies.

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In conclusion, we are continuing to work jointly with Departmental officials to correct the many problems I have discussed. It is my understanding that the Department will be offsetting future appropriations with excess obligated balances. I am glad that our work with the Department and the Committee prior to this hearing contributed to this development. This week, my senior managers along with senior program managers in the Department are meeting in Philadelphia. We have characterized this meeting as a "fraud symposium" where we will identify fraud prevention and detection opportunities and work toward making HUD a more efficient and effective agency.

I have been the Inspector General at HUD for little more than a year. It has been a productive time. I have a well-trained and dedicated staff. Our goal is to ensure that the billions of taxpayers' dollars appropriated by the Congress for HUD programs are used effectively to provide safe, decent, and sanitary housing for millions of Americans. The structure of HUD and the diversity of its programs make this a formidable task. But working together with program staff and the Congress, I think we can take positive steps to make HUD operate in an optimum manner.

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