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New Directions in Housing and Urban Policy: 1981-1989

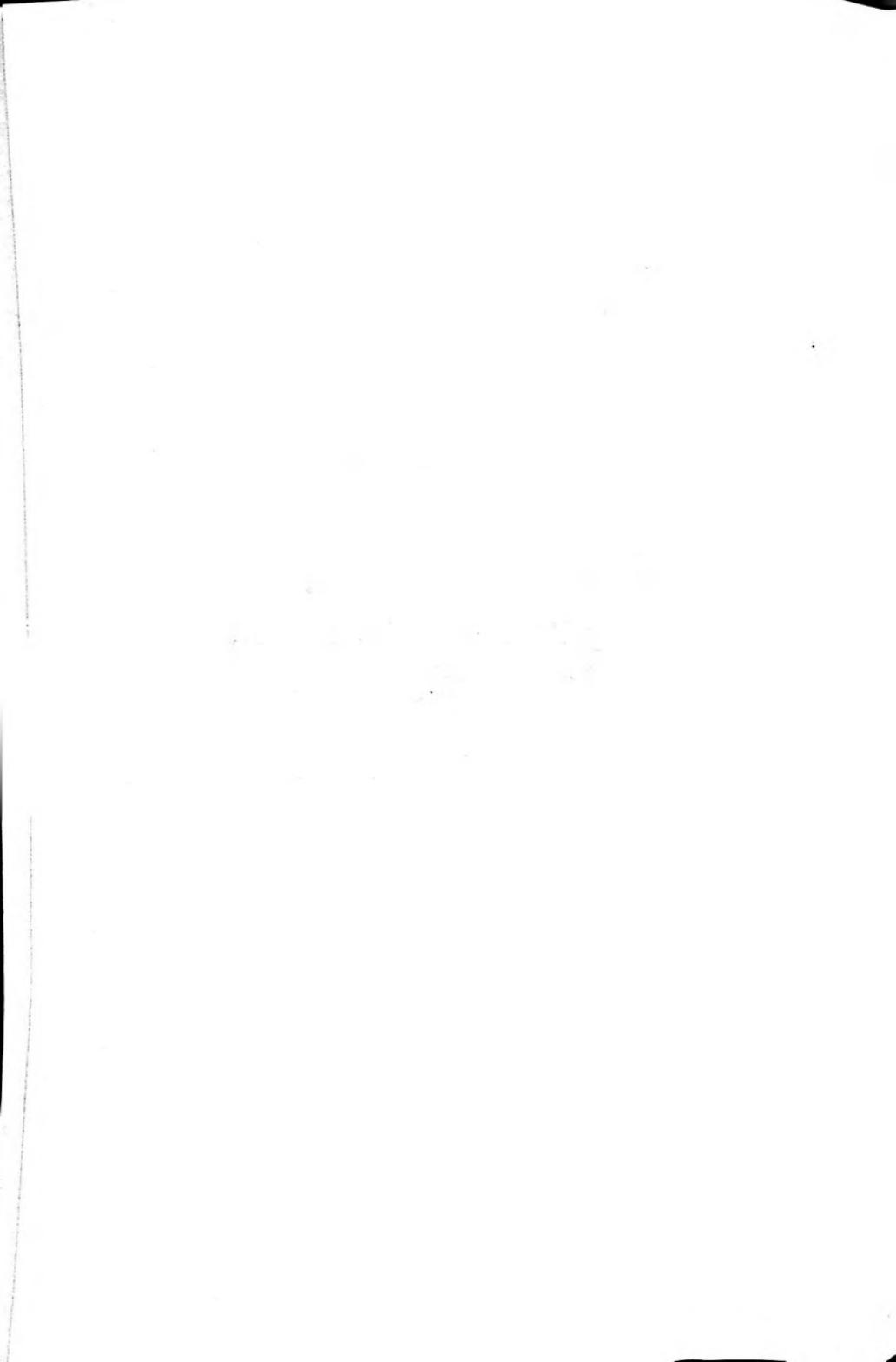
A Review of the Activities and Programs of the
U.S. Department of Housing and Urban Development

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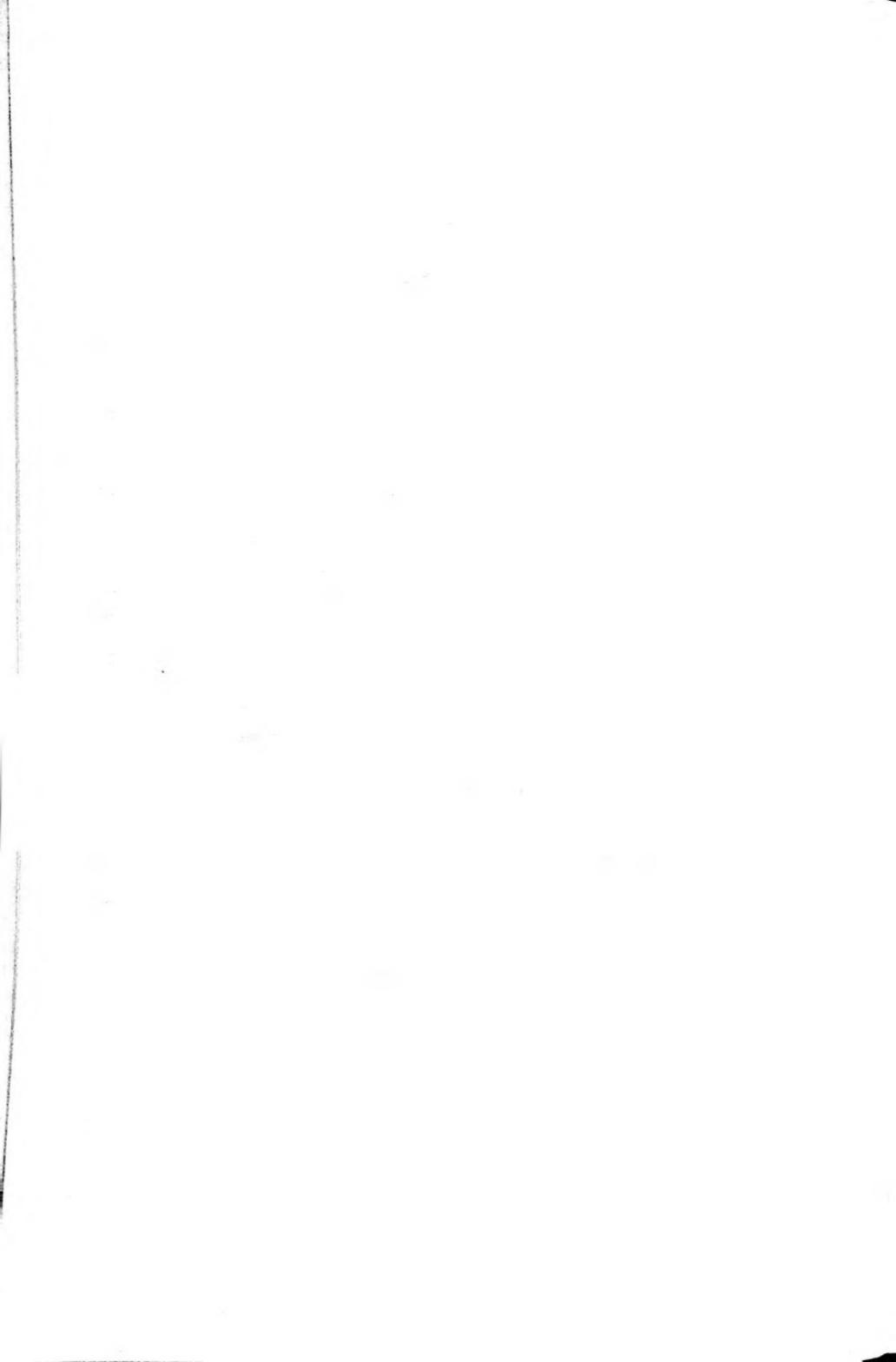
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Contents

Chapter I	HUD from 1981-1989: An Overview	1
Chapter II	Housing Assistance for the Needy	11
	Improving Public and Indian Housing	21
	Help for the Homeless	27
	Summary	30
Chapter III	Fostering Homeownership	33
	The Federal Housing Administration	33
	Easing the Path to Homeownership for Underserved Populations	39
	Government National Mortgage Association	45
	Federal National Mortgage Association	47
	Joint Venture for Affordable Housing	47
	Summary	50
Chapter IV	HUD's Role in Community Development	51
	Urban Development Action Grant Program	51
	State-Administered Community Development Block Grant Small Cities Program	53
	CDBG Entitlement Program	55
	Summary	61
Chapter V	Streamlining HUD's Management	63
	Regulatory Reform	67
	Summary	73
Chapter VI	Promoting and Strengthening Fair Housing	75
	Summary	81
Chapter VII	International Affairs	83
	Summary	87



HUD from 1981-1989: An Overview

The United States was entering a deep economic recession when the new Administration came to office in January 1981. Historically high interest rates and tight Government regulation had stalled industry, and the unemployment rate was rising. High inflation and heavy taxation strapped the consumer.

To combat these problems, President Reagan launched an Economic Recovery Program based upon four policy objectives:

- a substantial reduction in the growth of Federal spending;
- the prudent elimination of excessive regulation;
- a sizeable cut in the Federal tax burden; and,
- development of a monetary policy geared to stabilize the money supply and revitalize the economy.

The first two of these objectives held particular relevance for the Department of Housing and Urban Development (HUD), which is responsible for programs concerned with the Nation's housing needs, the development and preservation of its communities, and the provision of equal housing opportunity for every individual. HUD's incoming Secretary, Samuel R. Pierce, Jr., recognized an opportunity to reduce the cost of HUD's assistance through a redirection of housing and urban policy and the responsible reduction of the regulatory burden the Department's programs had been imposing upon State and local governments and the private sector.

Under Secretary Pierce, the Department enhanced homeownership opportunities by attracting increased investment - domestic and foreign - in mortgages and mortgage-related instruments; by streamlining FHA mortgage insurance and redirecting it to those not well-served by the private market; and by pursuing solutions to the problem of housing affordability. HUD sharply cut back the excessive paperwork requirements of its community development programs, while fostering local flexibility and decision-making and the proliferation of public/private partnerships in economic development. It made progress in helping the poor to meet their housing needs and drastically curbed the cost of such help. The Department continued and reinforced its support of equal housing opportunity and aggressively pursued strengthened enforcement of the Nation's fair housing law.

It was able to act on all these fronts virtually simultaneously through its various sub-Cabinet offices. Yet, one issue had gained particular prominence by 1981: the enormous cost of providing housing assistance to the most needy.

In 1981, the assisted housing debt* amounted to \$240 billion. It rose to \$244 billion in 1982, and was expected to reach a quarter of a trillion dollars the following year. Recognizing that a growing proportion of this mounting debt was attributable to the Section 8 New Construction Program, HUD's new leadership decided to sharply reduce, or terminate, the program, while developing more cost-effective means of serving the housing needs of the poor.

*The assisted housing debt is the total amount of money the Federal government owes States, banks, developers, public housing agencies, owners, and individuals to support housing for the families receiving housing assistance.

The long-term effectiveness of this plan of action may be measured by two key results: By the time the Administration left office in 1989 the assisted housing debt had been reduced to less than \$200 billion; at the same time, the number of assisted families had increased from 3.2 million in 1981 to 4.3 million by the end of 1988.

Housing Vouchers

To find a substitute for Section 8 New Construction, the Secretary solicited the recommendations of the President's Commission on Housing and of HUD's own Office of Policy Development and Research (PD&R). Both came up with the same answer: vouchers.

The basis for this recommendation included extensive research conducted during the 1970's under the Experimental Housing Allowance Program, and also a study by the Rand Corporation which found that the housing problem of the poor was one of affordability, not availability. That is, for the Nation generally and for most local areas, there was an adequate number of housing units available. (In fact, in the following eight years, rental unit vacancy rates actually increased from approximately 5 percent to approximately 8 percent.) The problem was that the poor could not afford the housing that was available in the private market. The need, therefore, was not for the building of new units but for an innovative way to help the poor pay for housing that already existed.

Vouchers held the promise of providing that help, and of doing so at less cost to the taxpayer. It was found that nearly three families could be provided shelter through vouchers, using existing housing, for the same amount of money it cost the taxpayer to assist one family by building a new unit for their use.

A voucher represents a payment to an eligible recipient that, generally, amounts to the difference between 30 percent of a family's income and the locally established payment standard for the unit occupied. A voucher is not tied to a specific unit of housing, but rather may be applied to the rent for any unit in the private market that meets HUD standards. Vouchers allow low-income families to shop for rental housing, just as other people do, offering them dignity and choice.

At the Administration's initiative, Congress authorized a voucher demonstration program in the Housing and Urban/Rural Recovery Act of 1983 (HURRA) and established vouchers as a permanent program in the Housing and Community Development Act (HCDA) of 1987, signed into law by President Reagan in February 1988. Under the demonstration phase, funds were appropriated for approximately 87,000 vouchers between 1984 and 1986. Most of these vouchers were used in support of the Rental Rehabilitation program. For the two following years under the permanent program, funds were appropriated for an additional 95,000 vouchers. A total of 150,000 families were using vouchers by late 1988.

Rental Rehabilitation

In addition to vouchers, HUD took a variety of other approaches to housing assistance between 1981 and 1989. One was to emphasize the rehabilitation of existing rental units to bring them up to standard. To avoid gentrification - the upgrading of housing beyond the ability of the needy to pay for it - goals were set requiring owners to rent units rehabilitated with HUD's assistance to low income families, often with the help of vouchers. To provide incentives for owners of such properties, HUD offered to subsidize up to one-half the cost of rehabilitation to a maximum of \$8,500 per unit. Again, at the Administration's request, Congress made this a permanent program in 1983.

The program proved effective not only in providing additional and improved housing for the needy, but also in attracting private as well as public investment to rehabilitation. Thus, by the end of FY 1988, over \$443.6 million in Federal funds had been committed to rehabilitate 117,791 units. Moreover, an additional \$847 million in private and public investment (a ratio of 2:1) was attracted to the rehabilitation effort for a total of \$1.3 billion.

Success in avoiding gentrification was measured by the fact that by 1988, 92 percent of the rehabilitated units were occupied by those whose income was below the median, and 58 percent of the assisted families had female heads of household.

Facilitating New Construction

HUD also increased housing for the poor by opening the pipeline of new construction for which HUD funds already had been committed. In early 1981, with mortgage interest rates around 18 percent and inflation at 13 percent, developers were unwilling to risk building the units for which they held HUD commitments. In fact, construction of such units was at a near standstill by the end of the previous Administration. In August 1981, to stimulate construction, HUD introduced the Financial Adjustment Factor (FAF), which provided for larger rent subsidy payments to sponsors of projects to compensate for the higher interest rate they would have to pay for borrowed funds. Overall, FAF accounted for 86,772 units which otherwise would not have been built.

Housing for the Elderly and Handicapped

HUD officials opted to continue new construction for the elderly and handicapped under Section 202 because the private sector was otherwise unlikely to meet this need. Nevertheless, by introducing new design features and competitive bidding for certain Section 202 projects, and by curtailing red tape, the costs for these projects were significantly reduced. In fact, the Administration's emphasis on cost containment proved so effective that, in FY 1985 alone, HUD saved an estimated \$100 million by these means in financing the construction of 12,400 units under Section 202 and Section 8.

Federal Housing Administration

HUD's authority to insure mortgage loans made by private lenders with the full faith and credit of the U.S. Government grew at an unprecedented rate between 1981 and 1989. The Federal Housing Administration (FHA), an arm of HUD, was authorized to issue mortgage insurance for less than \$40 billion in 1981, but at the Administration's initiative Congress raised this ceiling to \$96 billion in 1987. The Government National Mortgage Association (GNMA), another entity within HUD, increased its issuance of mortgage-backed securities from \$111 billion in 1981 to over \$500 billion by the end of 1988. Thus, in the eight years of the Reagan Administration, GNMA issued securities valued at almost four times more than it issued in the 13 years between its founding in 1968 and 1981.

Part of this growth reflected the success of the Reagan Administration's economic recovery program. As inflation, interest and unemployment rates declined during the 1980's, the demand for housing - and thus mortgage insurance - rose. The roles of FHA and GNMA in helping to meet this surge in demand were critical. That HUD met this challenge was no accident: it was the result of a policy, formulated and pursued by the Secretary of HUD and his staff and sanctioned by the President, to foster housing not only for the needy but across the board; to

help Americans realize the dream of homeownership, and thus help retain and create jobs in the housing industry. The availability of Federally guaranteed credit resulted in homeownership for 4,435,000 additional households between 1981 and 1989.

The preponderance of these homes were bought by low- to middle-income families. These were the families HUD targeted by proposing to limit FHA-insured mortgages to \$67,500 or, in high cost areas, up to \$101,250; by reducing down payment minimums from 5 percent to 3 percent on mortgages of \$50,000 and below; and by reducing family income requirements. In 1983, and again in 1987, Congress accepted these targeting proposals by the Administration and wrote them into law.

Congress also accepted HUD proposals for new and more flexible mortgage instruments qualifying for FHA insurance, such as Adjustable Rate Mortgages (ARMs) and Shared Appreciation Mortgages (SAMs), which also provided new homeownership opportunities for low- to moderate-income families. In 1988 HUD also helped develop Home Equity Conversion Mortgages, which were enacted in 1987.

Government National Mortgage Association

While FHA insures individual mortgages, GNMA guarantees securities backed by pools of such mortgages, thus creating a so-called secondary market that expands the credit available to finance housing. As noted, HUD's policies between 1981 and 1989 resulted in an unprecedented rate of expansion of the GNMA mortgage-backed securities program. The growth of GNMA securities by more than \$400 billion represents financing for about nine million homes.

This growth was fostered by specific HUD initiatives during the 1980's. First, GNMA began to guarantee securities backed by "jumbo" pools of mortgages originated by multiple lenders. This action enabled a larger number of lenders to participate in the GNMA program, thus increasing the availability of funds.

Second, GNMA launched a campaign in 1982 to attract investment in its securities by the trillion-dollar private pension fund industry. Consequently, by 1988 GNMA securities comprised the single largest type of mortgage-related investment by pension funds, accounting for over one-third of their mortgage-related holdings.

Third, for the first time in history GNMA securities were placed on the international market. GNMA obtained a listing for its securities on the Luxembourg Exchange in June 1983. In 1985 trading was initiated in Asia, and the first British unit trust ever based on mortgage-backed securities was announced. By 1988 an estimated \$10 to \$15 billion in foreign funds were invested in GNMA securities as a result of this initiative.

It was such HUD initiatives as these that brought an unprecedented flow of funds into housing in the U.S., and in particular for housing for low- and middle-income homebuyers.

Federal National Mortgage Association

In the mid-1980's a new investment vehicle for mortgage-backed securities emerged, called Real Estate Mortgage Investment Conduits (REMICs). It was estimated that REMICs might attract as much as \$60 billion into the mortgage market in the first year they were introduced, an estimate that proved to be low.

The Federal National Mortgage Association (FNMA) is a privately held corporation, regulated by HUD, with a mandate to increase the supply of funds for housing. When FNMA proposed issuing REMICs on an unrestricted basis HUD officials demurred. HUD determined that FNMA had certain advantages in the market over other private sector issuers of such securities, that competition would be hindered and the result would be a less efficient market; that is, the investment market for REMICs would be dominated by FNMA and less investment would be attracted to housing. Therefore, until October 1988 HUD withheld from FNMA unrestricted authority to issue REMICs, and the result was the entry of other private issuers into the market, greater competition, and larger infusions of funds for housing investment than would otherwise have been the case.

Joint Venture for Affordable Housing

During the 1980's HUD took steps to contain the escalating cost of new homes for middle-income families. Costly restrictions previously imposed by Environmental Impact Statements and Minimum Property Standards were responsibly eased, and the campaign for cost control was carried down to the community level through HUD's Joint Venture for Affordable Housing (JVAH).

Launched in 1982, the JVAH took aim at costly, excessively restrictive local building codes and fostered the use of innovative construction techniques. In line with the Administration's emphasis on public/private partnerships, HUD worked with national associations of private builders, developers, brokers and others, and — as an example of Federalism — worked with State and local jurisdictions to reduce building restrictions and red tape.

With results of early JVAH demonstrations showing savings of as much as 20 percent of the cost of comparable, non-JVAH houses, the program was accelerated. Between 1982 and 1986, 34 sites were authorized; 23 sites were added in FY 1987; in FY 1988, 175 sites were added, and the number of targeted sites proliferated.

All together, over 15,000 units had been produced nationwide under JVAH at average savings of over 14 percent per unit, without any sacrifice of quality or safety. Thus, while homes built under old existing codes and techniques were selling for an average of \$75,000, comparable homes in the JVAH program sold for about \$64,000. Projected overall savings for prospective homebuyers added up to almost \$170 million.

Moreover, JVAH was creating a bandwagon effect among community officials responsible for building codes. While restrictions were waived temporarily at the early demonstration sites, waivers were becoming permanent at an accelerated rate. Thus, 22 of the 175 approved sites for FY 1988 incorporated permanent regulatory reform at the outset, and the impetus seemed likely to carry forward through the 1990's and beyond. Among other advantages, the JVAH program required no direct Federal funding.

Public and Indian Housing

The number of public housing units increased from about 1.2 million to 1.3 million and the number of occupants increased from 3 million to 3.5 million between 1981 and 1989. In order to maintain public housing in good physical condition, during this period HUD made available \$8.5 billion in capital-cost approvals for public housing — the highest funding level in history for this purpose. Working with the 3,000 public housing authorities throughout the country, HUD focused on improved management for the most efficient and effective use of funds.

The Department took the lead in working with PHAs, residents, local officials and other agencies to combat the sale and use of drugs in public housing. At the same time, HUD sought to help residents improve their quality of life through new programs and demonstrations which would enable public housing families to free themselves from the cycle of poverty. Examples of these initiatives follow.

The Minority Youth Training Initiative, a demonstration that ran between 1983 and 1986, showed that young people in and around public housing projects could become self-supporting by learning skills in the building and maintenance trades. In collaboration with public housing authorities and through public/private partnerships with local business, HUD contributed \$2 million from modernization funds to the effort. About 75 percent of the almost 900 MYTI graduates found jobs, mostly in the private sector.

Project Self-Sufficiency (PS-S) was launched in 1984 to work with single parents in assisted housing. Again, HUD formed partnerships with local public and private sector groups to provide housing, day care for the children, and counselling, job training and placement for parents.

By 1988, 155 communities had participated in PS-S, and 134 of them reported that more than 29,560 single parents had applied to take part; 9,928 were selected. Forty-two percent had completed the program and either found full-time jobs or enrolled in college degree programs. HUD-prepared materials spread the word to other communities.

The Tenant Participation, Management, and Economic Development Project was designed to give public housing tenants greater responsibility for running their projects and also to encourage small business ventures by tenants. Endorsing the concept, Congress voted \$2.5 million to fund it in 1987, and in the summer of 1988 HUD awarded grants to 12 communities to develop it.

Helping the Homeless

HUD provided resources to help the homeless beginning early in the Reagan Administration. Because information about the dimensions of the problem and about the types of appropriate solutions was needed, Secretary Pierce initiated a study in 1983 to examine homelessness. That study, completed in 1984, found that 250,000 to 350,000 people were homeless at any given point in time. It also found that a large proportion of the homeless have serious disabilities stemming from mental illness, alcohol, or drug abuse problems.

As a result of the study, HUD examined its housing and community development programs and made modifications to improve their use for the homeless. HUD also undertook outreach activities to ensure that communities and organizations knew about the Federal resources. These efforts proved productive. For example, over \$165 million in Community Development Block Grant funds was spent during this period by States, urban counties, and local governments on activities to benefit the homeless. In addition, local housing authorities used some of their Section 8 certificate allocations for housing for the homeless.

Congressional action, primarily through the Stewart B. McKinney Homeless Assistance Act, established five new programs in HUD specifically targeted to the homeless. HUD gave the highest priority to implementing these programs and awarding the funds to recipients. Within three months of enactment and before the 1987-88 winter season, HUD had awarded 85 percent of the dollars available. By late 1988, HUD had provided nearly \$250 million of McKinney Act funds to communities across the country to help the homeless.

Community Development

A key Departmental goal was to help urban and rural communities mobilize their resources and attract investment in infrastructure, housing, and redevelopment. HUD officials approached this objective by implementing key Administration policies: Federalism, public/private partnership and deregulation. In all of HUD's principal programs in this area, the new approach worked.

A prime example was the Community Development Block Grant (CDBG) Small Cities Program. Prior to 1981 HUD administered this program directly, but in 1981 the States were given the option of taking responsibility for administering the funds themselves. By 1988 all but two States had picked up the option, and the results for economic development were dramatic.

The States tended to distribute available funds more widely, make smaller grants to more communities, and to emphasize economic development; which attracted investment from other sources. While the average grant to Small Cities under the HUD-administered program in 1981 was \$493,000, by 1988 the average State-administered grant was \$250,000. However, the smaller grants were leveraging private and public funds for economic development - in essence, new funds - at a ratio of at least four to one. Moreover, while only three percent of funds awarded to small cities were devoted to economic development in 1981, by 1988 the share of funds allotted to economic development had increased to 21 percent. Thus, smaller government investment, judiciously applied, spurred larger aggregate investment, creating jobs and enhancing local revenues in poorer communities throughout the country.

Simultaneously, HUD policies enabled the States to place greater emphasis on economic development in the use of CDBG entitlement funds. Deregulation accorded the States greater flexibility in developing public/private partnerships which resulted in more economic activity, even though the CDBG allotments were reduced as a result of Federal budgetary constraints.

The Urban Development Action Grant (UDAG) program was also honed by the new Administration and produced record results. Between FY 1981 and the end of FY 1988, \$3.4 billion in UDAG funds leveraged over \$23.3 billion in private investment in 2,311 projects nationwide, a ratio of better than seven-to-one.

With UDAGs, the creation of more than 411,000 new permanent jobs and more than 348,000 construction jobs, as well as the retention of over 63,000 jobs were anticipated. Moreover, cumulative UDAG investment in this period was expected to generate \$457 million in annual revenues for local governments.

While no new UDAG funds were appropriated after FY 1988 because of the Federal budget deficit, the UDAG experience demonstrated once again the value of the Administration's policies of decentralization, public/private partnerships, and deregulation in fostering economic development.

Towards the same end HUD sought Federal legislation to create Enterprise Zones in economically depressed urban and rural communities. This concept offered tax abatement and regulatory relief to such communities. The proposed program would be competitive, and designation would depend on the ingenuity of their Enterprise Zone designs.

In 1987, after repeated efforts by the Secretary and his staff, Congress passed Enterprise Zone legislation so limited that supporters of the concept were left to seek more effective legislation incorporating Federal tax incentives and regulatory relief. The concept took hold on the State level almost from the beginning of

the Administration, however, and HUD served as a clearinghouse for Enterprise Zone information for States and communities nationwide.

By 1988, more than 700 jurisdictions in 31 States and the District of Columbia had designated well over 1,000 Enterprise Zones and provided incentives, including tax exemptions relating to property, sales, motor usage, or inventory; fixed-asset or working capital loan pools; loan guarantees; and credits for hiring new employees, day care, training, or capital investments. These incentives created considerable business and employment.

An independent survey conducted in 1987 indicated that 67,400 jobs were retained and 113,600 new jobs created in the State enterprise zones. Capital investment in zones totaled \$8.8 billion nationwide.

Management of HUD

As noted above, by 1988, the goal of doing more with less had been reached at HUD. The Department's budget authority declined from \$31.9 billion in FY 1981 to \$15.4 billion in FY 1988. The assisted housing debt decreased from \$244 billion in 1982 to less than \$200 billion by 1988. And HUD actually increased the number of low-income families receiving housing assistance over the same period, from 3.2 million in 1981 to 4.3 million by the end of 1988.

Some of the reasons for this accomplishment are outlined above: a realignment of priorities that placed emphasis on the neediest and the under-served segments of the population; programmatic changes that focused on cost effectiveness; a policy of leveraging HUD funds by means of public/private partnerships; deregulation and decentralization. However, a key element of HUD's achievement in this period was a rigorous regime of efficiency in the Department's operations that was launched in 1981.

HUD's new management practices not only saved taxpayers money but improved service to the Department's constituents. Following are examples of initiatives and results during the 1980's:

- A 21 percent reduction in staff saved \$129 million annually.
- Improved financial forecasting and investment of FHA insurance funds yielded HUD about \$2.8 billion in investment income between FY 1981 and FY 1988.
- Cash management improvements saved HUD more than \$350 million between FY 1981 and the end of FY 1988.
- Reduced telephone, space, travel, and publication costs yielded \$33.6 million in savings between 1985 and 1988.

Significant improvements in debt collection were also effected in those years. When the Secretary asked in 1981 for an accounting of debt owed HUD, no one knew: such records were simply not available. Subsequently, new debt-tracking procedures and financial automation systems were introduced to supply the needed information. For the first time in HUD's history, a monthly report by region was instituted to keep track of delinquent debt for FHA programs. These and other aggressive debt identification and collection initiatives enabled HUD to increase debt collections, from \$1.8 billion in FY 1982 to \$3.8 billion in FY 1987.

In 1981, HUD's financial management systems were outdated. By 1985 most of these systems had been redesigned or upgraded to state-of-the-art technology, helping HUD managers improve their efficiency and effectiveness. As a result, for the first time since the early 1970's, the FHA insured fund has been certified by Price-Waterhouse as meeting generally accepted accounting standards. The fund had assets of over \$11.9 billion in 1988.

The Department also was reorganized to eliminate duplication, facilitate decision-making, and enhance HUD's responsiveness through its field offices, the level closest to the people affected by Washington's decisions.

A relentless campaign was waged at HUD between 1981 and 1988 against fraud, waste and mismanagement. The results, documented in the Inspector General's reports to Congress for those years, included: audits and investigations of program participants resulted in cash recoveries and savings of \$486 million; over 2,300 convictions of persons or firms doing business with HUD; and about \$307 million in unnecessary expenditures avoided.

The goal of HUD's personnel policies in the 1980's was to both reduce the number and improve the competence and performance of employees. Staff was reduced from 16,008 in January 1981 to 12,511 in September 1988, mostly by attrition. Personnel were also realigned to conform with the changed missions of the Department, and to that end training was stepped up. An Organizational Development Program expanded from 49 activities in FY 1985 to more than 100 in FY 1988. Supervisory and managerial skills and technical training for program specialists were emphasized. An awards program for employee suggestions produced ideas that saved HUD nearly \$19 million over the eight-year period, at a ratio of about \$100 in savings for every dollar awarded.

During this period HUD also contracted out to the private sector about one-third of its functions, realizing significant savings. The FHA Direct Endorsement Program, for instance, saved HUD more than \$50 million in staff time between FY 1983 and FY 1988.

Fair Housing

Repeated attempts before 1981 to strengthen the enforcement provisions of Fair Housing legislation included under Title VIII of the Civil Rights Act of 1968 had met with failure. However, Secretary Pierce led a sustained effort which resulted in the Fair Housing Amendments Act, passed by Congress in August 1988 and signed into law by President Reagan in September 1988. This Act made it easier for victims of discrimination to sue for redress and stiffened penalties against offenders. It also banned discrimination against the disabled and families with children, in addition to the classes already protected on the basis of race, color, religion, national origin, or sex.

The Administration also encouraged a Supreme Court decision legalizing "testing," a technique for identifying discriminatory practices. HUD in this period fostered public/private partnerships against discrimination, funding Community Housing Resource Boards working towards that end. In addition, HUD stepped up the drive to localize Fair Housing administration by encouraging State legislation that was substantially equivalent to the Federal law. Between 1968 and 1980 only 22 States and the District of Columbia had enacted such legislation. However, by 1988 the number of qualifying States had grown to 36 and local agencies to 79. As a result, the number of housing discrimination complaints which HUD referred to State and local agencies had soared from 434 in FY 1980 to 3,308 in FY 1988.

International Affairs

HUD achieved a number of "firsts" in the international field during the Reagan Administration. In addition to the offering of GNMA securities in overseas exchanges, as previously noted, new markets were opened abroad for U.S. companies offering goods and services in housing-related industries. Secretary Pierce

included top executives of such private firms in his missions to China in 1982 and to the Soviet Union in 1985, 1986 and 1987.

One example of the trade enhancement value of these initiatives was the participation of 116 U.S. firms from 26 states and the District of Columbia in an International Construction Exhibition held in Moscow in May 1987, making the U.S. the largest foreign exhibitor. Initiated and coordinated by HUD, the U.S. role at the Exhibition led to negotiations between U.S. participating companies and Soviet agencies involving the potential for hundreds of millions of dollars of trade.

Each of the issues touched on in this chapter is developed in greater detail in the following chapters. Together they constitute a record of what took place at the U.S. Department of Housing and Urban Development during the eight years of the Reagan Administration.

Chapter II

Housing Assistance for the Needy

The President's call for a "safety net for the truly needy," in a context of budget constraints, was a major challenge for HUD's new leadership. HUD officials were determined to do what seemed to some impossible in that first winter of deepening recession - simultaneously to increase the number of poor families HUD could help *and* decrease HUD's budget. How HUD achieved this goal is the theme of this chapter.

During his confirmation hearing before the Senate Committee on Banking, Housing, and Urban Affairs, Secretary Pierce made his objective clear:

I intend to quickly but carefully review the programs at HUD with a view toward cutting unnecessary costs and developing new ways of executing the Department's mission with fewer dollars.

That does not mean that I intend for HUD to turn its back on the poor, old, and needy, or to render a service of lesser quality to the public. On the contrary, I believe that if the efficiency of management of HUD is improved . . . HUD will be able to deliver a higher quality service with less money.¹

By 1981, HUD's cumulative obligations for housing assistance were nearing \$240 billion, with commitments running as long as 40 years into the future. In a period of high interest and inflation rates, Federal commitments of that magnitude constituted a threat to economic stability. A large and growing proportion of this debt was attributable to new construction under Section 8,² which was the costliest and least cost effective of the Department's housing assistance programs.

The new Administration decided, therefore, to propose terminating new construction under Section 8 and, at the same time, to develop alternative means of providing housing assistance to those families who needed it. The Secretary consulted with the President's Commission on Housing³ and HUD's own Office of Policy Development and Research (PD&R) on this issue, and both proposed vouchers as a key initiative. Essentially, a housing voucher represents a sum of money that a qualified recipient may present toward the payment of his or her rent.

A number of factors led to the voucher decision. A major one was a Rand Corporation study of the housing needs of low-income families. This study found that the primary problem of housing for the poor was one of *affordability*, not *availability*. That is, except for pockets of shortage in certain areas, enough rental housing units were in existence nationally to meet the demand. (The vacancy rate for rental units nationally was 5.2 percent in 1981; by 1988 the rate had risen to 8 percent.) The problem was that the neediest could not afford the market rents for available housing.

¹Hearing before the Committee on Banking, Housing, and Urban Affairs; United States Senate; Ninety-Seventh Congress; First Session; on the Nomination of Samuel R. Pierce, Jr., to be Secretary of the Department of Housing and Urban Development: January 13, 1981. Page 2.

²The statute referenced here is the U.S. Housing Act of 1937, which was amended by Congress in 1974 to include Section 8.

³This Commission, appointed by the President at the Secretary's request, consisted of leaders in the fields of housing and community development from both the public and private sectors. Their mandate was to contribute to the formulation of a national housing policy consistent with the Administration's overall objectives.

For example, a 1979 HUD study had documented that 51 percent of very low-income families (with incomes at or below 50 percent of area median income) residing in adequate housing were paying more than 30 percent of their incomes for rent - and 22 percent of them were paying over half of their incomes. If those figures were combined with the incidence of very low-income families paying over 30 percent of their incomes for inadequate shelter, the figure rose to 62 percent.⁴

The Voucher Initiative

A direct response to this challenge was a housing payments plan that subsidized families, rather than bricks and mortar. At any level of funding, more needy families could be housed with vouchers than by building new units. The voucher concept, plus a variety of other initiatives, offered the opportunity for a breakthrough toward the goal of cutting the costs of government and helping as many low-income families as possible.

The housing voucher gives low-income families access to the private housing market, offering them freedom of choice to select the type of housing and neighborhood they would like to live in. The family receives the difference between 30 percent of its income and the locally established payment standard which reflects the rent for a modest unit in their community.

Vouchers were an innovative approach to housing assistance, but the concept was not merely an untested theory. Another element of Section 8 of the housing statute had provided for helping needy families through certificates applied to the rent for existing units in safe, decent, and sanitary condition. Under this Section 8 Existing Housing Certificate program, HUD paid the landlord the difference between a fixed percentage of the eligible tenant's income and the monthly rental value of the unit in the private market. A ceiling was established on the total rent the family could be charged.

Thus, by 1981 it had been demonstrated that helping the needy pay their rent was far less expensive and more cost-effective than putting up new buildings for them. By putting the emphasis on housing people rather than building housing, more needy families could be housed adequately within HUD's budgetary constraints. While outstanding budget obligations for Section 8 new construction had reached \$92 billion, by contrast, obligations under the Section 8 certificate program totalled \$29 billion. The latter program was helping 23 percent more families at less than a third the overall cost of the Section 8 production programs.⁵

Building on this experience, and on the experience of an ongoing demonstration program,⁶ HUD developed the new voucher approach. The Department added or modified several features of the Section 8 Housing Certificate, to produce a Housing Voucher Program that was both more attractive to the recipients and less expensive to the government.

⁴U.S. Department of Housing and Urban Development and U.S. Department of Commerce, Bureau of the Census, *Current Housing Reports, Series H-150-77, Financial Characteristics of the Housing Inventory for the United States and Regions, Annual Housing Survey: 1977-Part C* (Washington, D.C.: U.S. Government Printing Office, 1979). NOTE: The Annual Housing Survey was renamed the American Housing Survey in 1984.

⁵*The Report of the President's Commission on Housing*. (Washington 1982), Page 15.

⁶HUD began the Experimental Housing Allowance Program (EHAP) in 1974 as a 10-year demonstration conducted in 12 cities throughout the Nation. Numerous studies were made of this program which tested various configurations for a voucher-type subsidy program and their impact on the supply and cost of housing, participation by diverse segments of the population, ethnic mobility, facility of administering such a program and other crucial issues surrounding this consumer-oriented concept.

Moreover, housing vouchers were intended to be "portable." Unlike Section 8 certificates, which were limited to use in a designated area and to moderate rehabilitation projects, vouchers could be used to help pay for any available housing of adequate quality in any part of the country where there is a participating public housing agency. This would allow recipient families to move to areas where employment opportunities were better, and provided them with unrestricted access to housing in any area.

Another new feature of the voucher program was the development of a "shopper's incentive," which put recipients in a better negotiating position with landlords. The recipient carried the subsidy, and could apply it to any rental unit as long as it met HUD's standards of adequacy. The actual rent charged would be negotiated between tenant and landlord without HUD setting a ceiling.

The crux of the shopper's incentive, however, was that if a tenant could find a safe, decent, and sanitary unit that cost less than the locally established payment standard, the fixed HUD portion of the rent would remain unchanged. As a result, the tenant's contribution to the total rent would decrease. Therefore, rather than paying 30 percent of income towards rent, the tenant would pay, for example, 25 percent of income towards rent and could pocket the 5 percent difference. Conversely, tenants would be free to pay more than 30 percent of their income for rent if they choose to do so, without affecting their eligibility for the voucher payment. This would make it possible for individuals to live in the neighborhoods of their choice for whatever reason - proximity to jobs, better schools, a safer drug-free environment, etc.

Housing vouchers also made it possible to integrate the poor into the larger community. This was difficult, and sometimes impossible, with housing construction programs. Although some did provide "scattered site" housing for low-income households, most subsidized construction had resulted in multifamily, high-density housing predominately - if not exclusively - occupied by low-income individuals or families. This "warehousing" of the poor, ironically, had created ghettos almost as hard to eradicate as those which housing assistance programs had been developed to eliminate.

Finally, the Voucher Program was designed to give HUD greater flexibility in budgeting. Under the Section 8 Existing Certificate program, the Federal Government was obligated to commit 15 years of budget authority for every contract. The fact was, however, that families generally participated in the program for less than 5 years. Therefore, the voucher commitment was designed to run 5 years, thus focusing on current needs without tying up funds for an unknowable future.

In government, of course, change takes time. Designing a viable voucher program was one thing; translating it into law was another. In order to win support for vouchers, Secretary Pierce focused on the task of forming a consensus in its favor both within and outside the Administration.

For instance, he had to win over those who clung to the idea of new construction as the primary means of housing assistance, either out of conviction or profit-motivated interest. (Some developers and investors had done well with government-subsidized construction.) There were also some political people who found new buildings more tangible and visible vote-getters than vouchers were likely to prove.

At the other end of the spectrum, some people feared that vouchers might wind up being an entitlement program costing more than Section 8 New Construction. However, Secretary Pierce assured these critics that housing assistance programs had never been entitlement programs, and that there was nothing in the Voucher Program to change that.

Congress finally included a voucher demonstration in the Housing and Urban/Rural Recovery Act (HURRA) of 1983, which was signed into law on the last day of November of that year. Winning the right to implement a modest-sized voucher program on a "demonstration" basis was the culmination of nearly three years work, designing and redesigning it in the light of political and budgetary realities and explaining its advantages to all concerned.

Even so, many at HUD regarded the new voucher authority as only a partial victory, feeling that Congress should have authorized a full-fledged broad-based voucher program. However, with this start, the Secretary was confident that vouchers would quickly be established as the key instrument of housing assistance for the needy for years to come.

Subsequent experience with vouchers tended to support this conviction. Appropriations for a total of 52,000 vouchers were provided in 1984 and 1985, and an additional 35,000 were funded in the 1986 budget. In 1987 the number of vouchers appropriated was 48,000; another 45,000 vouchers were added in 1988.

Any new program requires a "breaking-in" period, and the Housing Voucher Demonstration was no exception. Adjustments were gradually made to meet start-up problems, and before long the program's inherent benefits began to emerge. Recipient families also began to appreciate the expanded options that the shopping incentive afforded them. Moreover, as local public housing authorities and eligible families came to recognize the overall benefits of vouchers, the demand for them exceeded the Congressional allocation.

In order to analyze the Voucher Demonstration thoroughly, HUD contracted for an independent research evaluation. A report on first-year findings was issued in June 1987. The report, which focused on 20 of the Nation's largest local and State public housing agencies, compared the relative effectiveness of vouchers and the Section 8 Existing Housing Certificate Program in meeting the needs of recipients.

A key finding was that the rent-subsidy principle underlying both programs was working better in the mid-1980's than in the late 1970's. While less than half of the eligible families found units meeting HUD housing standards in the 1970's, by 1986 nearly two-thirds of the families were able to find such units.

The study also indicated that the distinctive features of vouchers - greater rent flexibility and the shopping incentive - had begun to catch on. One-fifth of voucher participant families were paying less than 20 percent of their income for housing. While other voucher families were spending a larger percentage of their incomes on housing, program experience suggested that they were choosing carefully. For example, a number of elderly households were using their vouchers, together with a higher out-of-pocket payment, to rent apartments with an extra bedroom. Also, large families were renting better-quality single family housing by paying somewhat more than the rent level set by the government.

In announcing the findings, Pierce noted: "We can see from these demonstration results that the voucher approach is working well, and is giving low-income tenants a broad range of choice for their housing. We fully expect that (future studies) will show that the greater freedom of choice offered families participating in the program will prove to be a key ingredient in addressing the housing needs of low-income families." In light of these assurances, Pierce called upon Congress to increase the level of housing voucher appropriations and to remove restrictions on the availability and flexibility of vouchers.

The evidence of vouchers' success had become clear. In 1987, Congress agreed and, as part of the Housing and Community Development Act of 1987, made the Housing Voucher Program a permanent vehicle for helping to house America's needy. By the end of 1988, 150,000 families were using vouchers to help pay the rent for their housing.

Rental Rehabilitation

Another major component of the new approach to housing assistance was to expand the supply of safe, decent, and sanitary housing for low-income families by rehabilitating existing units. Since government-subsidized new construction was both costly and inefficient, restoring rental homes and apartments to livable standards was explored as an alternative.

Rehabilitation, of course, was not a new concept. On an official visit to Western Europe in 1981, Secretary Pierce had inspected multifamily housing that had been repeatedly rehabilitated and remained liveable for a century or longer. The approach taken by HUD, however, was new. Substantial rehabilitation under Section 8 had often proved inordinately expensive. In many cases, where buildings had been gutted and then rebuilt, costs could be as high as - or even higher than - new construction. However, the President's Commission on Housing had identified some 2.6 million rental units that could be rehabilitated at modest cost and occupied by families eligible for HUD housing assistance.

These considerations gave rise to the Rental Rehabilitation Program, which was enacted into law in November 1983. The efforts of local communities in using their Community Development Block Grant (CDBG) funds for housing rehabilitation provided a valuable precedent for the development of this program. HUD's policy-makers recognized from the evidence of those initiatives that local officials already possessed the capacity to administer housing rehabilitation programs. By using a private market approach involving the development of other resources, and limiting the subsidy to 50 percent of eligible rehabilitation costs, up to \$8,500 per unit, the Federal government did not have to bear the total cost of the renovations. Also, by providing vouchers as rental subsidies to eligible tenants living in or willing to move into rehabilitated units, HUD was not required to provide 15- or 20-year subsidies and regulatory controls over each unit, as previous housing assistance programs had demanded.

HUD's Rental Rehabilitation Program thus reflected all of the goals of the Reagan Administration. First, it was structured to maximize local control and flexibility. Local officials, rather than the Federal government, would determine the specific uses of Rental Rehabilitation funds in their communities. They could use the funds to provide interest rate subsidies; to offer loans rather than grants; or to utilize combinations of loans and grants in their programs. The possible configurations were almost unlimited.

In addition, the Rental Rehabilitation initiative mandated that HUD's contribution would have to be matched dollar-for-dollar with funds from other sources. Thus no more than half the cost of rehabilitation could be provided through this program.

This was an obvious financial advantage, because it allowed HUD's resources to generate at least twice as much in capital investment for residential rental units. In fact, every Rental Rehabilitation Program dollar generated two dollars from other sources, primarily private funds. Again, however, communities were allowed the flexibility to use their CDBG or other public funds, or to determine that the matching funds had to be provided through the private sector.

A one-time capital commitment to rehabilitation provided yet another financial advantage of this program. Unlike other housing programs, which continued payments over a number of years for the rehabilitation of units, HUD's Rental Rehabilitation Program provided one-time, up-front assistance. As a result, HUD would not be continuing the spiral of unexpended funds which had plagued the Section 8 program. Nor would the Department need to control the operations of each project for a long period of time.

The Rental Rehabilitation Program became operational in communities around the country in October 1984. The program's performance in producing standard, rental housing affordable to lower-income tenants was impressive. The following highlights illustrate the extent and nature of the production and the low-income benefits by the end of Fiscal Year 1988:

- \$443.6 million committed to rehabilitate 117,791 units.
- That \$443.6 million generated \$847 million (1:2 ratio) in other funds, for a total of \$1.3 billion invested in the rehabilitation of these units. The average total rehabilitation cost was \$10,956; and the average Rental Rehabilitation subsidy was \$3,766 per unit.
- Completed units numbered 70,885, representing \$248.9 million in program funds.
- The program required that 70 percent of the funds be used to rehabilitate units that have two or more bedrooms and 15 percent of the funds be used to rehabilitate units having three or more bedrooms. By September 30, 1988, 71 percent of program funds were used to rehabilitate units with two or more bedrooms and 20 percent of program funds were used to rehabilitate units with three or more bedrooms.
- The program required that 70 percent of the funds be spent to benefit lower-income tenants. The actual lower-income benefit was 92 percent, and 71 percent of the households initially occupying rehabilitated units had incomes below 50 percent of the median.
- Fifty-eight percent of assisted families had female heads of household.
- As of September 30, 1988, 169 of almost 600 grantees committed 90 percent or more of their available funds from Fiscal Years 1984, 1985, 1986, and 1987.
- Most of the funds were directed to the smaller rental properties, which had been neglected in previous HUD housing programs. The average project size was four units.
- The program had been adopted by both large and small communities. Grants were based on a statutory formula and ranged in size from as little as \$50,000 annually for small cities to as much as \$20 million in one year for New York City, which alone received 10 percent of the total national appropriation.

Together, housing vouchers and the Rental Rehabilitation Program represented a new and balanced approach to housing assistance: providing flexibility and mobility for assisted families to live where they chose; and expanding the supply of standard, affordable housing. At the same time, this approach pointed to greater conservation of the Nation's housing stock, which could be used to supply the basic housing needs of lower-income families. It involved increased local decision-making, and increased emphasis on public/private partnerships. Moreover, the elimination of Section 8 New Construction made cost containment a reality. The door was opened for helping more needy people while using less Federal money.

Housing for the Elderly and Handicapped

By 1981, more than 11 percent of the U.S. population was elderly; with improvements in medical technology, they were expected to account for 20 percent of the population within the next 50 years. A considerable proportion of the elderly fell into the low- or very low-income category.

In their efforts to determine the basic housing needs of low-income Americans, HUD officials considered the special needs of these poor or near-poor senior citizens. They also heard from advocates of programs for the handicapped, and concluded that both these groups had special housing requirements that were not being met in the private sector housing market. It was clear that there was a need to continue HUD's Section 202 program, which provided for new construction of housing for the elderly and handicapped - housing that would not be produced in sufficient quantity without Federal subsidy.

However, in the past various inefficiencies had developed in the administration of the Section 202 program, and HUD officials determined that the program needed improvement. Numerous changes were effected to streamline the program and to tailor it to meet the needs identified in HUD's research and the findings of the President's Commission on Housing.

The Section 202 Program provided loans directly to non-profit sponsors for construction of housing for the elderly and handicapped. The law stated that HUD would establish the interest rate charged on the loans, on the basis of the Treasury Department's costs of funds.

As with other HUD subsidized programs, however, reservations for Section 202 projects for the elderly and handicapped were at a standstill in 1981 because of high inflation and interest rates. Borrowing was so costly that it was necessary to provide developers with additional incentives to build Section 202 projects. If housing for the elderly and handicapped was to be produced once again, action was essential.

Congress therefore mandated an artificially low interest rate to stimulate action on projects in the Section 202 pipeline. But there were still problems in keeping the pipeline flowing.

HUD regulations provided that fund reservations for Section 202 projects could be canceled after 18 months if the borrower had not begun construction and was not making satisfactory progress toward the start of construction. In 1981, there were projects in the pipeline that dated back to 1976. While HUD's paperwork requirements created some delays in construction starts, that alone could not account for 5-year-old reservations.

Early in 1982, HUD initiated a policy to speed up the application and processing procedures, so that the projects for which funding had been reserved would be developed more quickly. This also enabled HUD to weed out the applications for projects which were unlikely ever to proceed to the construction stage;⁷ and also provided a number of cost-containment measures.

Containing Costs in Section 202 Projects

In order to maximize the annual increase in the number of elderly and handicapped persons being served, HUD initiated measures to assure cost-effective building design. Because a high percentage of individuals in projects for the

⁷In 1984, HUD officials also adopted an Extension Policy, to accommodate unanticipated but reasonable delays in the completion of Section 202 projects; the policy was updated in 1987.

elderly lived alone, HUD required that at least 25 percent of all Section 202 projects consist of efficiency units. The same requirement was not imposed in projects for the handicapped, however, because handicapped individuals often live in larger family units.

HUD decided that sponsors of Section 202 projects should use competitive bidding to select contractors in order to obtain the best product for the least cost. However, Congress modified HUD's proposal by stipulating that competitive bidding would be required only in more expensive projects of sponsors that were not union-affiliated.⁸ This partial acceptance of competitive bidding did assure some savings, if not as substantial as would have been realized from the original HUD proposal.

In fact, those savings were documented in a special study of 12 Section 202 projects where competitive bidding had been used to choose the general contractors. The results showed an average savings of \$3,837 per unit for the 759 units that were built. The average savings per project was over \$242,000 - for a total saving for all 12 projects of almost \$3 million. This clearly showed that competitive bidding would enable HUD to provide more housing for the elderly and handicapped with the resources appropriated by Congress.

In most other instances, controlling costs for the Section 202 program involved minimizing construction or rehabilitation expenses. HUD was also able to reduce the costs of the program through various other initiatives. For example, sponsors of small projects were allowed to submit less detailed documentation of their costs, and HUD improved the efficiency of its debt collection practices.

The overall effects of the cost containment effort were gratifying. A study produced by the Urban Institute in 1984 verified a 15 percent reduction in the cost per unit for the Section 202 program.⁹ This meant more elderly and handicapped individuals could be housed more quickly and efficiently.

A subsequent audit by the General Accounting Office (GAO) of HUD's revised cost containment requirements for the Section 202 elderly housing program also substantiated their cost effectiveness. The GAO reviewed 179 projects, with almost 12,000 tenants, and found that construction costs for projects built under cost containment procedures averaged 16 percent less than those of projects built before the new requirements were imposed. It was further estimated that it would have cost about \$100 million more to finance the 12,400 units HUD approved for funding in Fiscal Year 1985 under Section 202 and Section 8 if these cost containment procedures had not been implemented.

A total of \$5.28 billion was reserved between 1981 and 1988 for Section 202 direct loans to build or rehabilitate 108,000 units, located throughout the country, for the elderly or handicapped.

Clearing the Section 8 Pipeline

The 1981 decision to discontinue new construction under Section 8 left the Administration to grapple with the problem of prior commitments under this program. The challenge was to honor commitments which were economically feasible, but at the same time take every opportunity to contain costs.

⁸Included in the Housing and Urban/Rural Recovery Act of 1983.

⁹Margery Austin Turner, *Building Housing for the Low-Income Elderly: Cost Containment and Modest Design in the Section 202 Program*. Washington, D.C.: Urban Institute, May 1984, Page 46.

There was also a time factor. The ravages of high inflation and interest rates in 1979-80 had all but stopped new construction of multifamily rental projects. If the low- to moderate-income families in need of housing were to be served, new units had to be made ready for occupancy as quickly as possible. HUD was able to move quickly to meet the challenge. In fact, the majority of subsidized units made available between 1981 and 1988 were the direct or indirect result of actions taken by HUD during Secretary Pierce's tenure. Of the estimated 1,442,000 units made available in this period, 1,353,000 were attributable to these actions.

At the end of Fiscal Year 1980, before the new Administration had taken office, there were 406,015 Section 8 new construction units in the pipeline, of which 163,863 had not yet started construction. The latter were delayed only partly by inflation; in some cases, developers had simply pocketed their commitments for future use. Unfortunately, however, no one is housed by a "commitment" - only a ready-to-occupy housing unit benefits the poor.

Because the previous Administration and Congress had underestimated the cost of producing Section 8 units and the extent to which inflation would reduce the purchasing power of Section 8 funds, HUD would have had to request additional funding to cover the total cost of all the reserved units. Early in 1981, HUD's new housing team determined that the Department should fund commitments for projects that were cost-effective and would ordinarily be making progress toward construction. To avoid the need for additional funding, however, HUD would deobligate or cancel commitments for projects that were hopelessly stalled or unreasonably expensive.

In the summer of 1981, the inflation rate was only beginning to fall, and even tax-exempt bond rates were too high to use for financing projects. It therefore appeared unlikely that any Section 8 housing would be completed without below-market interest rates. The Section 8 Tandem Program¹⁰ of GNMA provided a mechanism. Additional funding for interest rate subsidies for the Tandem program was provided by the Omnibus Budget Reconciliation Act of 1981. This was still not enough, but HUD came up with an innovative device for obtaining the rest.

On August 5, 1981, after several weeks of negotiations with the Office of Management and Budget (OMB), Congress, interest groups, and individual developers, HUD announced an offer of assistance to help finance Section 8 projects which were in the pipeline but unable to reach the construction stage because of high financing costs. This plan, called the Financial Adjustment Factor (FAF), provided for larger rent subsidy payments to project sponsors to compensate for the higher interest rates they would have to pay on borrowed funds.

This initiative cleared the way for the production of nearly 87,000 units for low-income families, and provided re-employment for thousands of construction workers. FAF did not require an increase in HUD's budget: funds recaptured from old commitments that had no prospect of moving forward provided the resources for the viable projects to begin construction.

Developers were required to increase their equity in the projects which, in turn, decreased the additional amount of Federal subsidy required for the projects. HUD also insisted that if projects were to receive the benefits of FAF, they had to begin construction by June 1982.

¹⁰Through the Section 8 Tandem Program, GNMA purchased mortgages from lenders for rental apartments subsidized through Section 8. GNMA then sold the mortgages, at a discount, to private investors, absorbing the loss from the discount and thus providing below-market-rate financing for Section 8 projects.

The creation of FAF allowed HUD to require progress and financial commitment from developers; it enabled projects that would never have been completed to be cleared from the pipeline; it became the vehicle for enforcing cost-control procedures; it stimulated a renewal of activity for a housing industry still depressed by high interest rates; and it started the production of shelter for those in need.

As a result of FAF, bond financing was provided for 86,772 units in the pipeline early in the Reagan Administration. Other contract amendments granted during this period enabled the production of additional units in the pipeline that otherwise would never have been built.

As the economic tide turned and interest rates began to fall, financing with tax-exempt bonds became more attractive for some projects in the pipeline; and funding for both GNMA's Tandem program and FAF stretched farther than expected. Thus, although the housing industry as a whole remained weak in mid-1982, HUD's actions helped greatly in launching its recovery - and the recovery, in turn, benefited HUD's assisted housing programs.

Construction In Tight Rental Markets

The 1981 study by the Rand Corporation¹¹ helped define the problem of housing for low- and moderate-income families as one of affordability rather than availability. It found no rental housing shortage on a national basis; nevertheless, there were pockets of housing shortage in various geographical areas. To remedy those spot shortages, HUD officials sought an alternative, limited new construction initiative that would avoid the pitfalls of the Section 8 program.

The President's Commission on Housing recommended the addition of a housing element to the Community Development Block Grant (CDBG) program. It suggested that HUD allow CDBG grantees (States and local governments) the flexibility to use their funds for new single or multi-family rehabilitation, or for additional rental assistance payments provided through their public housing authorities.

The advantages of the Commission's proposal were twofold. First, because of the structure of the CDBG program, there was no need to worry about the long-term costs that presented such a problem in the Section 8 program. Second, by allowing localities to determine their needs and how their funds would be used, the Commission fostered greater reliance on State and local officials. They could decide whether to house fewer families through new construction, or a larger number through rehabilitation and existing housing programs such as vouchers.

HUD's proposal was based on one of the Commission's recommendations, but instead of providing a separate element of the CDBG program, which might have become financially uncontrollable in the future, the Department proposed allowing new housing construction as an eligible activity in the CDBG program.

Congress was also searching for a limited new construction vehicle to compensate where necessary for the elimination of the costly, inefficient Section 8 New Construction program. In passing the 1983 Housing and Urban/Rural Recovery Act (HURRA), Congress added a new construction and substantial rehabilitation program called Housing Development Grants (HODAGs). This new program, however, contrasted sharply in several respects with the previous Section 8 production program. Unlike the previous program, HODAG required leveraging private sector investment. Moreover, the newly created program was subject to local initiative and to some extent of local control.

¹¹See Chapter I, page 2.

Under HODAG, the funding decisions for specific projects were made by HUD. State and local governments, however, could determine how the funds should be used: for example, whether they should be grants or loans, and whether they should be used for interest rate buydowns or other forms of assistance. Also, as in the Rental Rehabilitation program, HUD provided no more than half of the funds for development or substantial rehabilitation of the projects; and HUD's subsidy was a one-time contribution, rather than stretched over a 20-year or 30-year period as in the Section 8 program.

Still, the per-unit cost was high, largely because HODAG subsidized about eight units of middle-income housing for every two units of low-income housing. While this ratio was effective in stimulating private investment, the result was of limited benefit to the poor. The Department favored expiration of the program, which the legislation had set for 1989.

These initiatives and decisions demonstrated that HUD could create a more efficient system for serving the housing needs of the poor. They were complemented by HUD efforts to reform another component of assisted housing, the Public and Indian Housing programs.

IMPROVING PUBLIC AND INDIAN HOUSING

In 1981, Public Housing was a 44-year-old program, comprising 1.2 million housing units administered by nearly 3,000 public housing authorities around the country, and serving more than three million people at an annual cost to the Federal government of \$1.5 billion. In addition, almost half of HUD's \$240 billion debt was attributable to the public housing program.¹²

HUD's challenge was to improve the efficiency and effectiveness of public housing, which was an important part of HUD's overall effort to ease the housing problems of low-income families. The ultimate objective would be to make each public housing unit a good home in a good environment, valued by the tenant and the larger community.

The vehicles that HUD officials chose for achieving this goal were: 1) preserving and improving the existing stock; 2) containing costs; 3) decentralizing decision-making and control; and 4) promoting long-term management improvements within the PHAs. In addition, under the Reagan Administration, HUD gave impetus to opportunities for public housing tenants to own their units or help manage the projects where they lived.

Public and Indian housing had previously been included among the responsibilities of the Office of Housing and the Federal Housing Commissioner. However, in 1983 HUD established a separate Office of Public and Indian Housing, under its own Assistant Secretary, to provide a sharper focus to the management and improvement of these programs.

Modernizing Public Housing

The 1.2 million units of existing public housing in 1981 were a valuable national resource but one that, in many areas, was deteriorating rapidly. The challenge was to preserve the stock already in place, and to that end the new Office of Public and Indian Housing launched a major modernization effort.

¹²Subsidized housing for Indian tribes and Alaska Native Villages is a part of the public housing program. Thus, Indian housing is generally included in any reference to "public housing." More detail about Indian programs may be found in Chapters III and IV.

The need to make this effort was evident, and the statistics compelling. In 1981, almost half of the public housing inventory was more than 20 years old; in many projects the fixtures and systems were nearing the end of their useful life. A HUD survey found that over half the stock (55 percent) needed some degree of rehabilitation in order to meet the "decent, safe, and sanitary" standards required by statute. Thus, between 1981 and 1988, HUD made available \$8.5 billion in capital cost approvals to revitalize the Nation's public and Indian housing stock. This was the highest funding level in history for improving public housing.

The Congressionally mandated vehicle for delivering these funds was the Comprehensive Improvement Assistance Program (CIAP). In allocating CIAP funds, HUD officials emphasized cost-effectiveness in such areas as energy efficiency. Most public housing was constructed before the "energy crisis," and relatively little attention had been paid to adequate insulation and similar energy-conserving techniques. As energy costs skyrocketed, public housing was particularly hard hit by increasing utility costs. HUD, therefore, encouraged proposals by PHAs to use CIAP funds for improvements that would conserve energy.

In addition, in 1983 HUD applied \$16 million of CIAP funds to a one-time Tenant Weatherization Program to improve the space-heating in some units that lacked adequate insulation. This program allowed tenants to participate and in some cases do the work voluntarily to make their units more energy-efficient.

Cost Containment

While HUD officials emphasized the need to revitalize the public housing stock, they recognized the importance of doing so in the most cost-effective manner possible. The goal was to provide maximum housing assistance to the needy at minimum cost to the taxpayer, and the Administration made substantial progress towards containing the burgeoning costs of public housing while improving its quality.

For example, HUD exercised the same caution in spending money on new construction for public housing as in other assistance programs. New construction simply was not a cost-effective means of providing housing assistance; and new construction of public housing was even more expensive than other Federally sponsored construction programs. In a comparative cost analysis, HUD found that the costs of constructing all types of subsidized projects exceeded those for FHA-insured, unassisted units. Other types of HUD-subsidized programs cost 10 to 27 percent more than unsubsidized units; public housing units, however, cost an additional 55 percent.¹³

Nevertheless, in public housing, as in other housing assistance programs, the new HUD team stimulated movement through the pipeline of previously made new construction commitments. HUD officials were determined to translate viable commitments into housing units as quickly and as cost-effectively as possible for the benefit of those in need. As part of this effort, a recapture policy was instituted for previously committed units that had failed to meet construction start deadlines.

In order to curtail development costs for public and Indian housing, HUD imposed restrictions on common space, unit size, and amenities, just as it had done in the Section 8 program. A cap was established on allowable costs for public housing, and PHAs were allowed to determine their own trade-offs on project sites, designs, and amenities within that cap. As a matter of policy HUD also continued to favor scattered-site housing as opposed to high-rise buildings.

¹³Urban Systems Research and Engineering, Inc. *The Costs of HUD Multifamily Housing Programs: A Comparison of the Development, Financing and Life Cycle of Section 8 Public Housing, and Other Major HUD Programs.* (Washington: U.S. Department of Housing and Urban Development, 1982), Pages 7-27.

For Indian tribes and Alaska Native Villages, HUD encouraged the reuse of architectural plans, and the use of materials native to the location, in housing construction. It also fostered local decision-making by allowing Indian Housing Authorities (IHAs) to build as many units as possible with funds allocated to them.

As a result of these and related initiatives, future commitments for new public housing units were minimized and new emphasis was placed on production of units in the pipeline. By the end of FY 1985, the preconstruction public housing pipeline contained only 13,324 units, a decrease in unbuilt housing of more than 50 percent from 1981.

HUD public housing officials also considered the cost-effectiveness of modernization spending. It was recognized early on that standards of density, design, and location precluded the rehabilitation of some public housing. A "viability" test was instituted as a precondition of modernization funding, to ensure that the spending produced not only cosmetic changes, but lasting improvement.

In the end, Congress mandated more new construction for public housing than HUD had requested, but largely endorsed the new direction for assisted housing chartered by HUD's leadership: conservation and preservation of the existing, viable public housing stock.

Improving Local Control of PHA Operations

Originally, the role of the Federal government in public housing was to provide subsidies for construction, while the properties were operated and maintained by the local PHAs with funds from tenant rents. But in recent decades, very low income tenants represented a growing share of public housing occupancy. Because PHAs could charge only a fixed percentage of a tenant's income for rent, the aggregate rental income of most public housing projects was no longer sufficient to pay the full cost of its operations and maintenance.

Over the years, Congress had provided increasing subsidies to PHAs to make up the shortfall between rental and other income and operating and maintenance costs. This growing dependence on the Federal government had the unfortunate effect of tightening HUD's ties to the PHAs and simultaneously unravelling relations between PHAs and the communities they served.

HUD officials set out to return as much decision-making authority as possible to the local PHAs, in order to help them be more responsive to local needs and preferences. A major HUD legislative initiative for FY 1985 proposed to eliminate the highly regulated CIAP. It was to be replaced with a comprehensive grant, which would devolve to localities responsibility for making decisions on the timing and location of capital expenditures on public housing. To promote rational planning, the legislation proposed to allocate predictable annual amounts to each PHA, replacing the uncertain annual "lottery" and reward for grantsmanship under which CIAP operated. The Comprehensive Grant became law in the Housing and Community Development Act of 1987, and HUD was required to develop the allocation formula for Congressional approval.

At the same time, HUD helped PHAs develop and improve their management capability. Particular emphasis was placed on PHAs that were laboring under pronounced management and financial difficulties. While the number of these PHAs was small, they accounted for a significantly high proportion of the public housing inventory in urban areas.

HUD formed a staff to work exclusively with these "troubled" PHAs. A private consulting firm was hired to conduct an independent, comprehensive management

review of one such PHA, and provide it with training and technical assistance. HUD's Inspector General also conducted an audit of 18 such PHAs and made several specific recommendations for change. On the basis of the findings of these studies, HUD strengthened the guidelines for reviewing and alleviating the problems of the troubled PHAs.

While HUD public housing officials focused their efforts on the worst of the inventory, they made clear in public statements that both tenants and taxpayers were, by and large, being served well by the program. Most public housing authorities were well-managed and did, in fact, provide a good home in a good environment for low-income people. To emphasize this point, in 1985 HUD established an annual Public Housing Agency Performance Awards competition, to give public recognition to the many deserving and innovative PHAs operating around the country. HUD also worked with the public housing industry to develop performance indicators for good management. PHAs able to meet those indicators were "decontrolled," or relieved of HUD monitoring and oversight in certain operational areas. By the end of 1988, over 450 PHAs had been decontrolled.

Similarly, HUD officials focused on finding solutions to the problems of troubled IHAs. Whereas the percentage of troubled non-Indian PHAs was relatively small, approximately 36 percent of IHAs were classified as troubled. By 1986, however, 19 IHAs, or 11 percent of the total, had been removed from the financially troubled category. The Department's success in this endeavor resulted from enhanced cooperation between tribal and IHA leadership and the diligence of HUD's field offices in providing increased assistance and oversight.

By emphasizing the rehabilitation of existing public housing and minimizing the construction of new units, HUD made better use of Federal revenues. It also heightened the value of Federal funds by extending cost-containment measures to public and Indian housing, and providing concentrated assistance to financially troubled IHAs and PHAs. Through these and other innovative measures, HUD was able to offer public housing occupants a more pleasing environment and way of life.

Quality of Life Initiatives

During the 1980's, the Department used a series of demonstrations to develop innovative programs to improve the quality of life for low-income residents of public and assisted housing. Known collectively as the Quality of Life Initiatives, these demonstrations were designed to address specific problems, beyond that of shelter, which were routinely faced by low-income individuals and families.

The initiatives had in common a number of factors not usually identified with Federal programs. They emphasized local design and control; they relied significantly on public/private partnerships involving local officials, private enterprise, housing authorities, and voluntary, non-profit organizations; and - most significantly - they allowed low-income individuals to participate fully in improving their lives.

The early results of the demonstrations were impressive, with at least one becoming part of HUD's permanent program structure.

Minority Youth Training Initiative - MYTI addressed the special needs of minority youth, whose unemployment rates had been consistently higher than those of any other segment of society. MYTI enabled disadvantaged young men and women living in or near 18 public housing projects to learn housing management and maintenance skills, while performing needed repairs on the projects.

HUD provided a total of \$2 million in public housing modernization funds to the 18 demonstration cities, with additional funding provided by the Department of Labor's Jobs Training Partnership program. The local demonstrations were supervised by Private Industry Councils, composed of representatives of local governments, unions, and business and industry.

The MYTI trainees developed skills in computer operations, electronics (installations and repairs), and hotel/motel maintenance. After their training and education was completed, MYTI helped them obtain full-time jobs in housing maintenance or management in PHAs or with private organizations. About 75 percent of the almost 900 MYTI graduates were placed in jobs, mostly in the private sector.

The programs in Norfolk and Baltimore were particularly successful for their participants. After the first round of an Apartment Maintenance Training Program conducted by the National Association of Home Builders, 100 percent of the graduating students were employed by private apartment management firms.

MYTI's success led to the inclusion of tenant training as an eligible activity for any PHA under HUD's Comprehensive Improvement Assistance Program. A guidebook was prepared by the Office of Policy Development and Research to help communities establish similar programs.

Project Self-Sufficiency - The second Quality of Life Initiative, which was launched in September 1984, also applied the principle of public/private partnerships to helping those at the bottom of the economic ladder become employable. Project Self-Sufficiency (PS-S) was designed to motivate and train single parents of very low-income families to take responsibility for their futures.

Of more than 6.7 million single parents in the United States, a high proportion were minority women, and over half had poverty-level incomes. They shared with other low-income households the need for safe, sanitary, and affordable housing. Many also lacked marketable job skills, and had no practical knowledge of how or where to seek employment; indeed, often they even lacked the motivation to seek jobs. They also faced the need to make suitable, and affordable, arrangements for daycare so they could accept employment.

Project Self-Sufficiency created a mechanism for addressing this spectrum of needs. The demonstration was initially linked to 5,000 Section 8 housing certificates in 78 communities - urban and rural, large and small - which had been selected because they promised a high degree of public/private/voluntary cooperation in administering the program.

HUD provided each participating community with housing certificates; locally, other public and private agencies furnished child care, transportation, counseling, education, job training, and placement assistance. The objective was to provide participants with the skills and services they needed to make the transition from dependency to productive employment.

About 10,000 families in a total of 155 communities were served by the demonstration. By May 1988, 134 participating jurisdictions reported that 29,660 single parents had applied; 9,928 had been selected to participate. Forty-two percent of the enrollees had completed the program, and either obtained full-time jobs with growth potential or enrolled in 2- or 4-year colleges. The average hourly wage of those who were working was reported in excess of \$5.00. Thirty-five percent of the participating communities were still providing services to PS-S participants. HUD also developed materials to assist other communities in establishing self-sufficiency programs.

Public Housing Home Ownership Demonstration - On August 21, 1984, HUD launched a nationwide Public Housing Home Ownership Demonstration, offering public housing residents the opportunity to become owners of their own units. The principal objective was to assess the potential for converting public housing rental units to homeownership.

The idea behind the demonstration was to encourage participation in the American dream of homeownership for its economic and sociological benefits; and that residence in public housing should not automatically exclude low-income families from participating in that dream. The demonstration tested a number of ways that public housing authorities could help low-income tenants purchase their own units. HUD established basic requirements for PHAs to participate in the demonstration, but left most issues of eligibility and sales price up to individual PHAs, local governments, and tenant groups.

Seventeen public housing authorities took part in the demonstration. By 1988, there had been 218 sales at 11 sites, including 107 single family scattered-site units at nine locations and 111 multifamily units at two sites. Units were sold both fee- simple and as cooperatives or condominiums, at prices that made the cost of homeownership affordable for low-income households. Various types of financing were employed. All the purchasers were counselled in the responsibilities of homeownership and financial management, and received training in home maintenance.

Small Business Opportunities Project - This initiative was based on the premise that many public housing residents possess the interest and ability to become entrepreneurs and enjoy the opportunities that the dynamic American private sector provides to move up the economic ladder. The demonstration linked potential entrepreneurs with investment capital and sources of training in business skills to help them realize that ambition.

The project was patterned after the successful and independently motivated efforts of tenants at Kenilworth-Parkside, a public housing project in Washington, D.C. Acting without even the stimulus which HUD later provided, they launched a hair styling shop, a window- and screen-repair firm, a trash collection company, and a food cooperative.

HUD selected the Opportunity Resource Institute (ORI) to help public and private sector leaders organize small business development coalitions in four CDBG-eligible jurisdictions: Broward and Dade Counties, Florida; New Haven, Connecticut; and Cleveland, Ohio.

With ORI's assistance, the newly formed coalitions worked with low-income potential entrepreneurs to help them develop, launch, and operate their own small businesses, which included building and apartment maintenance firms, landscape services, daycare centers, and similar ventures. By 1988, 27 public housing residents had completed training and were developing business plans. The coalitions had created access to more than \$100,000 in seed capital, and acted as a continuing resource for new ventures.

Tenant Participation, Management, and Economic Development Project - This demonstration grew out of the belief that good PHA-tenant relationships enhance the success of well-run public housing projects; which, in turn, benefit from the participation of tenants in their management. Active tenant involvement in maintenance and management decisions positively affects the physical condition of housing projects and the quality of life of their residents.

During the summer of 1988, HUD awarded matching grants to 12 communities that had expressed an interest in tenant management. With local matching funds, these grants allowed tenants to obtain technical assistance in organizing tenant associations, training members for management roles, learning business management skills, and operating educational and job development projects.

The grants also helped finance economic development activities, including a variety of small businesses established and managed by public housing residents.

Congress endorsed this initiative by including it in the Housing and Community Development Act of 1987, which provided \$2.5 million per year for 1988 and 1989 to allow PHAs to hire specialists to assist residents in undertaking housing management.

OASIS Initiative - The OASIS Initiative focused on reversing physical deterioration and rising crime rates in troubled public housing and the surrounding neighborhoods. It tested a method, developed by the Fort Lauderdale Housing Authority, for improving the quality of life in public housing developments and blight-stricken neighborhoods.

Beginning in 1985, the OASIS technique was implemented in Houston, Texas. The PHA worked with residents, private businesses, community groups, and the city's police, public works, and community development agencies to analyze the causes of decay and the strengths and weaknesses of the community. They targeted resources to the area of greatest need to accomplish rapid, visible revitalization; and adopted longer-range strategies to reduce crime and drug traffic, rehabilitate housing, and revitalize neighborhoods. Residents began to take pride in improving their homes and grounds and reopened businesses.

HUD also conducted the Child Care Demonstration which was authorized under the 1987 Housing Act. The program funded non-profit organizations to operate child care facilities in public housing to determine whether such on-site capability would enhance employment prospects for public housing parents. Annual allocations of \$5 million were made for 57 demonstration sites in both 1988 and 1989.

HELP FOR THE HOMELESS

For the most part, during the 1980's low-income people who became recipients of HUD's subsidized housing programs did so because they had been paying too great a portion of their incomes for rent; or living in substandard accommodations; or, in some cases, facing both problems. However, the homeless by definition had no permanent place to live.

While sensitive to the plight of the homeless, HUD officials recognized that there were numerous, divergent estimates - but few hard data - about their number or characteristics, about where they were concentrated in the United States and about what kind of services were available to meet their needs. Secretary Pierce personally believed that the problems of the homeless involved more than their lack of shelter and sought more information on the problem.

HUD 1984 Homeless Study

For that reason, in 1983, HUD initiated a comprehensive study to determine the number of homeless persons at any one time, to develop their demographic profile, and to establish a reliable estimate of the shelter space available to them. The results were, in many instances, surprising and, in all cases, enlightening. The study generated the following information about the homeless:

- Between 250,000 and 350,000 people were homeless on an average night in January 1984.¹⁴
- Most of the homeless were in large metropolitan areas; however, contrary to popular belief, the highest per-capita share of the homeless population was found in the West, rather than in the Northeast.
- The majority of the homeless were white, single men, ranging in age from their late 20's to mid-30's. Almost half of them suffered from mental illness, alcoholism or drug abuse. Over the preceding 20 years, however, the homeless population had changed to include more single women, minorities, family members, mentally ill individuals, and young people.
- Over half of the homeless had been unemployed for a long time or had never been employed. Few were middle-income, skilled workers who had recently become homeless because of losing their jobs.

The study uncovered additionally useful facts about provisions for the homeless.

- Shelters existed for housing approximately 111,000 people, with about 8,000 of these spaces serving run-away youth, and roughly 12,000 serving abused women. In addition to these emergency shelters, many homeless individuals received vouchers to stay temporarily in hotels or apartments.
- The number of emergency shelters was increasing: 20 percent of the existing facilities had been created less than one year prior to the study.
- Most shelters offered meals, laundry facilities, psychiatric counselling, and employment and housing referrals.
- Most of the funds for shelters were donated by individuals, corporations, or other private sources; while Federal, State and local governments provided the lesser portion. Most shelters (94 percent) were operated by the private or non-profit sector. City and county governments ran only 6 percent of the total number.
- Although half of the shelters were unable to meet the demand in January 1984, average occupancy for all the shelters during that month was only 70 percent.

Upon releasing the study in May 1984, Secretary Pierce announced his intention to use it for determining HUD's future policies:

"This report provides the first national profile of the homeless population, based on systematically collected data, and reveals a very different picture of who the homeless are, compared to the traditional stereotype of street persons. . .

"As this report makes eminently clear, long-term solutions . . . must take into account the diversity of the population. I believe this study will be helpful and useful to both public and private officials in their efforts to address the needs of the homeless."¹⁵

Initiatives and Progress

HUD and other Federal agencies joined the private sector in increasing efforts to aid the homeless. President Reagan created an Interagency Task Force in 1983 to coordinate Federal efforts and work with the States, localities and the private

¹⁴Because the need for temporary or emergency shelter varies throughout the year, HUD used this "point-in-time" reference. The research team determined to concentrate on the month of January, a month when the weather intensified the plight of the homeless.

¹⁵"Housing Secretary Pierce Provides First National Profile of Homeless Population and Emergency Shelters," News Release (Washington, D.C.: Department of Housing and Urban Development, May 1, 1984).

sector in meeting the needs of the homeless. While most Federal funds for the homeless came from the Federal Emergency Management Agency (FEMA), other parts of the Executive Branch made significant contributions toward alleviating their problems as well. For example, one-fifth of the Community Services Block Grant funds allocated to cities by the Department of Health and Human Services was used for the homeless. The Department of Defense made some military buildings available for shelter, and by the end of 1987, 15 shelters were operating on military reservations. At the same time, over two million pounds of food were donated by military commissaries around the country to food banks for the homeless.

HUD also played a multifaceted role in providing for the homeless. From 1983 to 1988, cities and States used \$165 million in CDBG funds to provide shelter and meet other needs of the homeless. Also, some single family properties in the HUD inventory were designated for the homeless, and a few PHAs reserved public housing units for their use.

In FY 1986, HUD set aside 1,000 Section 8 existing housing certificates to develop a model shelter program for the chronically mentally ill, who form the largest single group of the homeless. Illustrating the Administration's emphasis on public/private partnerships, the program was structured as a joint venture with the Robert Wood Johnson Foundation. A public/private advisory committee, composed of experts in mental health, urban development, and government, was formed by the Foundation to oversee the program.

Emergency Shelter Grants and Transitional Housing Demonstration Programs

Subsequently, the Homeless Housing Act of 1986 created two new programs to assist homeless persons, the Emergency Shelter Grants Program and the Transitional Housing Demonstration Program. These programs were incorporated into the Stewart B. McKinney Homeless Assistance Act, which President Reagan signed into law on July 22, 1987. Appropriations for FY 1987 through FY 1989 under this Act totaled \$1.2 billion.

Under the Transitional Housing Demonstration Program, HUD sought innovative approaches for providing housing and support services to help make the transition to independent living. The objectives of the program were to determine:

- The cost of acquiring and/or rehabilitating or leasing, existing structures to provide housing for homeless persons;
- The cost of operating the housing and providing support services to its residents; and
- The effectiveness of these services in assisting homeless persons.

Under this program, HUD offered assistance to eligible governmental and private non-profit entities in the form of: (1) interest-free advances of up to \$200,000 or 50 percent of the cost of acquisition and/or rehabilitation of existing structures for use as transitional housing; (2) up to 50 percent of annual operating costs of the transitional housing; and (3) technical assistance to program recipients in carrying out these activities. The first year of the program was funded at \$5,000,000 to allow funding of approximately 5 to 10 projects.

The second new initiative arising from the 1986 legislation was the Emergency Shelter Grants Program. This provided States and local governments with \$68 million for FY 1987 and FY 1988 to increase the quality and quantity of shelters serving the homeless. A total of 731 communities received either entitlement grants directly from HUD or funding through the States in 1987; and in that year

approximately 57 percent of the funds were spent on shelter rehabilitation activities, 36 percent on operations, and 7 percent on services for the homeless.

The McKinney Act also established three additional programs in HUD to aid the homeless:

- The Permanent Housing for the Homeless Handicapped program, which provided funds to States for long-term housing for handicapped persons who are homeless or "at risk" of becoming homeless;
- The Supplemental Assistance for Facilities to Assist the Homeless program, under which HUD provided assistance for comprehensive approaches to address the immediate or long-term needs of the homeless or funding to supplement that provided under the Emergency Shelter Grant or Transitional Housing Demonstration programs; and
- Section 8 Moderate Rehabilitation Assistance for Single Room Occupancy Dwellings program, which provided rental assistance payments to pay the cost of the rehabilitation of single room occupancy dwellings, such as residential hotels, for priority occupancy by homeless individuals.

HUD moved quickly to implement the McKinney Act programs and to make the funds appropriated for these programs available to governments and private organizations for use in the winter of 1987-1988. By mid-December 1987, all 50 States and more than 320 eligible local governments under the Emergency Shelter Grants program had received their formula allocation of funds under this program, and competitive awards of funds had been made under the Transitional Housing Demonstration program, the program of Supplemental Assistance for Facilities to Assist the Homeless, and the Section 8 Moderate Rehabilitation program. By October 1988, competitive awards had been made to 338 grantees, including non-profit organizations, public housing agencies, and local and State governments.

In addition to these program activities, the McKinney Act assigned to HUD the administrative responsibility for the Interagency Council on the Homeless. The Council was organized in September 1987, elected HUD Secretary Pierce as Chairman, and the Department of Health and Human Services Secretary Otis Bowen as Vice-Chairman, and submitted its first report to Congress in October 1987. First, the Interagency Council on the Homeless focused on implementing the McKinney Act programs assigned to its member agencies; then on coordinating Federal efforts; next, on improving cooperation between the public and private sectors.

The future of the homeless is as complex as the individuals themselves. While housing is a fundamental problem for them, it is not their only problem. As HUD's 1984 homeless report concludes:

"Improving the condition of the homeless over the long term requires tailoring public and private responses to fit their widely-varying needs rather than placing (sole) emphasis on emergency shelters.¹⁶

SUMMARY

At the beginning of 1981, HUD's programs were, for the most part, expensive and inefficient. Inflation was rampant, construction was virtually at a standstill, and consequently people waiting for housing assistance were not reaping the benefits of HUD's programs. It was obvious that strong measures were needed to counteract the failures of the past and shape the future of housing assistance programs.

¹⁶A Report to the Secretary on the Homeless and Emergency Shelters (Washington, D.C.: U.S. Department of Housing and Urban Development, Office of Policy Development Research, May 1984), Page 50.

Early HUD actions expedited the production of units for which commitments had already been made and which were considered feasible. As a result of new procedures generated by HUD, per-unit costs of production declined. By and large, these efforts produced the desired results.

The Reagan Administration's most noteworthy contribution, however, was to set a new and successful course for housing assistance. HUD officials developed a comprehensive plan for providing housing assistance to those in need, while minimizing the financial resources drawn from the Federal government. The new policy had several major components.

First, recognizing that the housing problem of the poor was largely one of affordability, HUD concentrated its resources on subsidizing the cost of rental payments for qualified families rather than providing new structures. It was in those terms that the voucher initiative was developed.

At the same time, HUD provided for new construction activities where there was a demonstrated need, and on a more cost-conscious basis. Thus, the Department continued its Section 202 housing program for the elderly and handicapped and initiated cost-saving improvements in it. HUD also proposed allowing communities to use their CDBG funds for residential new construction.

In addition, HUD initiated a Rental Rehabilitation program, with a high degree of local control, to increase the stock of adequate housing with minimal financial investment and minimal Federal control.

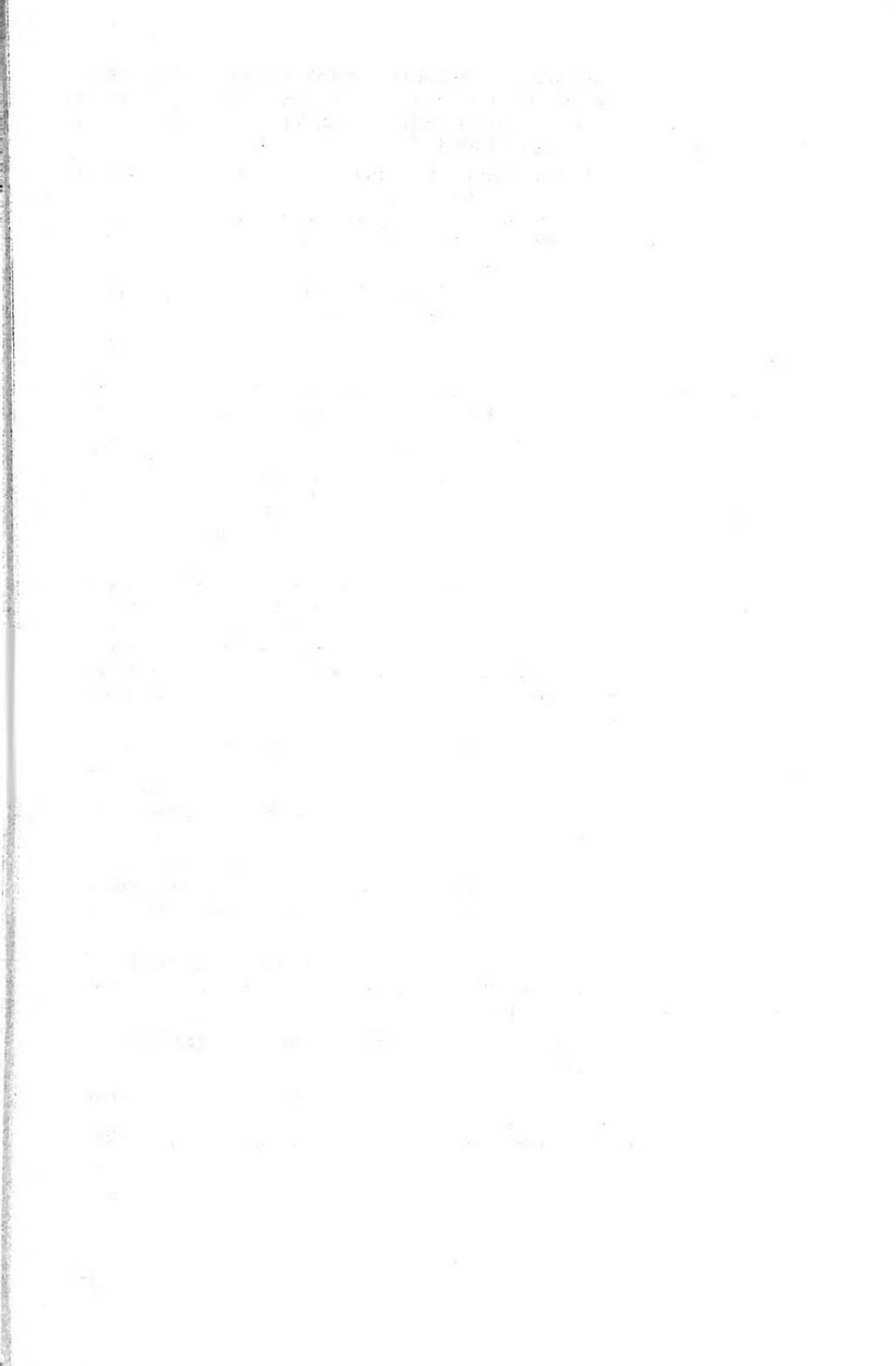
Concurrently, HUD effected basic improvements in its public and Indian housing programs. By establishing a sounder footing for the effective and efficient operation of PHAs and IHAs, and increasing emphasis on modernization, the Administration significantly improved the prospects for public and Indian housing. Overall, the number of public housing units increased from about 1.2 million to 1.3 million, and the number of occupants increased from 3 million to 3.5 million between 1981 and 1989.

A 1984 HUD study laid the groundwork for effective action on homelessness, and the Department worked cooperatively with other governmental agencies to ameliorate the hardships of this population. HUD approved the use of CDBG funds to provide shelter and meet other needs of the homeless, while extending assistance through other programs.

When the Stewart B. McKinney Homeless Assistance Act was passed in 1987, HUD moved swiftly, ensuring that assistance under such provisions as Emergency Shelter Grants and the Transitional Housing Program was available to the homeless for the winter months.

Although by the end of 1988 much remained to be done, the policies established by HUD during the Reagan Administration accounted for some significant improvements in the assisted housing picture.

- The debt for assisted housing, which had reached \$243 billion by 1982, had been reduced to \$200 billion by 1988.
- At the same time, the number of assisted families increased: from 3.2 million in 1981 to 4.3 million by the end of 1988. Thus, there was an increase of about 1.1 million families receiving housing assistance during the Reagan Administration.



Fostering Homeownership

The scope of HUD's mission encompasses housing across the board: creating as many opportunities as possible for Americans, particularly low- to middle-income homebuyers, to realize their dream of owning their own homes. To that end, and consistent with the principle of public/private partnership, one goal was to attract capital to housing and thus strengthen the economic base of the housing industry.

Recovery from the economic recession the Administration inherited in 1981 was essential for a healthy housing market. Skillful use of government's insuring authority and increased investment in mortgages and mortgage-related instruments would contribute to the health of that market. Within HUD, the Federal Housing Administration (FHA) insures mortgages, and the Government National Mortgage Association (GNMA - or Ginnie Mae) issues mortgage-backed securities, creating a secondary market for mortgages.

By law, both of these authorities reside within HUD. By law, too, HUD has oversight responsibility for the Federal National Mortgage Association, a privately held corporation which purchases mortgages and issues mortgage-backed securities. While GNMA is limited to issuing securities backed by mortgages insured by FHA and guaranteed by the Veteran's Administration (VA), FNMA focuses on conventional, privately insured mortgages.

Through a series of innovative initiatives, HUD officials in this era attracted capital to housing on an unprecedented scale. This chapter traces the initiatives that produced these results in the strengthening of American housing. Reviewed, too, are new departures in mortgage instruments, regulatory relief, and decentralization, all of which contributed to housing records in the 1980's.

THE FEDERAL HOUSING ADMINISTRATION

Founded in 1934 as one of the many Depression-era initiatives for restoring a faltering economy, the Federal Housing Administration has a substantial record of service to the Nation's homebuyers.

FHA manages mortgage insurance programs that encourage private lenders to grant mortgages to low- and moderate-income homebuyers who would not qualify for mortgages by conventional standards. FHA insurance reduces or eliminates the risk of an otherwise unacceptable investment for the lending institutions. It thus opens the door to homeownership for many millions of Americans who could not otherwise qualify. When a homeowner with an FHA-insured loan fails to make agreed-upon payments, FHA pays the lender nearly all of the unpaid loan balance, including interest. The loan is then assigned, or title to the insured property is transferred, to the FHA.

Over the years, America became a nation of homeowners. A home brings a measure of respect to its owner and symbolizes such traditional values as family, hard work, and economic security. Being a homeowner establishes a family's identity within the community, and provides the underpinning for social stability.

The pre-FHA world of home financing would be scarcely recognizable to today's homebuyer. Mortgage terms were short, typically ranging from three to five years.

The characteristic mortgage provided for the payment of interest only; no part of the payment was used to reduce the outstanding balance. Thus, at the end of the very short term, a homebuyer either had to pay off the whole mortgage balance or get involved in an endless series of refinancings.

The FHA loan, created by the National Housing Act of 1934, instituted the concept of regular monthly payments used to reduce the loan balance. FHA loans were for dramatically longer terms - initially up to 20 years and later stretching to the 30-year term prevalent today. In short, FHA offered homebuyers both the benefit of predictable, relatively low payments and an escape from the uncertainties of constant renegotiation. Best of all, when the last payment was made, the home belonged to the homeowner and not the bank.

The FHA-insured mortgage became a catalyst for change in the design of conventional non-FHA mortgages as well. FHA was the laboratory that proved the practical soundness of these new mortgage concepts. As private lenders adopted many of the elements of FHA-insured loans, the prospect for homeownership improved for increasing numbers of Americans.

Another important housing resource is the Nation's rental housing stock. Rental housing constitutes more than one-third of all occupied units nationwide, and half of all occupied units in the central cities of metropolitan areas are rentals. Through its insured multifamily loans, FHA has also been a force in stimulating investment in unsubsidized rental properties.¹

FHA had an enormous influence on American life. At the start of 1981, FHA insured over 14 million units of single family housing representing total loans of \$203.3 billion. At the same time, multifamily insurance, in its variety of programs, guaranteed \$46.23 billion in loans for 3,042,000 units. These figures increased substantially during the Reagan years: by the end of FY 1988 over 19.1 million units had been insured for \$479.8 billion; 3,546,000 multifamily units for over \$73 billion. Units, of course, represent families sheltered, so the real story of FHA is in the impact that it has had on people.

FHA At Risk

Nevertheless, in 1981 voices were raised to question whether FHA was still needed. While acknowledging its contributions in the past, critics felt that the private mortgage market had absorbed the lessons of the FHA experience and could, therefore, replace it. They also questioned whether the favored treatment accorded investments in housing through tax advantages and FHA insurance did not drain resources from other sectors of the economy.

HUD officials carefully weighed these arguments. They concluded, however, that it was the high value Americans assigned to homeownership that accounted for its importance in the U.S. economy. Further, annual investment in housing as a percentage of the Gross National Product had actually fallen in the 1970's, so it was difficult to argue that housing was crowding out other investments.

They also concluded that, while there was some overlap between FHA and private insurance of single family mortgages, the FHA tended to serve younger homebuyers with less cash for a downpayment. Conventional lenders, on the other hand, served older, higher-income buyers. A subsequent study by the U.S. League

¹This chapter focuses on single-family home ownership; however, it is important to note that FHA also plays a vital function in its activities to insure multifamily housing including facilities for the elderly and handicapped, and some are discussed on pages 44-45.

of Savings Associations confirmed this pattern.² (Furthermore, HUD proposed a limit of \$67,500, which could be raised to \$90,000 in high-cost areas, to the size of FHA insured mortgages. A proposal to increase the high cost limit to \$101,250 was adopted by Congress in 1987.)

It was clear that younger families with modest incomes needed FHA to realize their dreams of homeownership. HUD officials therefore concluded that FHA should be redirected to concentrate on meeting the needs of that segment of the population, plus inner-city and rural homebuyers who were often unserved by private lenders.

First-time homebuyers were singled out as a class for a number of reasons. Because they frequently had modest incomes, limited credit histories, and insufficient savings for big downpayments, individuals and families just embarking on their career usually tried to buy lower-priced "starter homes." They therefore often failed to qualify for financing on the terms prevalent in the conventional market.

Inner-city residents of all ages often had lower incomes and lacked a satisfactory credit record. More significantly, inner-city properties often needed repairs, which necessitated higher outlays by buyers, potentially increasing the amount they had to borrow – but not the current value of the property, on which conventional lenders based their willingness to lend. In addition, some private lenders discriminated illegally against buyers in neighborhoods the lenders considered risky.³

Homebuyers in rural areas have suffered from both a shortage of mortgage credit and a lack of lending institutions. The few lenders operating in rural areas often invested only a small portion of their funds in mortgages. Some were relatively unsophisticated in the areas of mortgage credit; others preferred investing in shorter-term, higher-yield loans; and still others were inhibited by the low or uncertain incomes of rural borrowers.

Nevertheless, the issue of FHA's role was raised again in 1986, when the sale of FHA to the private sector was tentatively proposed in the early stages of formulating the Administration's FY 1987 Budget. Secretary Pierce agreed to study the proposal and appointed a Task Force, which included representatives of HUD, OMB and Treasury and was chaired by HUD's General Counsel. The group recommended additional efforts to target FHA programs more effectively to those not served by the private sector and to reduce FHA's existing competitive advantages over private lenders.⁴ Those studies continued, but there was no change in the Department's goal: to maximize the opportunity for the private sector in providing mortgage credit, while preserving – for the time being, at least – FHA's essential role.

The discussions of FHA's role proved very useful. All parties emerged with a sense of the importance of the institution and a recognition that FHA should continue its efforts to minimize competition with the private sector.

²In the 1983 study, the League found several dissimilarities between buyers of FHA-insured homes and conventional purchasers. First, the typical purchaser of an FHA-insured home was 30 years old, compared with an average age of 34 in the conventional market. Less than a third of FHA-insured homes were purchased by families with incomes over \$35,000; but more than half of conventional mortgage buyers had incomes exceeding that amount. Sixty-two percent of FHA-insured homes – but just over half of conventional homes – were purchased by families with two wage earners.

There were also differences between the prices of homes purchased with FHA insurance and those without a Federally affiliated mortgage. The median price of an FHA-insured home at the time was \$56,100, as opposed to \$65,000 for a conventional home. Only 12 percent of FHA purchasers, but over 35 percent of conventional purchasers, bought homes over \$80,000 in value.

³See Chapter on Fair Housing.

⁴Report of the FHA Task Force, HUD, January 28, 1987

The remaining issue was how to steer FHA insurance to those not effectively served by the private sector. Some proposed making FHA insurance more restrictive, by defining eligibility by category (e.g., first-time homebuyers) or income limits; and by reducing by almost one-third the total amount of insurance which could be written in a single year.

HUD's housing officials, on the other hand, believed that FHA programs should be better tailored to the needs of first-time, inner-city, and rural area homebuyers. They were also troubled by the idea of slashing the credit ceiling. Housing is not always a "normal" industry, but is characterized by boom and bust cycles. Since 1979, the housing industry had been in a tailspin as a result of high interest rates. By the time the Reagan Administration took office, it had sunk into one of its deepest troughs since World War II. Given these considerations, HUD officials felt it was crucial that a healthy amount of credit should be available through FHA insurance to help propel any future recovery. Again, their arguments prevailed.

During the Reagan Administration FHA successfully met two major challenges: that of redirecting its business and coping with dramatic increases in loan volume as the economy improved. How the Agency did this, and the details of its performance, will be covered later.

Housing in the Doldrums

It is hard to overstate the economic difficulties of the housing industry, which had been in a recession since 1979, and the homebuying public at the start of the Reagan Administration. The high rates of inflation and interest, plus excessive government regulations during the 1970s, had seriously depressed the industry. It would take two years of economic improvement before the housing industry would recover.

By 1981, the price of homes had been driven beyond the reach of a great many Americans. The upward spiral of interest rates reached a peak in the fall of that year when the yield (the interest rate shown on a mortgage plus the prepaid points) reached 18.09 percent for FHA loans, and 18.45 percent for conventional mortgages.

At the same time that interest rates were hitting historic highs, home prices were also escalating at an unprecedented pace. Between 1970 and 1981, the average sales price for an existing home tripled, from \$25,700 to \$78,300. New home prices conformed to the same pattern, with the average sales price increasing from \$26,600 in 1970 to \$83,000 in 1981. This rapid rise of prices severely diminished homeownership opportunities, especially for families seeking to buy their first homes, rather than trade up.

Beginning in 1979, the combination of high interest rates and high prices had drastically reduced housing purchases. New home sales, which had numbered 817,000 transactions in 1978, began declining rapidly; by 1982, they had fallen by 42 percent, from 709,000 units in 1979 to 412,000 units in 1982. The total value of home mortgage loans declined from \$185 billion in 1978 to less than \$100 billion in 1982.

Not only were the housing expectations of American families thwarted, but a major American industry also entered one of its deepest recessions in 1979. Housing starts slid from more than 2 million units in 1978 to 1.1 million annually in 1981 and 1982. The recession also exacted a high human cost in terms of housing-related unemployment. Total construction employment shrank by over 17 percent

at the low point of the downturn. Membership in the National Association of Realtors (an indication of the workforce selling housing) also fell sharply.

Thus, the housing industry found itself forced to "pay the piper" for mistakes largely made beyond its purview. The ravages of inflation in the late 1970's had created an affordability gap impossible for most first-time homebuyers to bridge. Real estate speculation had become rampant as housing was recognized as almost the only kind of investment that was appreciating more rapidly than inflation. Compounding the effects of inflation were the restrictive "no-growth" policies in many communities which created an artificial scarcity of housing that further spurred price increases.

The fact that many existing homeowners and speculators enjoyed rapid appreciation in the value of their properties had hidden the basic illness eating at the housing industry. But by the early 1980s the mask had been stripped away. The Nation came to the painful realization that homeownership was receding as a possible dream, and homebuilder after homebuilder was forced into bankruptcy.

Recovery and Resurgence

By 1982 the Reagan Administration's Economic Recovery Program was taking hold, and the resurgence of the U.S. economy began in November of that year. The housing industry was among the first to rebound, helped by a rapid drop in the rates of interest and inflation.

Indeed, the demise of inflation as an important economic factor was a major development in setting the stage for recovery. In 1979 and 1980, inflation had raged at 13.3 and 12.4 percent, respectively. In a dramatic reversal, the rate began to fall in 1981, and by 1982 had dropped below 4 percent. From that year through 1988, in fact, the average annual inflation rate was just 3.4 percent.

Lower inflation rates at first seemed too good to last, and some prognosticators suggested that they wouldn't. But, as time went on, the expectation of renewed inflation also diminished, contributing significantly to a general reduction in interest rates. This spurred a renewal of activity in all sectors of the economy. The Gross National Product surged, retail sales boomed, and industrial production increased.

Best of all, Americans began to return to work. The unemployment rate dropped from the recession high of 10.8 percent to 6 percent, and towards the end of 1988 fell to just 5.3 percent - its lowest level in 14 years. Between the end of 1982 and 1988, almost 18 million new jobs were added to the U.S. labor market as the total labor force reached new highs.

Housing led the economic recovery as the door to home ownership opportunity swung open for millions of American families. Home sales began to surge in late 1982. Sales of new homes reached 623,000 in 1983, an increase of more than 50 percent over 1982. They continued to rise almost without pause, reaching 750,000 in 1986 and then declining to 671,000 in 1987. Similarly, sales of existing homes reached 2,719,000 in 1983, 35 percent higher than the previous year. That trend also continued upward, to 3,565,000 in 1986, and declining slightly to 3,526,000 in 1987. Loans for single-family residences rose by more than 364 percent between 1982 and 1987, reaching about \$450 billion in both 1986 and 1987.

As the buyers returned to the housing market, the industry enjoyed commensurate gains. Housing starts rose to more than 1.7 million units in 1983, an increase of 60 percent over the previous year, and peaked at 1.8 million in 1986. Housing

starts were 1.62 million in 1987 and 1.47 million in 1988. As a result, America's construction workers returned to the job: the building industry employed 15 percent more people in 1984 than it did at the low point of the recession.

FHA played an important role in assuring the strength and endurance of the housing recovery. To enable FHA to continue to play this role, HUD monitored housing credit demand; and when FHA applications hit historically high levels in the first half of FY 1983, the Administration requested and Congress granted an increase in the FHA credit ceiling, from \$39.8 billion to \$45.9 billion. Additional increases proved necessary in the next few years; in 1988 Congress set the FHA credit ceiling at \$96 billion. These higher ceilings were justified by the increased demand for loans. Applications in FY 1982 numbered just 301,000; in FY 1983 they nearly tripled to 876,000, and in 1986 new records were set as FHA received 1.8 million applications, followed by 1.4 million in 1987.

Of course, the drop in interest rates was the most significant factor in the housing recovery. In September 1981, before the President's Economic Recovery Program had taken effect, the regulated FHA interest rate hit a high of 17.5 percent (not including prepaid points). By December 1986, the deregulated FHA interest rate, as set by the market, had dropped to 9.0 percent, its lowest level since June 1978.

The difference of 8.5 percentage points meant tangible savings for those families obtaining FHA loans. The payment on a typical 30-year, \$60,000 loan decreased from \$880 a month for principal and interest to \$483, or a savings of \$397 per month. Over the 30-year life of a loan, the total savings would amount to \$142,920.

The combination of lower interest rates, less rapid inflation of housing prices, and rising household incomes had a dramatic impact on the Housing Affordability Index. Published monthly by the National Association of Realtors, this index measures the ratio between the median price of an existing single family home and the median-family income.

In 1981, before the effects of the Economic Recovery Program had begun to be felt, a median-income family had just 68.9 percent of the income needed to purchase a median-priced home. By 1986, a similarly situated family had 105.7 percent of the necessary income - and by the start of 1988 that figure had risen above 113 percent. (These figures assume a 20 percent downpayment, and use the Federal Home Loan Bank Board's effective rate on single family loans closed.)

Simply put, these figures indicate that, while in 1981 a family with a median income had little hope of being able to buy a median-priced home, by 1986 that purchase was within their reach; and subsequently became even more affordable.

The unprecedented demand for FHA-insured loans also extended to refinancing of existing loans made during the high-interest years. FHA's processing system was not geared to cope with this volume of business, and a logjam seemed inevitable. HUD responded with a series of moves designed to increase flexibility and speed up processing. Steps were taken to cut red tape for all loan applications and to streamline the refinancing process; cases were shifted from busier FHA offices to those experiencing a more normal workload. HUD detailed employees from other tasks to help with the processing, authorized overtime for existing employees, and hired temporary staff. As a result, the flood of applications was processed by HUD's field staff with far fewer delays than might have been anticipated.

In short, during the Reagan Administration FHA performed as it was originally intended in helping to guide the housing industry from recession to recovery. Because FHA loans react more quickly to reduced interest rates in the secondary markets, they tend to be ahead of conventional loans in lowering interest rates

and increasing volume. Therefore, although private sector activity propelled the recovery, the availability of FHA-insured loans both stimulated and sustained the housing recovery.

EASING THE PATH TO HOMEOWNERSHIP FOR UNDERSERVED POPULATIONS

As has been noted, the decision was made early in the Administration to focus FHA programs specifically on targeted groups. To achieve that objective, HUD undertook a number of carefully crafted initiatives.

Help for First-Time Homebuyers

For first-time homebuyers, there were two major roadblocks on the path to home ownership. They needed cash for the 10 to 20 percent downpayment most lenders required; and they had to show incomes sufficient to meet lenders' criteria and support payments on the homes they wanted to buy. Yet young adults, often with growing families, had difficulty accumulating the savings needed for their downpayments. And, in the early stages of their careers, many could not meet the income requirements set by conventional lenders.

HUD attacked the downpayment problem with a proposal that was ultimately adopted by Congress in the Housing and Urban/Rural Recovery Act of 1983 (HURRA). HURRA authorized a lower downpayment on the first \$50,000 of a home's value, reducing the required figure from 5 percent to 3 percent. This lowered the downpayment on a \$50,000 mortgage from \$2,000 to \$1,500, a reduction of 25 percent. While a savings of \$500 may seem relatively insignificant, it can be enough to make the difference between affordability and impossibility for some young families.

To help first-time homebuyers qualify for loans, FHA relaxed its underwriting standards. Again, the change was directed toward the marginal homebuyer. Previously, FHA required that a family could spend no more than 35 percent of its net effective income (total income less Federal tax withholding) for housing expenses, and 50 percent of that figure for total fixed liabilities (that is, the total of housing payments plus such expenses as car loans, personal loans and credit card payments).

In 1982, FHA's income-expense ratios were raised to 38 percent for housing and 53 percent for total fixed liabilities. This administrative change recognized that most Americans were willing to devote a larger portion of their incomes to housing. The relaxation was modest enough to maintain the integrity of the insurance fund, but large enough to help many prospective homebuyers.

At the same time, FHA took steps to conform to the private mortgage market by offering several new types of mortgages designed, in part, to help first-time buyers. The years of high interest rates had encouraged private lenders to introduce a variety of alternative mortgages that permitted buyers to pay below-market interest rates, at least in the early years of the loan's life. Some of these alternative loans were introduced by FHA by administrative action; others required legislative approval. Among the alternative loans introduced administratively by FHA in 1982 were Growing Equity Mortgages (GEMs), which allowed young homebuyers to negotiate a lower interest rate from a lender in return for a shorter loan term.

In 1983, Congress approved the Administration's request for legislation to allow FHA to insure Adjustable Rate Mortgages (ARMs), which allowed borrowers to obtain mortgage loans at an initially low interest rate, making it easier for first-timers and other eligible buyers to qualify. The lender was permitted to raise the

rate of interest periodically, usually on an annual basis, to reflect prevailing market conditions. Adjustments were permitted only as set forth in the original mortgage and "capped" so that a sharp rise in interest rates during a single year could not impose an excessively large increase in monthly payment on a borrower, who might be unable to absorb it.

Meanwhile, GNMA introduced a mortgage-backed securities program exclusively for the new FHA ARMs. The GNMA guarantee on FHA-insured ARMs allowed those loans access to the important secondary financing market. By the fall of 1988, GNMA had guaranteed over \$4.56 billion in securities backed by ARMs, and other guarantors of mortgages in the secondary market had also entered the field.

HUD also contributed significantly to the development of Home Equity Conversion Mortgages which Congress included as an FHA program in the Housing and Community Development Act of 1987.

Improved FHA Services for Rural Areas

Traditionally, people in rural areas have difficulty obtaining all types of loans, especially mortgages. Lending institutions, even those using FHA insurance, can rarely generate enough business in rural areas to make their operations there cost-effective. To bridge this gap, HUD authorized urban lenders without rural offices to allow real estate brokers to prepare FHA loan applications in return for a fee. This helped increase FHA-insured loan placements in rural areas without imposing unrealistic demands on lenders.

HUD also took other steps to facilitate mortgage lending in rural areas. In earlier years, rural lenders had been discouraged from offering FHA-insured loans by HUD's red tape, which required a separate application for FHA insurance, in addition to the lender's application and that required by the secondary market purchasing agency. Rural lenders often did not have the personnel to cope with multiple applications. So, to simplify their task, HUD began to allow them to use the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation forms for their FHA insurance applications.

Rural lenders also share with others the need to replenish the available funds by selling their mortgages on the secondary market. The low volume of business in rural areas made secondary market sales difficult, however, because it took rural lenders a long time to accumulate enough loans to create "packages" large enough to be saleable in the secondary market. HUD responded to this problem by creating a new GNMA II securities program, which could be joined with those of other issuers to create "jumbo" pools guaranteed by GNMA.⁵ Thus, small rural lenders could sell their loan portfolios more readily and use their replenished funds to make additional mortgage loans.

HUD also began allowing greater flexibility in financing manufactured homes and autonomy for lenders to approve loan applications. Both actions, which are discussed in more detail later, were important tools for rural areas. When combined with other Departmental initiatives, they improved access to mortgage credit by rural residents.

⁵See Page 46 for description of GNMA II.

Serving American Indians⁶

HUD, under the Reagan Administration, also focused the Department's responsibility for meeting shelter needs of American Indians. While many had very low incomes and needed the assistance of HUD's subsidized housing programs, approximately 10 percent of those living on tribal lands had the financial means to become homeowners. There was, however, a serious lack of credit services on Indian tribal lands, and often the only housing was subsidized housing. This meant that Indians who did not need subsidies often were forced to move off the reservation. That deprived the Indian community of its successful role models as well as some of its most productive citizens.

FHA, therefore, seemed to have an especially appropriate role to play in helping Indians who lacked access to the conventional mortgage market.

Until the latter part of 1983, however, HUD's efforts to serve potential Indian homeowners were stymied by the collective land ownership system on Indian reservations. HUD could not insure units where the transfer of the property was restricted. A similar situation existed in Hawaii, where the land is owned by an entity of the State rather than by individuals. These problems were resolved by HURRA, which granted HUD the right to issue FHA insurance on homes with property-transfer restrictions. HUD then implemented the regulatory changes necessary to expand FHA to the Indian tribal lands and Hawaii, expanding the homeownership opportunities of those who lived there.

The thrust of this redirection was to reach out to those excluded from traditional mortgage programs, and provide middle-income Indians with the option of becoming homeowners while remaining on tribal land. The Chairman of the Navajo Indians, for example, estimated in 1988 that under the new law as many as 10,000 Navajo families alone could qualify for FHA-insured loans, doubling the housing supply on the reservation within three or four years.

Similarly, FHA programs were being developed in 1988 for some of the U.S. Territories. By that year a program was already in place in the Northern Mariana Islands, and a demonstration program was being developed in American Samoa; opening the way for FHA insurance in those Territories.

Negotiated Interest Rates

By law, the Secretary of HUD was obligated to set a ceiling on the interest rates for virtually all FHA-insured mortgages. In 1981, the new Administration opened this issue for thorough examination. HUD officials found, first of all, that while the FHA rate tended to be lower than the market rate, lenders usually made up the difference by charging prepaid points. A point is 1 percent of the mortgage, and has to be paid by the seller or the homebuyer at the time the purchase is completed. That meant the up-front cost could be sizable - \$500 for one point on a \$50,000 mortgage.

In times of rapidly accelerating interest rates, moreover, lenders would frequently adjust the points they charged upward, if FHA did not move quickly to increase the allowable interest rate on the mortgage. It was FHA policy that the buyer would pay only one point, and that the seller would pay all other points.

This artificial system had several drawbacks. Sellers resented being required to pay points to secure the purchaser's financing. It was widely believed that sellers who anticipated the use of an FHA-insured mortgage compensated by raising the

⁶More details about programs for Indians and Alaska Natives appear in Chapter II and other sections of this Chapter; see also Chapter IV, pp. 59, et. seq.

selling price to cover the highest likely number of points they might have to pay. If successful, this would cause an unwarranted inflation in home prices. In the worst cases, high points drove sellers to reject outright potential buyers using FHA financing.

To eliminate these distortions, HUD asked Congress to authorize FHA to move to a negotiated interest rate. Under a negotiated system, the market - and not a regulatory ceiling - determines the interest rate. In addition, the new system would enable FHA purchasers to benefit from a wider choice of housing units.

This proposal by HUD met with skepticism from several sources. Some members of Congress persisted in believing that, by setting an FHA rate, the agency was controlling interest rates. Despite the initial doubts, however, in 1983 HURRA incorporated HUD's proposal for a negotiated interest rate on FHA-insured loans.

Once again, the name of the game was flexibility. Negotiated rates gave buyers and sellers the flexibility to design financing packages best suited to their needs. Some homebuyers used this flexibility to reduce their long-term interest costs, by paying higher discount points up front. Others chose to pay a slightly higher interest rate, when market conditions required, to reduce the discount points that they, or the sellers, had to pay. In either case, however, home sellers apparently continued to pay the bulk of the discount points on FHA-insured mortgages.

In further response to changing market conditions, FHA introduced provisions for homeowners with high-interest mortgages to refinance their loans when rates fell. Previously, HUD had no relevant regulations, since this situation had never before existed. But with the sharp decline in interest rates in 1983-84, HUD moved quickly to adapt FHA's programs to meet the needs of homeowners wishing to reduce their monthly payments.

Direct Endorsement

The conversion by FHA to negotiated interest rates represents the government's adoption of private sector practices. However, in single family loan processing, HUD went a step beyond simply imitating private sector practices and actually brought in the private sector as a partner in the loan approval process. The new arrangement was called Direct Endorsement. It allowed decisions on the credit-worthiness of the individual homeowner and on the value of the property to be made by the private lender in conformance with HUD criteria. Once the lender completed the necessary processing, the loan package would be returned to HUD, which, after checking a few statutory requirements, endorsed the loan.

The assurance of HUD endorsement was vital to the integrity of the process; that is, the lender had to be assured of HUD endorsement for the delegation of authority to be effective. To ensure that its quality standards would be met by lenders, HUD conducted desk audits of 100 percent of the lender's work for the first six months of its participation in the Direct Endorsement program. If the lender completed this probationary period with satisfactory performance, only half its loans, selected on a random basis, continued to be reviewed by FHA in desk audits. Ten percent of its loans continued to be subjected to exhaustive examination, involving a total reworking of the mortgage package by HUD employees.

These quality controls assured HUD that the public was receiving appropriate service from the private lender and that there was no unanticipated risk to the FHA fund. The FHA fund covers the mortgage and loan insurance activities of about 40 HUD insurance programs, which are grouped into four separate insurance funds: the Mutual Mortgage Insurance Fund, the Cooperative Management Housing Insurance Fund, the General Insurance Fund and the Special Risk

Insurance Fund. Each fund is treated as a separate entity in terms of income, expenses, and net reserve position.

Direct Endorsement provided much faster service to the homebuyer. The procedure eliminated the old process in which both the lender and HUD had to thoroughly review every application, a time-consuming process. Direct endorsement saved the time that had been spent transmitting documents between the lender and HUD, often several times in the course of one application, and in HUD's review and approval process. Timeliness is always important to homebuyers, and crucial when interest rates are volatile; delay in consummating a loan can mean higher interest rates or even lost purchase opportunities. Direct endorsement enabled HUD, in cooperation with the private lenders, to deliver speedy and accurate service, successfully accomplishing its mission.

Manufactured Housing

HUD is also responsible for financing programs for manufactured housing, which the Department saw as a resource for providing affordable homeownership for many Americans and, for some, easily accessible "starter" homes from which they could later trade up to conventional housing. HURRA implemented many of the Administration's proposals for improvement in the manufactured housing programs. For example, the mortgage limit for the purchase of a manufactured home was increased from \$22,500 for single-part units and \$35,000 for multi-part units to \$40,500 for either size. The ceiling on loans for a single- or multi-part manufactured home and lot was increased from \$35,000 to \$50,000. These mortgage limits were made subject to upward adjustment in high-cost areas. HUD also instituted a major reform to encourage lenders and communities to assign manufactured homes the same status as conventionally built homes.

In addition, HUD obtained legislative authority to allow FHA to insure loans on manufactured homes in parks exclusively for the elderly, who sometimes prefer to live in communities composed only of their contemporaries. Prior to this legislation, manufactured home insurance had been guided by multifamily program restrictions, which required the availability of lots to families with children. This requirement made the properties much less desirable to many older Americans.

In 1985, the Department responded to nationwide health concerns and published regulations governing the emissions of formaldehyde from plywood and particle-board used in manufactured homes. This was the first Federal health and safety regulation of a toxic emittant material commonly used in construction.

Subsequent experience with manufactured homes showed inordinately high rates of foreclosure, repossession, and depreciation. To counteract the adverse impact of these problems on homebuyers and on the FHA insurance fund, HUD initiated a series of regulatory changes early in 1987.

Deregulation

Reducing the burden of government regulation was a major component of the Reagan Administration's program, and HUD put great emphasis on the deregulatory effort in this period. The Department's goal was to support the dynamic housing market, by providing home purchasers, tenants, lenders, and State and local governments with prompt, efficient service. Where programs and procedures interfered with that objective because of a lack of regulatory flexibility, HUD officials set out to remove any regulatory roadblocks to efficient service and operations.

One of the first problems tackled by HUD was the requirement for Environmental Impact Statements (EIS) on subdivisions seeking blanket FHA eligibility. An EIS is a formal analysis, supervised by HUD but carried out by the builder, which details the effect of the project on the surrounding community and its environment. Under regulations in place in 1981, HUD required an EIS on any subdivision of more than 500 units. The EIS process is, however, expensive and time-consuming; moreover, HUD had discovered that housing projects with fewer than 2,500 units generally have only a marginal impact on the environment. HUD therefore raised the threshold from 500 to 2,500 dwelling units, effectively removing the EIS requirement from 99 percent of subdivision applications. This reduced developers' costs without sacrificing environmental quality.

Another regulatory problem was presented by Minimum Property Standards (MPS), which were part of the original FHA insurance program enacted in 1934. The MPS had been designed to assure lenders and consumers that housing insured by FHA would meet at least minimal standards of quality. At that time, there were no national building standards, and the uneven quality or absence of local codes and inspection procedures necessitated this Federal response. Subsequently, however, the need for a Federal role diminished as consumer demands forced builders to provide amenity levels and quality of workmanship at least as high as the MPS. Further, the emergence of national model building codes adopted and enforced by local governments also assured a high quality of construction.

Since federally imposed standards were no longer needed, HUD changed the single family MPS to remove the marketability and liveability criteria. The Department subsequently proposed regulations to defer to local model codes for health and safety requirements. This removed overlapping Federal regulations and reduced the cost, but not the quality, of FHA-insured single family buildings.⁷ For multifamily housing, HUD also eliminated unnecessary requirements and adopted the health and safety criteria in the national model building codes used by State and local governments.

Multifamily Coinsurance Programs

In support of President Reagan's emphasis on public/private partnerships for economic growth and development, HUD officials worked to increase the involvement of the private sector in meeting America's housing needs. As a part of this effort, the Department expanded its Coinsurance Program to include HUD's Multifamily Housing programs.

Coinsurance, first authorized by the Housing and Urban Development Act of 1974, was a mechanism by which private lenders assumed a portion of the risk for FHA-insured loans in return for a high degree of autonomy in processing. However, it was not until 1983 that coinsurance was applied to HUD's multifamily programs.⁸ In the following years the program grew steadily; by the end of FY 1988, close to 1300 projects with a total mortgage value in excess of \$8 billion had been coinsured.

Under Coinsurance, HUD-approved lenders could perform all the underwriting, servicing, and property disposition involved in a project. Eliminating the need for

⁷Also, while HUD recognized rent control as a subject for local determination, it was also aware that HUD's own controls frequently threatened the financial security of FHA-insured projects and created a disincentive for investment in maintaining or developing multifamily dwellings. Therefore, for most unsubsidized rental projects, HUD decontrolled rents completely; for others, where controls were required by statute, HUD lessened significantly the regulatory restrictions it had formerly imposed.

⁸Included were retirement service centers, board and care facilities, nursing homes, and similar facilities under Sections 221(d) and 223(f).

duplicative efforts by HUD and the lender reduced the length of time needed to approve multifamily mortgage insurance applications.

The program made it possible for lenders to offer lower interest rates, because they had greater control over the approval of borrowers, and because coinsured loans could be packaged for resale as mortgage-backed securities guaranteed by GNMA. Coinsurance also reduced potential claims on the FHA insurance fund and the resultant drain on the Treasury, by requiring lenders to share the risk.

Protecting FHA from Fraud

While FHA single family programs definitely "worked," in the sense that they were actuarially sound, attracted a high volume of business and showed a profit, they had been vulnerable - like many government programs - to fraud and abuse. Secretary Pierce was particularly anxious to minimize opportunities to defraud the Department and put his personal authority behind efforts to achieve the goal. In June 1985, he established the Single Family Task Force to study problems in FHA's Single Family insurance programs and to recommend changes in regulations or operating procedures necessary to minimize abuse of those programs. Many changes were implemented to "fine tune" the programs without detracting from their overall effectiveness.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

GNMA was created in 1968 to support the Government's housing objectives by establishing secondary market vehicles for residential mortgages, thereby attracting private capital to the maximum extent feasible. GNMA played a major role in furthering the Reagan Administration goal of expanding homeownership opportunities for low- and middle-income Americans.

GNMA issues mortgage-backed securities (MBS), which increase the availability and affordability of credit for housing by providing an efficient vehicle for channeling funds from the securities markets into the mortgage market. GNMA also helps ensure that mortgage funds are available throughout the country and has all but eliminated regional differences in the availability of mortgage credit.

GNMA guarantees privately issued securities backed by pools of mortgages insured by FHA and Farmers Home Administration (FmHA) or guaranteed by the Veterans Administration (VA). Investors who hold the securities receive a monthly "pass-through" of the principal and interest payments due on the pooled mortgages. The GNMA guarantee assures securities holders of receiving timely payment of the scheduled monthly principal and interest as well as any prepayments, and of early recovery of principal on the underlying mortgages.

Several statistics highlight the dramatic growth in GNMA's Mortgage-Backed Securities Program during the 1981-89 period:

- The dollar amount of GNMA securities issued increased from a cumulative total of \$111 billion to over \$500 billion at the end of FY 1988. The nearly \$400 billion issued represented about 80 percent of the total issued during the entire life of the program. About nine million housing units were financed as a result.
- The number of pools of mortgages (packages of mortgage loans of \$1 million or more) which back privately-issued securities grew from 51,557 to more than 200,000.

- GNMA securities traded in the secondary market – a prime measure of their liquidity and popularity – increased at an unprecedented rate during this period.

A number of GNMA initiatives contributed to its expanded role in the secondary mortgage market, including:

- **Broadening the Domestic Investor Base in Mortgage-Backed Securities**

Working with the Department of Labor, the Internal Revenue Service, and business and labor representatives to break down counterproductive regulations and artificial barriers, Secretary Pierce encouraged pension and retirement funds to invest more heavily in GNMA securities. According to HUD statistics, GNMA securities consequently comprise the single largest type of mortgage-related investment by both public and private pension funds, accounting for over one-third of their mortgage-related holdings.

Significantly, in the mid-1980's the individual private investor discovered the safety, liquidity and high yield which Ginnie Mae securities represent. Spurred by favorable articles in the national investment media and the increasing availability of GNMA unit trusts and mutual funds (with investment minimums of \$1,000 or less), individuals who previously lacked the ability or inclination to invest in these securities began to do so in record numbers. In fact, individual investors comprised the single fastest-growing category of GNMA investors during this period.

At the same time, GNMA initiated a cooperative effort with the Securities and Exchange Commission, the National Association of Securities Dealers, and broker-dealers themselves to combat unfair and misleading advertising in the marketing of GNMA securities. GNMA also issued a series of educational brochures designed to inform the public about investment opportunities.

- **Providing International Investment Opportunities**

The Secretary also led the drive to make GNMA securities available in significant quantities in global capital markets for the first time in GNMA's history. The result of this initiative was that overseas investment in GNMA's rose from negligible levels in the 1970's to between \$10 billion and \$15 billion in the 1980's. GNMA obtained a listing for its securities on the internationally recognized Luxembourg Stock Exchange in June 1983. Further progress was made in 1985, with increased trading in Asia and the announcement of the first British unit trust ever backed by mortgage-backed securities.

- **Continuing Innovations in Mortgage-Backed Securities Offerings**

GNMA instituted several important changes during the Reagan Administration to reflect the diversity of mortgages appearing in the marketplace, including the institution on July 1, 1983, of the GNMA II program. Key features of GNMA II included the use of a central paying and transfer agent and the availability of "jumbo" pools – large, geographically dispersed multiple-issuer pools, including many with adjustable rate mortgages. Technological innovations accompanying the implementation of GNMA II were soon emulated by the private sector.

Other innovations between 1981 and 1989 included allowing securities backed by pools of "buydown" mortgages (1981), permitting securities backed by 15-year loans (1982), implementing a new 10-year Graduated Payment Mortgage (GPM) pool (1982), providing a new Growing Equity Mortgage (GEM) security (1983), and introducing a program for pooling certain coinsured project mortgages (1983).

• Increasing Administrative Efficiencies

Challenged with an ever-increasing volume of paperwork, GNMA developed new uses for computerization, including electronic pool monitoring. Improved administrative efficiencies helped GNMA keep pace with a three-fold increase in the number of mortgage pools outstanding, with virtually the same number of employees it had in 1981.

In 1986 GNMA moved towards implementation of electronic book-entry for GNMA securities through the privately owned Mortgage-Backed Securities Clearing Corporation (MBSCC). Securities clearances, settlement, and trading through the depository afford better pricing for investors, provide increased market efficiencies, and virtually eliminate fraud.

The foundation was also laid for GNMA's automated commitment line system, which became operational in 1987. This system was designed to register and track commitment authority granted to mortgage bankers by providing a credit line against which the issuer can draw for securities issuance. By replacing the cumbersome and uncertain pool-by-pool commitment process, this gives lenders more control over their mortgage securities issuance and reduces paperwork for all parties.

In short, progress during these years yielded a stronger and brighter future for GNMA. In partnership with the private sector, including the homebuilding, banking, and securities industries, GNMA added stability and credibility to the secondary mortgage market and helped to fulfill the Administration's agenda of affordable homeownership for Americans.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

In the mid-1980's a new investment vehicle for mortgage-backed securities emerged, called Real Estate Mortgage Investment Conduits (REMICs). It was estimated that REMICS, which permit highly selective targetting of investments, might attract as much as \$60 billion into the mortgage market in the first year they were introduced, an estimate that proved to be low.

The Federal National Mortgage Association (FNMA) is a privately held corporation, regulated by HUD, with a mandate to increase the supply of funds for housing. When FNMA proposed issuing REMICS on an unrestricted basis HUD officials demurred. HUD determined that FNMA had certain advantages in the market over other private sector issuers of such securities, that competition would be hindered and the result would be a less efficient market; that is, the investment market for REMICS would be dominated by FNMA and less investment would be attracted to housing. Therefore, until October 1988 HUD withheld from FNMA unrestricted authority to issue REMICS, and the result was the entry of other private issuers into the market, greater competition, and larger infusions of funds for housing investment than would otherwise have been the case.

JOINT VENTURE FOR AFFORDABLE HOUSING

By the time the new Administration took office at the beginning of 1981, homeownership was becoming an increasingly elusive goal for the average American. The high interest and inflation rates of 1979-80, and the recession into which the Nation was sliding as 1981 began, were among the more obvious causes of this situation. A less obvious cause was the growth of regulation of housing design and construction that was steadily driving up the cost of new homes. Some building specialists, including members of the President's Housing Commission, calculated that overregulation had added as much as 20 percent to housing costs.

Early in the fall of 1981, HUD created a task force to consider options for increasing the affordability of housing even in the face of the existing economic situation. The task force determined a strategy for responsible deregulation that would lower the cost of home construction, and thus prices, for the homebuyer. Its report was delivered on November 20, 1981, and on January 20, 1982, Secretary Pierce publicly announced the launching of the Joint Venture for Affordable Housing (JVAH).

As the program's name suggests, cooperation between the public and private sector, and among government authorities, was to play a key role in achieving the goal of cost reduction. Essentially, the success of the JVAH turns on the development of effective public/private partnerships between local governments and the housing industry. To foster these partnerships, HUD joined with the National Association of Home Builders.

As time went on, the partnership was steadily broadened to include a growing number and variety of organizations: the American Planning Association, the Council of State Community Affairs Agencies, the International City Management Association, the Manufactured Housing Institute, the National Association of Counties, the National Association of Realtors, the National Association of Real Estate Brokers, the National Conference of State Legislatures, the National League of Cities, the United States League of Savings Associations, the Urban Land Institute, the National Association of Home Builders - and HUD.

While these organizations were national, the JVAH focused on their local constituencies because regulatory restrictions on housing were largely local. HUD could act as a catalyst and could reduce and simplify its own regulations - both of which it did - but the real challenge was to induce State and local authorities to reexamine regulations in their jurisdictions that drove up building and development costs.

The regulations in question varied from community to community. They ranged from processing requirements that caused costly delays in subdivision and site approval, to unreasonably high (and expensive) standards for subdivision roadways and sewerage systems, to restrictions on the use of newer and more efficient construction techniques and materials.

For example, in early 1980, a typical county planning authority required eight separate application forms, each with accompanying instruction sheets, to establish a Planned Unit Development. By revising the applications, the agency was able to consolidate them into a single, one-page form for a single development project, reducing the developer's paperwork costs and the time needed for the applications to be processed. These savings could be passed on to the homebuyer.

When the JVAH was launched in January 1982, 11 demonstration projects were authorized in ten States. Early results indicated that home prices could be significantly reduced; indeed by as much as 20 percent, if local authorities and builders and developers worked together toward that goal.

As the JVAH demonstration expanded to additional sites, HUD's Office of Policy Development and Research continued working with construction industry groups to develop additional technology and innovative approaches, which resulted in increased savings. The Office developed and published case studies on each of the original demonstration sites. In addition, the National Association of Homebuilders Research Foundation, the contractor throughout the demonstration phase, also produced such other publications as "Building Affordable Homes - A Cost Savings Guide for Builders/Developers."

A continuing evaluation of the JVAH demonstration provided strong justification for implementing the JVAH concepts and technology throughout the housing industry. Toward that end, responsibility for implementing the JVAH was assigned to HUD's Office of Housing in the fall of 1986.

The Office of Housing organized the program on a Regional and field office basis and set an overall goal of at least one JVAH site for every State. Regional representatives were selected to administer the program, and field office JVAH representatives were also named in target localities. In addition, the Regions and field offices were required to develop JVAH implementation teams; hold seminars; develop strategies and economic profiles for targeted sites; and establish contact with appropriate local and State officials, local housing industry officials, and interested builders. Regional and field staff were trained to work with builders and local officials on establishing JVAH sites and on utilizing the lessons learned from JVAH even where no officially designated site existed.

Overall results surpassed expectations. By 1988, at least one site had been established in each State. While 34 demonstration sites had been established between 1982 and 1986, an additional 23 sites came on stream in 1987, and 175 were added the following year. By the end of FY 1988, there was a total of 232 sites nationwide, containing 15,325 approved units.

Direct savings to those who bought these homes averaged 14.1 percent per unit. JVAH homes were selling at \$64,780 on average while comparable non-JVAH units were priced at \$75,413. On a national basis, these figures represented nearly \$170 million of savings for JVAH homebuyers.

A basic goal of the JVAH program was regulatory reform at the local level. In the early years of the demonstration, communities waived some regulations on a temporary case-by-case basis. However, by 1988 communities began to make these reforms permanent. Thus, of the 175 sites approved in FY 1988, 22 incorporated permanent regulatory reform at the outset.

Urban Homesteading

The Department's Urban Homesteading program was also maintained and expanded during this Administration, in order to promote homeownership opportunities for lower income families and help revitalize declining neighborhoods. This program provides for the transfer of unrepaid, residential properties held by HUD, FmHA, and the VA to States or local governments with homesteading programs approved by the Department. Homesteading communities, in turn, conditionally convey these properties for a nominal price (usually \$1, plus closing costs) to qualified families or individuals. Priority is given to applicants at or below 80 percent of the median income for their areas who are otherwise qualified to participate.

Homesteaders agree to repair, maintain, and occupy these homes for at least 5 consecutive years. The properties must meet health and safety standards within one year of initial transfer, and must be brought up to local standard within 3 years. When all requirements are met, homesteaders receive full and clear title to the properties.

Homesteading localities are required to target the program to locally designated neighborhoods and to upgrade neighborhood services and facilities. The homesteaders' ability to finance necessary repairs or willingness to contribute a substantial amount of self-help are other key factors.

The single family homesteading program transferred 6,115 properties to over 150 communities between 1981 and 1988, and was reauthorized at \$13.2 million

for FY 1989. The States of Ohio, Virginia and Wyoming participated as "local" homesteading agencies, operating in more rural areas where no one locality could efficiently mount a program. Similar applications were also being developed by the States of Georgia, Michigan and Oklahoma in 1988.

HURRA authorized HUD to undertake a Local Property Urban Homesteading Demonstration during fiscal years 1984 and 1985. The purpose of the Demonstration was to encourage local governments to develop effective programs for acquiring unoccupied, one-to-four unit properties in the process of tax foreclosure for homesteading. Localities were encouraged to negotiate the acquisition of properties in the early stages of foreclosure to minimize deterioration and to reduce rehabilitation costs. The Department selected 11 localities in December 1984 at a funding level of \$2 million. Grants to the localities ranged from \$21,470 to \$300,000. Localities acquired 129 properties during the Demonstration period and spent \$1,488,477. Several cities lacking Federally owned properties were able to participate in the Demonstration using local properties for homesteading.

SUMMARY

Housing was in the doldrums when the Reagan Administration took office in 1981. However, the success of the President's Economic Recovery Program and of HUD policies initiated by the Secretary and his staff resulted in a dramatic housing turnaround in the first term, which was augmented in the second.

Between 1981 and 1988, the insuring authority of FHA and GNMA's issuance of mortgage-backed securities were expanded; as a result new capital was attracted to housing at unprecedented rates. At the same time, HUD instituted regulatory relief at all levels of government, which contributed to the expansion of housing opportunity, particularly for first-time, and low- to moderate-income homebuyers. The growth of GNMA in those years is indicative of the effectiveness of these policies: between 1981 and 1988 GNMA insurance grew from \$111 billion to over \$500 billion. The nearly \$400 billion difference represents an estimated nine million homes for Americans with FHA-insured or VA-guaranteed mortgages.

In the same period, a deregulatory initiative called the Joint Venture for Affordable Housing, enabled low- to moderate-income Americans to purchase homes for an average of over 14 percent below comparable homes built under old codes. Nationwide, more than 15,000 homes built under JVAH saved homebuyers nearly \$170 million. As a long-term effect, excessive local building restrictions were increasingly curtailed.

While the housing industry was in a deep recession in 1981, it recovered during the Reagan era, helping Americans once again realize the dream of homeownership.

HUD's Role in Community Development

Under the Reagan Administration, programs of HUD's Office of Community Planning and Development (CPD) were tailored to stress economic growth by means of public/private partnerships and local public entrepreneurship. To this end, establishment of Enterprise Zones, a strategy for urban and rural economic development embodying both these concepts, was a principal Administration goal.

While Congress delayed passage of Enterprise Zone legislation, the idea took hold in State houses and city halls throughout the country. By the end of 1988, 37 States had enacted their own Enterprise Zone legislation, and both Pennsylvania and the District of Columbia had adopted the concept by executive order. As a result, thousands of State zones had been designated. Many were already flourishing, producing jobs and local revenues.

At the same time, HUD worked to make its Community Development Block Grant (CDBG) program more flexible, in order to accommodate disparate local needs, foster local decision-making, and enhance private sector participation in the economic development process. Red tape was reduced as regulations and procedures were streamlined. The following is a review of developments in CDBG and other established CPD programs, and in Enterprise Zones, between 1981 and 1989.

URBAN DEVELOPMENT ACTION GRANT PROGRAM

The course of the Urban Development Action Grant (UDAG) program from 1981 to 1989 illustrates, in a number of ways, the decision-making process and management style at HUD during the Reagan Administration. UDAG, which had been budgeted by the previous Administration at \$500 million for FY 1982, came under considerable criticism, largely from those who believed that the Federal government should not be involved in funding local economic development projects. On the other hand, many mayors and local officials found the UDAG program useful, particularly because of its emphasis on cooperation in economic development projects: between the localities and the Federal government, and between the public and private sectors. Nevertheless, the UDAG program was slated for rescission in FY 1982 by the Office of Management and Budget.

In order to obtain an objective analysis of the program, Secretary Pierce ordered it evaluated soon after taking office. The preliminary findings indicated that criticism of the UDAG program focused more on its performance than on its objectives. UDAGs were intended to leverage private investment, and thereby stimulate job creation in targeted areas, for economic development projects that could not be successfully launched without the relatively small but crucial infusion of Federal funds. Criticism centered on projects where UDAG money seemed only to substitute for other investment. These early study results indicated:

- Strong support for UDAGs both in the private sector and at all levels of government.
- Exceptional effectiveness in leveraging large amounts of private investment.
- Some overstatement of the objection that UDAGs were funding projects which would otherwise have been privately funded (the "substitution" issue).

- Smaller sums of money than previously budgeted would be adequate to continue UDAG, because of a backlog of uncommitted funds.
- Opportunities for fine-tuning and re-targeting that could increase the efficiency and effectiveness of the UDAG program.

Based on these findings, HUD officials concluded that a more carefully focused UDAG program would enhance its effectiveness as an instrument for private sector economic development and job creation, and thus contribute to the Administration's Economic Recovery Program.

The next step was to present the case, as HUD saw it, in favor of continuing the program. At a meeting with the President, the Secretary of HUD and the Director of OMB presented their cases for and against, respectively, retaining UDAGs. The President decided to retain it. The UDAG program was subsequently authorized at the lower figure of \$435 million, and included in the Omnibus Budget Reconciliation Act of 1981. UDAG survived another attempt at its rescission in the FY 1983 budget.

While recommending continuation of the program, HUD's 1981 evaluation made a number of recommendations for fine-tuning UDAGs. These included:

- Increased vigilance, particularly at the local level, to further reduce the use of UDAGs as substitutes for private investment, rather than in cases where private financing was infeasible.
- Strengthened oversight to ensure effective and efficient grant management and continued financial commitment.
- Increased targeting and selectivity of UDAG projects.
- Encouragement to local governments to recycle or reinvest their revenues from UDAG projects by establishing local UDAG programs. These would promote additional development and maximize the leveraging capacity of the original Federal investment.
- Focusing more specifically on economic development projects.

With respect to the latter, the report suggested "placing primary emphasis on industrial and commercial projects, or on mixed-use projects, which included housing only as an integral part of a local economic development strategy." This emphasis on promoting permanent job creation and creating additional local tax revenues through economic development was incorporated into the 1981 legislative amendments to the UDAG program.

Local Jobs and Local Revenues

The UDAG program showed impressive results in leveraging private investment and creating jobs. A total of 2,311 projects, including 1,022 in small cities and 1,289 in metro areas, were approved between FY 1981 and the end of FY 1988. They leveraged over \$23.3 billion in private investment in distressed cities with \$3.4 billion in UDAG funds. In other words, each dollar in Federal funds attracted nearly \$7 in private investment over this period. More than 411,000 new permanent jobs and more than 348,000 construction jobs resulted from these projects, and over 63,000 jobs were retained. UDAGs also contributed significantly to the growth of local tax revenues: cumulative UDAG investment between FY 1981 and the end of FY 1988 generated \$520 million per year in revenues for local governments.

At the same time, HUD simplified UDAG regulations and the accompanying application and reporting forms. The Department also revised the eligibility

requirements to help cities with high unemployment rates, and strengthened the role of the field offices.

The Housing and Urban/Rural Recovery Act of 1983 (HURRA) continued authorization of the UDAG program at \$440 million for each of the following three fiscal years.

In 1985, in the face of mounting budget deficits, the Administration called for an end to UDAGs along with many other programs government-wide. However, Congress, supported by a coalition of governors and mayors, kept UDAG in the budget at reduced funding levels. By FY 1988, UDAG funding was authorized at \$225 million, or about half the level that had been proposed for FY 1982. The appropriations act for FY 1989 eliminated funding for the program, leaving only funds recaptured from projects which had received preliminary approval in prior years.

STATE-ADMINISTERED COMMUNITY DEVELOPMENT BLOCK GRANT SMALL CITIES PROGRAM

Beginning in 1974, the Community Development Block Grant (CDBG) program for Small Cities had been HUD's principal resource for helping nonentitlement communities, that is, with less than 50,000 population, and urban counties with populations under 200,000.

The program was intended to help these small cities and counties meet their needs for community and economic development as well as housing revitalization. The new HUD leadership team sought to improve the best features of the CDBG Small Cities program and align them with the overall thrust of the Administration's policies.

HUD officials felt strongly that the program should be transferred to the States in order to place decision-making responsibility closer to the level of need. They argued that States were in a better position than HUD both to understand and respond to local needs. Moreover, it was believed that by eliminating one level of bureaucracy, a State-administered program could reduce paperwork and, thereby, its operational costs.

These convictions led to a basic redesign of the Small Cities CDBG program. At the Administration's request, Congress authorized this new design in the Omnibus Budget Reconciliation Act of 1981. The States were given the option of assuming administrative responsibility for the Small Cities program within their boundaries, while HUD was required to continue exercising oversight responsibility.

States Choose Responsibility

In FY 1982, the first year States could elect to administer the new CDBG Small Cities program themselves, 36 States and Puerto Rico opted to do so. The following year, 10 more picked up the option, spurred on by the success of the others. By 1988, only Hawaii and New York were still under the HUD-administered program.

The 1981 legislative amendments, and the 1982 regulatory changes that HUD established to implement them, effectively simplified and streamlined the program. The new approach offered States maximum flexibility to design and implement their individual programs within the framework of the statute. They were allowed to determine their own methods for distributing funds, set their own priorities and establish their own policies and processes. The Secretary's Discretionary

Fund¹ was made available to channel technical assistance to the States to help them develop their programs.

State Initiatives

Typically, the States undertook two main initiatives in administering the CDBG Small Cities program. First, they launched outreach efforts to increase smaller communities' awareness of the availability of CDBG funds, and provided technical assistance to help newly involved communities shape effective programs. Second, the States encouraged leveraging: the use of public funds to attract private investment.

The success of these efforts was documented by a study conducted by Urban Systems Research and Engineering, Inc. (USRE)², and an evaluation by the General Accounting Office (GAO)³. The data that follow were drawn from these sources, and from HUD's *Consolidated Annual Reports to Congress on Community Development Programs*, 1981 through 1988.

Outreach and Technical Assistance

The USRE study found that the States that elected to administer the CDBG program were more effective than HUD had been in communicating the availability of funds to their small cities. State administrators recognized that small cities, towns, and rural communities frequently operated with only part-time, non-salaried officials. Even though Federal funds had been available to them for some time to counteract decline or decay, many officials lacked the time or expertise to research and tap these available resources. State officials recognized that outreach and technical assistance were key elements in expanding the range of program recipients to include these previously overlooked communities.

The administrators of a number of State programs found that outreach efforts also enabled them to establish closer working relationships with local governments. Several of the State agencies involved had little prior experience working with local governments, and their administrators perceived the CDBG program as an opportunity to forge new linkages. Moreover, State officials believed they were in a better position than HUD field offices to promote the program in various localities.

Leveraging Private Sector Investment

Throughout the 1980s, HUD encouraged economic development activities and public/private partnerships to improve communities' potential for economic growth. The Omnibus Budget Reconciliation Act of 1981, as noted, gave CDBG grantees the flexibility to put greater emphasis on economic development. The States overwhelmingly took up HUD's challenge to leverage private resources and concentrate on growth-producing activities. In fact, 33 of the 46 States administering their own CDBG programs included leveraging private sector investments as a factor in their selection criteria. Funding for economic development activities increased significantly during the first three years of the Administration⁴.

¹The Secretary's Discretionary Fund is an amount set aside each year by Congress out of the overall CDBG appropriation to fund four categories: CDBG for Insular Areas, CDBG for Indian Tribes, Technical Assistance for Title I programs and Special Projects for States and local governments.

²"The State CDBG Program; First Year's Experience," USRE, May 1983, HUD/PDR/636.

³"States are Making Good Progress in Implementing the Small Cities CDBG Program," GAO, September 1983, GAO/RCED-83-186.

⁴U.S. Department of Housing and Urban Development, Office of Community Planning and Development, *Consolidated Annual Report to Congress on Community Development Programs* (Washington, D.C.: U.S. Department of Housing and Urban Development 1984). Pages 54, 55, and 59.

As a result of greater leveraging and emphasis on economic development, the State-administered program grants could be smaller than corresponding awards under the previous system. In fact, State grants under the new program proved to be half that of the HUD-administered program, averaging \$250,000 as opposed to \$493,000. The States continued to grant smaller amounts through 1988 in efforts to make the program more accessible to larger numbers of smaller communities.

The success of State efforts to increase leveraging is documented in a GAO study⁵ of the first year of the State program. In that sample, the number of projects leveraging investment from other sources rose by almost 400 percent; and the total amount leveraged grew by over 900 percent. The States clearly made every HUD dollar do more.

The program also helped the States position themselves to develop advantageous relationships with private sector investors. In 1983, program statistics showed that for projects leveraging other investment, one dollar of HUD financing generated nearly four dollars from other sources, a ratio sustained through 1988. Overall, the result of the Small Cities program was to focus the attention of these communities on economic development activities that leverage investment from the private sector.

As a result of the States' efforts to develop outreach initiatives and involve the private sector, by 1985, 33 States had special economic development set-asides. Moreover, a larger proportion of funds was being committed to activities designed to develop public/private partnerships and provide jobs to low- and moderate-income people.

CDBG ENTITLEMENT PROGRAM

As HUD's largest community development mechanism, the CDBG Entitlement program - funded at more than \$2.6 billion in 1981 - was carefully scrutinized by HUD officials when they first took office. Serving 583 metropolitan cities and 86 urban counties⁶, this program, by its very scale, provided a highly visible testing ground for some key Administration initiatives. Properly directed, it could demonstrate the value of local and private initiative, and of active partnership between the two in a climate of reduced Federal oversight.

In early 1981, the new Administration launched its Economic Recovery Program to combat the deepening recession. The program depended heavily on public/private partnerships at the local level as a key to economic revitalization. Local authorities were encouraged to use CDBG funding to stimulate economic growth in collaboration with the private sector.

Localizing Decision-Making

The challenge to HUD's CDBG officials was to refine the Entitlement program, allowing communities greater flexibility in using their funds for development. On April 21, 1981, the Department proposed a number of major legislative changes aimed at reducing its role in the CDBG program. The Department sought to ease its control of the application process which had been used to provide policy direction, by substituting a much shorter statement of objectives. Federal influence on a front-end development strategy was reduced, and the decision-making process left to the local participants. Program accountability was shifted to the post-grant review and audit by HUD. All of this helped implement the Administration's policies of deregulation and decentralization.

⁵op. cit., Footnote 3, page 54

⁶By 1988, the numbers had grown to 737 metropolitan cities and 121 urban counties.

The emphasis on local design and decision-making, removing counterproductive Federal requirements, and streamlining necessary regulatory protections, also responded to HUD's perception of local needs and concerns. In meetings with governors, mayors, and other State and local officials, Departmental officials heard a consistent call for more flexibility and fewer requirements. They recognized the impact that joint ventures between the public and private sectors could have on both industry and community, and sought to increase opportunities for such problem-solving, goal-oriented partnerships. These possibilities were enhanced by legislation, which HUD requested and Congress passed in late 1981, enabling CDBG grantees to provide direct assistance to for-profit businesses.

In a collateral initiative, HUD promoted public/private development of community energy systems, such as district heating and cooling. These systems could substantially reduce energy costs in a community, and thus both retain and attract businesses, producing jobs and stimulating further economic development.

These and other initiatives enabled HUD to reduce Federal impediments to local decision-making, returning responsibility for program design to the local level, where both Congress and the Administration intended it to be. Unnecessary regulations were eliminated and others were streamlined, all with the clear intent of giving greater control to program participants.

More Development with Less Funding

A key factor in the Administration's equation for economic recovery was to tighten control of the Federal budget and reduce its rate of growth. CDBG entitlement grants were among the programs for which funding levels were cut back as part of this increased fiscal discipline. The response by local governments to this greater fiscal restraint was to take the lead in developing a whole new range of innovative measures, designed to make the Federal contributions stretch further and do more.

Nowhere is this better exemplified than in economic development, which gained rapidly increasing status as a local priority. A study conducted for HUD showed that economic development grew substantially, even in the face of smaller Federal grants. For example, the City of Los Angeles seized upon the 1981 amendments as an opportunity to increase the emphasis on economic development in its use of CDBG funds, packaging them with other grants to leverage large private investments.

This result was consistent with the Administration's conviction that, given the flexibility, local governments could and would take the lead in promoting strong economic growth.

Promoting public/private partnerships - that is, fostering and increasing private enterprise involvement in urban revitalization efforts - was a major goal. Such partnerships also provided a major source of development funding for many cities. For instance, in 1981, Phoenix used a special CDBG loan program to borrow \$10.8 million to redevelop its downtown area. Local officials estimated - accurately - that the loan would leverage more than \$130 million in private funds: a 12-to-1 ratio. This demonstrated the extent to which local government initiative could influence private enterprise involvement in rebuilding local economies.

As part of its effort to stimulate more development - and other community benefits - with less funding, HUD conducted the Neighborhood Development Demonstration Program. The Department awarded up to \$50,000 to participating neighborhoods able to come up with matching funds from local business,

individuals, non-profit or other organizations. The size of the Federal grant was dependent upon the match proposed, the degree of economic distress, and the number of housing units in the neighborhood.

By the end of 1988 - not quite half way through the program - about \$2.4 million in Federal funds had been matched by about \$1.3 million in local funds which:

- created new permanent jobs;
- established or expanded businesses;
- developed new - or rehabilitated or managed existing - housing;
- developed fair housing counseling, youth training, health services, day care; or,
- helped such voluntary neighborhood improvement efforts as clean-up programs or community gardens.

Enterprise Zones

During his campaign for the Presidency in 1980, Ronald Reagan proposed Enterprise Zones⁷ as an innovative approach to economic development in distressed communities. The idea was to designate a specific number of such communities as Enterprise Zones, and offer incentives involving Federal tax and regulatory relief which would encourage entrepreneurs to establish or expand businesses in the zones. The design and administration of such zones were to be the responsibility, primarily, of the States and localities. This would allow economic development to be localized, and nurtured by public/private partnerships, consistent with the new Administration's Federalism policy.

In pursuit of this objective, HUD officials developed legislation to initiate Federal Enterprise Zones, and the first such Administration bill was sent to Congress in early 1982. By 1984, the Administration's bill had passed the Senate twice and won more than half the members of the House as co-sponsors. However, the House leadership failed to bring the legislation to a vote.

A limited version of the proposal was authorized in the Housing and Community Development Act of 1987, which was signed into law in early 1988. Despite its limitations, in 1988 HUD issued regulations for implementing the 1987 law, and sought nominations for urban and rural zones from interested cities.

While Enterprise Zone legislation moved slowly on the Federal level, the concept was eagerly embraced by States and localities all over the country. Between 1983 and 1988, 36 States enacted their own Enterprise Zone legislation, targeting resources from existing State assistance programs. The District of Columbia and Pennsylvania implemented programs administratively.

At the Federal level, several agencies contributed to the growth of State Enterprise Zones. For example, in 1987 and 1988, the Economic Development Administration of the Department of Commerce provided funding priority for projects relating to the zones. Farmers Home Administration (FmHA), in the Agriculture Department, launched an outreach program to ensure recognition of the zones as resources in its rural development activities. Many State Enterprise Zones also received Community Development Block Grants and other HUD funds.

⁷For further information, see "Enterprise Zones in America, a Selected Resource Guide," annotated bibliography of Enterprise Zone reference material, HUD-1022-PDR; Enterprise Zone Clearinghouse, HUD, CPD, Washington, D.C.

By 1988, more than 700 jurisdictions in 31 States and the District of Columbia had designated Enterprise Zones and provided incentives, including tax exemptions relating to property, sales, motor usage, or inventory; fixed-asset or working-capital loan pools; loan guarantees; and credits for hiring new employees, day care, training, or capital investments. These incentives created considerable business and employment.

An independent survey⁸ conducted in 1987 indicated that 67,400 jobs were retained and 113,600 new jobs created in the State Enterprise Zones. Capital investment in zones totaled \$8.8 billion nationwide. While all of this activity cannot be attributed solely to zone designation or incentives, the State Enterprise Zones programs were an important influence in generating economic activity where little or none had occurred before.

Small business start-ups and expansions accounted for most activity in State Enterprise Zones, although large manufacturing and service companies also undertook significant investments and created or retained large numbers of jobs in the zones. The following examples illustrate the diversity of zone activity around the country:

- Connecticut's legislation provided venture capital loans, corporate income tax credits, employment training vouchers, and reimbursements to local governments of 60 percent of property taxes abated and \$1,000 for each manufacturing job created. Connecticut officials estimated that their program, in its first 2.5 years, generated substantial new private sector investment in Enterprise Zones, saving over 5,000 jobs and creating more than 5,000 new jobs in those areas.
- As a result of its earliest experience with a noncompetitive zone program, Florida passed new legislation sunsetting its original zones and creating a competitive program, through which it designated 30 Enterprise Zones. The most successful of the original zones were among the 30 new ones, and they continued their progress with similar incentives plus new State sales tax exemptions.

Florida provided loans and grants for community development corporations in State Enterprise Zones, as well as tax credits for new and expanding businesses. The State also offered industrial revenue bonds and tax increment financing, available only in zones. Among the successfully implemented zones was Tampa's Ybor City, an old cigar manufacturing center with a number of historical structures, which was redeveloped as an "old town." Several new restaurants and a winery were opened, creating 250 to 300 new jobs. Other small business openings added over 100 more jobs.

- The State of Illinois had designated 68 Enterprise Zones by 1988. During the first two years of its program, the State reported that 3,555 jobs were created and more than 5,360 jobs saved. New investments totaled over \$154.5 million.
- In Louisville, Kentucky, a small lumber company opened as the first zone business, employing 125 people, 70 percent of whom were considered disadvantaged. Louisville's success prompted its neighboring communities, Shirley and Jefferson Counties, to petition for an expansion of the zone to include them.
- In Baltimore's zone, a business and technical center was set up, which attracted over 35 new companies - small businesses - with 125 new jobs.

⁸*Business Facilities Magazine*, Red Bank, N.J., May 1987, pp. 41-46.

- By 1986, Louisiana estimated that its Enterprise Zone legislation had been responsible for creating 6,797 construction jobs and 10,575 permanent jobs.

These success stories are testament to the power of an idea – the idea of Enterprise Zones. Although Federal action on this proposal was late and limited, HUD played a key role in encouraging States to adopt zone legislation, and in providing a clearinghouse to facilitate information sharing among the States.

Programs for Indians and Alaska Natives

HUD applied the policies of the Reagan Administration to meet the special requirements of American Indians and Alaska Natives. The Department adapted the concept of public/private partnerships to the efforts on behalf of these populations to extract the greatest value from each Federal dollar spent on them. This involved assigning the highest priority to the efficient use of funds in order to do more with less. HUD also stressed economic development as a key objective in order to help Indians and Alaska Natives and their communities work toward economic self-sufficiency. In addition, technical assistance was stressed in order to improve the managerial and related skills of program participants.

Partnership Initiatives

HUD officials worked with tribal leaders to create new partnerships involving major national Indian affairs associations, the FHA, State governments, and Indian Housing Authorities (IHAs). Between 1983 and 1988, these partnerships enabled HUD to rehabilitate more Indian housing at lower cost than in previous years.

In 1983, HUD established the Secretary's Committee on Indian and Alaska Native Programs, which met periodically in various locations across the country. This Committee consisted of one tribal representative and one housing authority representative from each of the six Indian field office jurisdictions, and one representative each from the National Tribal Chairman's Association, the National American Indian Housing Council, the National Congress of American Indians, and the National Urban Indian Council. The Committee recommended revision of regulations and legislation to improve program delivery, and proved to be a valuable instrument in improving HUD's Indian housing programs.

In 1985, the committee recommended the separation of Indian Housing and Public Housing regulations, a recommendation later included in the Indian Housing Act of 1988⁹. Its members helped revamp the Annual Capabilities Assessment, a method of evaluating Indian Housing authorities, making it more responsive to the needs of HUD and the IHAs. The Committee also reviewed the proposed consolidated regulations of the Indian programs and submitted comments on the changes it deemed necessary. It also discussed and made recommendations on implementation of the new Indian Housing Act, including the Self-help Housing program.

In addition to performing its role as liaison between Indian tribes and the Secretary of HUD, the Committee successfully identified problems with HUD Indian programs and proposed tribal solutions.

Also, in 1983, Congress passed an amendment, which HUD had requested, to allow the use of FHA insurance on tribal lands¹⁰. This forged a partnership between the mortgage industry and the Federal government, through which the private sector gained the protection it needed to allow eligible Indians to purchase

⁹Public Law 100-358, June 29, 1988.

¹⁰See Chapter 111, pp. 29, et. seq.

unsubsidized homes, remaining on the reservations while enjoying the benefits of home ownership.

In order to increase leveraging of Federal funds, some States began supplementing HUD's funds for Indian housing programs. For instance, in 1983 HUD approved a partnership with the State of Alaska to build a 120-unit project in Anchorage for elderly Alaska Natives, with the State contributing 65 percent of the development costs and HUD funding the remainder.

HUD also allowed IHAs to fund as many housing units as possible within a specified dollar limitation. This decreased the cost of producing an average Indian housing unit by approximately \$20,000 from its FY 1981 level. As a result, in FY 1983 HUD was able to reserve funds for 2,325 homes, 325 more than it anticipated from the funds appropriated by Congress. In FY 1984, HUD reserved 635 more homes than Congress had anticipated.

Increasing the Impact of HUD's Resources

HUD's goal of doing more with less brought increased efficiency and effectiveness, as well as lower costs, for its programs on Indian reservations and in Alaska Native villages.

The Department made better use of its Indian housing funds by curtailing amenities and by encouraging the re-use of model building plans. It also initiated training to improve administrative efficiency. Changes in Department of Labor regulations resulted in lower labor costs for producing subsidized housing units, especially on remote reservations. As a result of these and other initiatives, the average cost of producing an Indian housing unit decreased from \$74,900 in 1981 to \$55,820 in 1986, a reduction of over 25 percent, which subsequently levelled off.

By streamlining the application process for Indian tribes and Alaska Native villages, HUD strengthened the impact of its financial contribution to Indian tribes through its community development programs. The application process was changed from a two-step to a one-step process, reducing paperwork and increasing efficiency.

The Department also began distributing its CDBG funds for Indians more efficiently. A 1979 study showed no relation between the needs and funding levels of the Indian tribes. To address this problem, in 1982 HUD began to focus on need in determining the amount of funding to allocate to Indian tribes and Alaska Native villages. In FY 1982 and FY 1983, HUD distributed its funds solely on the basis of population; in 1984, it began considering poverty and overcrowding in making its funding determinations. Through this process, HUD began making better use of its funds by channeling them to areas where they were most needed.

Economic Development Means Self-Sufficiency

Just as HUD officials encouraged cities, counties, and States to act more independently and adopt policies that would stimulate their economic growth, they saw that HUD's greatest contribution to American Indians would be to enable them to become more self-sufficient and less dependent on Federal assistance. In order to achieve this goal, economic development activities would have to be increased, and the high unemployment rate on Indian reservations would have to be brought down.

Indians made significant progress in self-sufficiency during this period. HUD issued formal guidelines for Indian communities to compete for UDAGs and, in 1982, the first two action grants were awarded to Indian tribes. One grant was

earmarked to assist in the construction of a 150-room hotel on a reservation in Arizona, and the other was intended to help expand a wire-harness manufacturing facility in Mississippi. Because private funds must be leveraged for each UDAG dollar, Indian tribes' increased use of the UDAG program generated private sector investment to benefit Indians, particularly by creating employment opportunities on tribal lands.

Indian tribes also used an increasing share of their CDBG funds to carry out economic development projects. In FY 1981, Indian communities used only 16 percent of the CDBG funds for economic development and 32 percent to rehabilitate housing. In contrast, by FY 1983, 32 percent of the funds were being spent for economic development projects and only 18 percent to upgrade housing - a complete reversal in the use of funds. After 1983, the two elements became more balanced. For FY 1987, economic development projects made up 25 percent of CDBG funding and housing rehabilitation accounted for 32 percent.

In 1983, Indian tribes benefitted from the Job Training Partnership Act, enacted to increase employment opportunities for the jobless. Thirty-six Indian tribes received \$7.5 million from this one-time appropriation. HUD added \$380,000 from recaptured funds for additional commercial and industrial development activities, thus furthering their objective of long-term economic growth.

Technical Assistance Spurs Expertise

Recognizing the high unemployment rate among Indians and the vital role of economic development for Indian tribes, HUD provided technical assistance to increase Indian prospects for economic growth. Between 1982 and 1988, HUD spent \$2.41 million from the Secretary's Discretionary Fund to train tribes to be more competitive in submitting CDBG and UDAG proposals, to increase tribal skills in rehabilitation management, and to devise practical economic development strategies and improve financial and business skills. These additional efforts helped Indian tribes learn how they could help remedy their problems and attain long-term prosperity for their people.

SUMMARY

Under the Reagan Administration, HUD's relationship with State and local governments, Indian tribes, and Alaska Native villages evolved into one of partnership, rather than paternalism. As full partners and not dependents, they were encouraged to assume greater responsibility for their own futures, and HUD regulations were modified to allow them to do so. Department officials understood that the economic health of the States, localities, and other jurisdictions could not continue to depend primarily on Federal largesse, but could best be achieved by using HUD's resources as leverage for private sector investment. The new era that began in 1981 was one of opportunity and self-renewal for communities and their residents alike.

Recognizing the potential of the UDAG program to foster economic expansion and job creation, especially in the 1980-82 recession, HUD officials sought and won the program's continuation. However, as reduction of the budget deficit became increasingly important, the Administration called for the termination of UDAG along with other Federal economic development programs. At the same time, UDAG's long-term impact was reinforced by the program's requirement for local governments to reinvest their project revenues, which would continue for years, in new economic development initiatives that would leverage additional private sector investment.

By streamlining the CDBG entitlement program and allowing States to administer their own Small Cities programs, HUD more effectively tailored its assistance to meet each State's needs. Similarly, by allowing greater flexibility and demanding less paperwork of CDBG entitlement grantees - the large cities and urban counties - HUD increased the value of its financial contribution. Both sets of reform increased reliance on public/private partnerships and emphasis on long-term economic growth and job creation.

The Department applied the same principle to its programs for Indian tribes and Alaska Native villages, allowing greater local decision-making and control, and reducing burdensome application requirements.

HUD officials considered the President's Enterprise Zone initiative a key to economic revitalization in depressed areas. While the Administration succeeded in obtaining only restricted Federal Enterprise Zone legislation, the concept caught on in the States. More than half of them created their own programs and designated thousands of zones. The new investment generated and jobs created or saved in the State zones demonstrated the validity of the Enterprise Zone concept.

All in all, the year 1981 saw the birth of a new era of greater economic growth, decentralization, and reduced dependence on Federal largesse. HUD encouraged this trend through all of its program reforms and new initiatives, and by 1989 could look back on a period of significant progress in fulfilling its policy objectives.

Streamlining HUD's Management

While the number of families receiving housing assistance from HUD increased by over one million from 1981 to 1988, the Department's budget authority for housing assistance was reduced by more than two-thirds - from about \$24.7 billion in FY 1980 to \$7.6 billion in FY 1988. Over the same period, the assisted housing debt declined from over \$240 billion to less than \$200 billion. Secretary Pierce's promise to Congress in 1981 that HUD would "deliver a higher quality service with less money" was fulfilled.

The changes in HUD's programs during this Administration resulted in both service improvements and reduced costs. Basic changes in Departmental operations and management, however, also contributed significantly to the large decline in HUD's overhead, as well as improving services to its constituents.

Enhancing Managerial Leadership and Accountability

One of the first objectives of the new HUD team was to get the Department working on a sound, businesslike basis. To that end, first-rate managers were recruited and efficiency and accountability became their watchwords. Few organizations, public or private, of HUD's size and complexity can claim to have implemented the range of improvements in planning, budgeting, and general management functions that HUD launched in 1981 and largely accomplished over the following eight years.

First, the Secretary established Departmental goals and objectives consistent with those of the Reagan Administration. The new team then examined HUD's statutory objectives and undertook a major redirection of its programs and internal activities.

The Secretary also established several important forums within HUD for senior-level review of important policy and management matters, including a Budget and Legislative Review Group of high-level policy executives. This group reviewed all HUD legislative and budget proposals each fiscal year, made recommendations on them to the Secretary, and helped integrate Departmental program activities with the legislative and budget process. A Regulation Development and Clearance Procedure was also established.

Some of the earliest complaints the new management team heard from officials in Headquarters and the Regions were about the time and effort spent on "feeding elaborate management information systems" that proved irrelevant to the decision-making process. To correct this, HUD officials reviewed and streamlined the existing management information systems, so that the information needed to manage the Department's programs could be obtained more quickly and easily.

Reducing Costs and Improving Financial Control/Management

Management improvements, together with budget and policy decisions made in conformity with new policies, reduced the overall size of HUD's program budget by one-half. The new team undertook a wide variety of efforts to reduce costs without jeopardizing the efficient delivery of HUD's programs. These included:

- A 21 percent reduction in full-time, permanent staff between January 1981 and October 1988 resulted in savings of \$129 million annually.

- Development of a new cash forecasting system and pursuit of a more aggressive investment policy for the FHA insurance funds enabled HUD to earn approximately \$2.8 billion in investment income between FY 1981 and FY 1988.
- Implementation of improved cash management technologies to expedite collections and control payments saved more than \$350 million between FY 1981 and the end of FY 1988.
- Collections are received by electronic funds transfer to HUD's various accounts in the Treasury. Ninety-eight percent of collections are received electronically. \$5,565 million were collected electronically in FY 1988.
- FHA debentures are now created electronically by telecommunications with the Federal Reserve Bank of Philadelphia, which acts as our fiscal agent for these debentures.
- \$9,575 million in disbursements were made by electronic funds transfers. This accounts for about 75 percent of total disbursements.

The Department also actively supported the objectives of the President's Private Sector Survey on Cost Control (Grace Commission).¹ The Commission's report included about 50 recommendations for HUD under ten major headings, plus additional recommendations for such programs as mortgage insurance, loan guaranty, and energy conservation programs, which applied to other agencies as well. The Commission's recommendations for HUD covered accounting and financial management systems, organization, debt collection, management of assets, and specific program improvements. Even before the Grace Commission Report was released, the Department had been making major improvements in the areas covered, and savings already were being realized or forecast.

Debt Collection

When the new Administration team took office in 1981, HUD had no centralized system for keeping track of the debt owed the Department. No one knew how much the total debt amounted to, or what part of it was delinquent; and there was no mechanism in place for debt collection. HUD officials therefore set about to determine the size and status of the debt, install a system for keeping data current and accurate, and institute a coordinated debt collection program.

New debt-tracking procedures and financial automation systems were introduced to supply the needed information. For the first time in HUD's history, a monthly report by Region was instituted to keep track of delinquent debt for FHA programs.

The Department also restructured its debt collection efforts for the Title I program (which provides FHA insurance on loans to finance manufactured home purchases or property improvements). Historically, each HUD Field Office handled debt collection for its area, but during FY 1987, all Title I debt collection efforts for three Regions were consolidated into a single experimental service center in Seattle. Before the consolidation, collections had totalled \$154,000 per staff year; after the consolidated center opened, its employees collected about \$300,000 per staff year. Because the Seattle Service Center was so successful, a second debt collection center was established in Albany, New York, in 1988.

Other aggressive debt collection initiatives implemented at HUD included the following:

¹Report to the President, President's Private Sector Survey on Cost Control, Vols. I and II, GPO, Washington, D.C., 1984.

- Participation in an Internal Revenue Service Refund Offset program to collect delinquent debt on FHA Title I loans, which resulted in about \$21.9 million in offsets and about \$6.5 million in voluntary repayments in FYs 1986 through 1988.
- Participation in the Federal Salary Offset program to collect delinquent debt from 433 debtors employed by the Federal Government, including active and retired military and civilian personnel and active U.S. Postal employees, resulting in collections of about \$2 million in FYs 1985 through 1988.
- Installation of an automated telephone dialing system, called Autocall, that facilitated contacts with mortgagors whose mortgage payments were 10 days past due, which generated approximately \$53 million in collections between FY 1986 when it was installed, and FY 1988.
- Implementation of a Credit Alert Interactive Voice Response System, which mortgage lenders could query directly to determine whether FHA loan applicants had a record of defaults on previous FHA-insured loans. This substantially improved the loan prescreening capacity of FHA lenders, and enabled HUD to avoid \$508 million in claims, or about \$182 million in losses, between June 1987 when the credit alert system was implemented and late 1988.
- Contracting with private sector companies to operate "off-the-shelf" automated systems, which employed the latest technology, to service debt, saving HUD the cost of developing its own systems and permitting the new technology to be adopted more quickly. Contracted systems were put in use for servicing single family notes, Title I notes, and Secretary-owned housing projects.
- Reporting seriously delinquent debtors to private collection agencies began in 1988. 15,900 consumer debts totalling \$98.8 million were referred. Through November 1988, these agencies had collected \$351,000. Commercial debt, totalling \$363,000 (329 accounts), was also referred. Through November 1988, \$22,000 had been collected.
- Moving aggressively to reduce the loan assets held and serviced by the Department. During 1988 HUD received \$171.6 million in a sale of Public Facility Loans, and at year's end had negotiated a sale of single family mortgages expected to bring in about \$30 million; a major sale of multifamily notes was awaiting final OMB approval. These sales increase short-term revenues to the Department and pass the servicing burden on to the private sector.
- Treating IRS notification (Form 1099-G) on write-offs of uncollectible debt as additional individual income.
- Using the IRS's Skip-Tracing program to obtain current address information on debtors.
- Allowing members of the public making Freedom of Information Act (FOIA) requests to use MASTERCARD and VISA credit cards to pay their fees. About 25 percent of FOIA payments were collected by credit card in 1988, amounting to \$37,000 per month. This policy not only facilitated payment of FOIA fees by the public, but simplified the bookkeeping required of HUD.

These efforts enabled HUD to exceed its debt collection goals each year after 1981, with an annual increase in total collections as well. In FY 1982, \$1.8 billion was collected; that rose to \$2.2 billion in FY 1983, and \$2.7 billion in FY 1984, \$3.0 billion in FY 1985, \$3.3 billion in FY 1986, and \$3.8 billion in FY 1987.

The success of these initiatives can also be measured by the increase in foreclosures referred to the Justice Department. Of the \$1.5 billion in delinquent debt at the end of FY 1987, \$1.1 billion were in foreclosure.

As early as May 1982, the Office of Management and Budget recognized HUD's effectiveness, congratulating Secretary Pierce for his "outstanding leadership" in achieving notable improvements in HUD's debt collection efforts.

Financial Automation

Upon discovering that the Department's financial systems were inadequate to the production of accurate, timely financial data tailored to specific decision-making requirements, HUD officials made upgrading of the Department's financial systems an early priority.

By 1986, most of HUD's financial systems had been redesigned or upgraded to state-of-the-art technology, so that they could safeguard internal controls and produce both periodic and *ad hoc* financial reports. These new financial systems gave HUD managers the tools to effectively manage the Department's wide-ranging financial activities. In addition, they enabled HUD to more promptly implement major new programs, such as Section 530 monthly and one-time premiums, a highly regarded new single family claims payment system. Cash management improvements that were commended by the Secretary of the Treasury, and debt collection systems used as models by other Federal agencies were also implemented.

One major new automated processing system, CHUMS, was implemented nationwide in FY 1985 to assist HUD staff in processing single family mortgage insurance applications. Before CHUMS, HUD had only limited systems that merely provided status information and summary data. The new system reduced staff research time, speeding responses to lenders' requests for the status of applications. CHUMS helped HUD deal with the record-breaking 130 percent increase in home mortgage applications between FY 1985 and FY 1986.

Through a Lender Access System, activated in FY 1987, a lender could get an FHA case number for a mortgage applicant plus an appraiser's name within an hour. Previously, lenders had to contact HUD by telephone or in writing, and requests were processed manually, sometimes taking weeks to fulfill.

A new automated single family claims payment was implemented during FY 1985. It dramatically improved service to lenders by decreasing the average time to process a claim from 180 days in 1985 to eight days in 1987. The time savings also enabled HUD to avoid substantial interest payments on lender claims for the period from the date of default until settlement. By 1988, the new claims system was saving HUD an estimated \$81 million a year.

Reorganizing the Department

HUD officials enhanced efficiency by realigning various organizational functions. These included:

- Abolishing the Office of Neighborhoods, Voluntary Associations and Consumer Protection; and transferring its functions to other offices to eliminate duplication.
- Merging two duplicative levels of field offices when they existed in the same city, and assigning greater responsibility to the field organization.
- Redirecting the role of the Office of Policy Development and Research to focus on policy analysis and provide advice to the Secretary.
- Reorganizing the Office of Housing-Federal Housing Administration, to create a separate, new Office of Public and Indian Housing under an Assistant Secretary to give greater attention to these important areas.

- Creating a Deputy Under Secretary for Intergovernmental Relations to assure smooth and effective coordination with States, localities, and constituent groups, especially at a time when numerous changes were being made in HUD programs.
- Consolidating in the Office of General Counsel the responsibility for drafting and producing all Departmental regulations, and for reviewing all existing or proposed policies for necessity and impact, in order to eliminate the non-essential and achieve greater deregulation.

The Administration also proposed abolishing the Solar Bank, which provided funds to lenders through State governments to subsidize loans for solar energy devices, pointing out that it duplicated other programs. The Bank's authorizing legislation contained an expiration date of September 30, 1987, and the Department proceeded to phase out its activities.

Phasing Out the New Community Development Corporation

Another cost-cutting initiative undertaken by the Reagan Administration was the elimination of unsuccessful programs. At HUD, the New Communities program was a prime example. Created in 1968 and renewed two years later, the program established a New Communities Development Corporation within HUD, which guaranteed the land acquisition and development debt of 13 developers of new communities; that is, planned cities created artificially by developers rather than evolving naturally over time.

Only one of the communities had proven financially successful; by January 20, 1981, HUD had acquired nine unsuccessful ones and was paying the debt service of the remaining three failed projects. Given the new objective of terminating unsuccessful programs, HUD sold the assets of those it had acquired by mid-1984, and completed liquidation of the program and the Corporation by the end of that fiscal year. By the end of 1988, the cost to the Federal Government had reached about \$520 million. A report summarizing the Department's experience with New Communities was produced in the summer of 1984.

Improved Field Coordination and Reorganization

In order to ensure HUD's responsiveness at the level closest to the people and to the localities affected by Washington's decisions, the Department restructured its field organization, consolidating Regional and field offices and strengthening the role of the Regional Administrators. The reorganization reduced management overhead, saving an estimated \$30.8 million between 1983 and 1985. To bolster local management, 60 key field managers were recruited from the Department and elsewhere.

HUD also restructured its Field Management Performance Evaluation System to address weaknesses cited by the Office of the Inspector General, the General Accounting Office, and the President's Private Sector Survey on Cost Control.

The Regional debt control procedures were strengthened; and the Office of the Deputy Under Secretary for Field Coordination was assigned a stronger role in meeting its Audit Verification responsibilities.

REGULATORY REFORM

Deregulation – reducing the volume and complexity of Federal strictures on State and local governments and the private sector – was a major part of the Reagan Administration's overall policy. By deregulating the Department's activities whenever possible, HUD minimized the procedural burden imposed on its consti-

tients, saving time and resources for those using the Department's funds and services, fostering greater flexibility and control at the State and local levels, and allowing HUD staff more time to otherwise help the Department's constituents.

By 1980, the sheer volume and scope of Federal rules and regulations were adding \$100 billion to the cost of goods and services in the American economy.² Giving regulatory reform high priority, the Reagan Administration directed every department to review and prune the existing body of regulations to eliminate the non-essential and ensure that necessary regulations were clear, thorough, and timely.

After extensive review of Departmental procedures, HUD officials opted for a complete revision of the regulatory process.

Improving the Regulatory Process

In 1981, HUD's procedures for developing regulations were both time-consuming and inefficient. The process for developing regulations originated in the program areas, which prepared the first drafts. These were then reworked by attorneys in the Office of the General Counsel (OGC) and further reviewed by other appropriate program offices. The process encountered frequent delays as program officials and departmental attorneys argued over language and intent, and when reviewing offices requested extensions of time to complete their work. Changes in style or content, moreover, necessitated repeated reviews, as every office concerned demanded the right to approve the final language.

To replace this cumbersome procedure, beginning in 1982, OGC's Division of Legislation and Regulations was given responsibility for drafting regulations, as it already did legislation, for all the program offices. The new arrangement was analogous to private sector practice, where corporate operating divisions are, in effect, clients of the company's general counsel.

In its role as an "honest broker," OGC greatly expedited the process, drafting regulations which were circulated for review and response within a two-week period. Under this new system, the General Counsel became the arbiter of disputes within or between program offices on the language or substance of regulations.

Despite the improvement made in HUD's internal clearance procedures, the regulatory process remained lengthy. The Department is statutorily required to allow time for review by appropriate Congressional Committees, which meant regulations were held up, sometimes for months, while awaiting Congressional review - an institutional problem for which no solution seemed available.

Success in Deregulation

Improving the process for developing regulations contributed to sound management at HUD, but procedural changes meant little if they did not positively affect the Department's constituents. To lighten the heavy hand of the Federal government, it became HUD's goal to streamline regulations, simplify paperwork, and cut out duplicative or unnecessary procedures.

In the CDBG Small Cities program, the States were authorized to set priorities and develop policies and requirements without HUD's constant intervention - which saved over 300,000 staff hours while increasing the program's flexibility. For the larger entitlement cities and urban counties, HUD replaced its complex

²Report by the President's Task Force on Deregulation, August, 1983, Office of the Vice President, Washington, D.C.

application form with a shorter statement of objectives, relying on local certification that the statutory CDBG requirements would be fulfilled, and removing tight Federal controls in favor of local decision-making. Environmental impact analyses of community development programs were streamlined to focus resources on significant environmental issues.

HUD's housing programs for the needy were similarly modified to reduce excessive regulation. Standardizing the treatment of tenants' income deductions, reducing paperwork requirements for the Comprehensive Improvement Assistance Program, and eliminating overlapping hearings for alleged lease violations and grievances all provided regulatory relief for PHAs.

The principles of deregulation also extended to FHA's insurance programs. The Delegated Processing initiative allowed mortgage lenders to approve applications for FHA multifamily insurance; and the Department eliminated Environmental Impact Statements as a requirement for all but the largest subdivisions. Both these changes created a faster, less burdensome process for lenders and developers, and ultimately for homebuyers. HUD-imposed red tape was also cut by dropping its Minimum Property Standards in favor of local model codes for health and safety requirements. For single family mortgage lenders and homebuyers, HUD instituted Direct Endorsement processing and gained Congressional authorization to allow interest rates and discount points to be negotiated between lenders and borrowers. These initiatives speeded loan processing and gave homebuyers greater choice in structuring their mortgage loans.

These deregulatory initiatives gave States and local governments more flexibility, control, and time to operate their programs; allowed well-run PHAs more authority and flexibility; saved time and money for developers of FHA-insured housing; reduced interference with, and increased autonomy for mortgage, lenders; and simplified the process of obtaining loan approval. In short, virtually everyone touched by HUD's programs experienced the advantages of deregulation.

Attacking Fraud, Waste, and Mismanagement

The Department and its program participants had previously been the subjects of numerous investigations and audits that disclosed gross waste, fraud, and mismanagement of the resources entrusted to them. Correcting this problem became a key Departmental goal, and the new HUD leadership recognized the need to install more effective internal controls to counteract such abuses.

Steps taken to eliminate fraud, waste, and mismanagement in HUD programs included:

- Enhancing the fraud and waste prevention program by increasing managerial accountability and employee awareness, and improving management controls. The Secretary's Committee on Fraud, Waste, and Mismanagement completed 36 studies resulting in increased attention to the Department's systems for issuances and evaluations, and determining tenant eligibility.
- Directing attention and resources to the single family insurance programs, where serious problems were identified in loan origination. As a result of abuses by real estate brokers, mortgage companies, credit agencies, appraisers, and officials, HUD had been induced to insure large numbers of loans for unqualified buyers, jeopardizing its mortgage insurance fund. In 1985, the Secretary created a task force to develop managerial tools to prevent this kind of fraud, and Congress adopted its proposal in the Housing and Community Development Act of 1987.

In addition, beginning in 1984, the Office of Inspector General (OIG) expended over 40 percent of its investigative resources and 25 percent of its audit resources in combatting fraud and abuse in single family programs.

- Focusing attention on tenant eligibility for rental assistance where an estimated \$200 million or more was lost annually through fraud, and another \$80 million through administrative error. The Department implemented a quality control system for tenant eligibility, and got legislative authority to require the necessary information to conduct computer matching. The OIG also developed a Tenant Integrity Program to instruct administrators on how to prevent and detect these types of abuses.
- As the Inspector General noted in his semiannual reports to Congress for Fiscal Years 1981 through 1988, audits and investigations of program participants resulted in cash recoveries and savings of \$486 million; over 2,300 convictions of persons or firms doing business with HUD; and about \$307 million in unnecessary expenditures avoided.

Improving Personnel Management

As a part of HUD's drive to do more with less, personnel management meant not only reducing the number of employees; it also meant balancing the skills with the changed missions of the Department, providing training and staff development, and focusing on accountability and productivity. HUD reduced its full-time staff by more than 20 percent, from 16,008 in January 1981 to 12,511 in September 1988, primarily through attrition.

In the process, HUD focused on lowering the number of positions that had been pushed by "grade creep" into the higher civil service grades. By reducing staff and consolidating offices, the Department was able to eliminate unnecessary layers of supervisory jobs, achieving a 10 percent reduction between FY 1983 and FY 1988 in the number of employees in Grade 11 and above.

Despite these reductions, the Department increased its minority employment from a total of 31.9 percent in 1981 to 40 percent in 1988. Black employees increased from 24.5 percent to 30.6 percent of the workforce, and employment of women at HUD rose from 48 percent in 1981 to 56.7 percent in 1988.

The Department also improved its employees' skills with organizational tasks. HUD officials understood that the Administration's policies of decentralization and the switch from new construction programs to housing vouchers would significantly affect HUD's organizational structure and staffing needs. Therefore, from the outset they gave careful attention to the relationship between HUD's policy and management changes and their impact on staffing needs and skills, and structural relationships with client States, cities, and PHAs.

As the Community Planning and Development programs were restructured, for example, HUD officials made special efforts to provide training and technical assistance to help displaced employees. The number of ongoing HUD Small Cities grants was significantly reduced, minimizing the staff required to continue the HUD program. Employees affected by these program changes were provided retraining and absorbed into other positions. The Department also initiated an evaluation of the Small Cities transfer, which included its impact on HUD's staff as well as on State and local government staffs.

Staff Development

HUD officials recognized the importance of staff development, and increased training, emphasizing supervisory and managerial skills and technical training for

program specialists. As of FY 1986, 82 percent of the Department's supervisors and managers had received training. At the same time, unit costs were reduced and savings of more than \$1 million achieved through the use of self-instructional training tools.

The Training Division utilized organizational development consultants in working with managers and staffs to improve communications and work relationships, increase productivity, reduce costs, and improve efficiency and morale. The Organizational Development Program expanded from 49 training program in FY 1985 to more than 100 in FY 1988.

HUD's management strongly supported the IDEAS program, which gives awards to employees who contribute suggestions that resulted in savings to the government. Between 1981 and 1988, award-winning ideas at HUD produced nearly \$19 million in tangible benefits, realizing more than \$100 in savings for the Department for every dollar paid in awards under the program. In addition, many ideas improved productivity or resulted in better service to HUD clients.

Strengthened Program Performance Monitoring and Evaluation

Another management goal was to improve program performance through better monitoring and evaluation. With the implementation of the Management Planning process, HUD focused its Regional performance evaluation system on efforts to further the goals of the Management Plans. On-site performance reviews, in conjunction with scheduled reporting of program information and financial data, enabled managers to identify and anticipate difficulties. The new Management Planning process increasingly involved the Under Secretary and all Assistant Secretaries in the evaluation and monitoring of Departmental plans.

Improving Disposition of HUD-Owned Properties

FHA must often assume ownership of housing on which insured mortgages are foreclosed. This aspect of FHA operations had not previously received the policy-level attention demanded by the magnitude of the HUD-held inventory and the impact of foreclosures on the insurance fund. Beginning in January 1981, HUD took steps to reduce the time elapsed between acquisition of foreclosed properties and their disposition to responsible private ownership. As a result, the Department reduced its holding costs, and tenants in multifamily properties regained more quickly the benefits of financially responsible private management. Between 1981 and 1988, HUD reduced its multifamily inventory from 881 projects containing 93,544 units to 77 projects with 11,522 units.

The disposition process for single family properties was also overhauled in this period. Sales were accelerated by new incentives to both buyers and brokers, by reduced paperwork (one letter-sized document replaced five forms), and other innovative techniques. Results were record-breaking. Sales jumped from 13,166 homes in FY 1980 to 80,164 homes in FY 1988. In FY 1988, houses sold for an average price of \$38,050. This record number of sales provided a return of well over \$3 billion to the FHA funds.

Contracting Out to the Private Sector

During this period HUD contracted out many activities which could be more efficiently and effectively performed by the private sector. By 1988, more than 33 percent of HUD's functions were being performed by private firms, or by State and local governments. Among some of the major functions were printing, library operations, custodial services, internal control reviews, and automated data

processing. HUD also contracted out Section 312 Loan Servicing. In addition, HUD used the services-for-fee appraisers and data entry personnel for its single family FHA insurance programs. HUD also contracted with area management brokers and property managers to manage single family and multifamily acquired property, respectively.

The largest HUD function transferred to the private sector was underwriting on single family FHA-insured mortgages. Before FY 1983, HUD staff did all of the underwriting. That year HUD introduced the Direct Endorsement program³, which allowed qualified private lenders to process and close FHA mortgage loans. In FY 1988, about 90 percent of all single family underwriting was performed by the lenders. Direct Endorsement benefitted the mortgage lending community by allowing the high volume of FHA-insured loans to be processed more promptly and with less paperwork. It also saved the Department more than \$50 million that would otherwise have been required to hire staff to handle FHA's increased workload.

Other Cost-Saving Initiatives

Other cost-saving initiatives undertaken included: reducing office and warehouse space; oversight of long distance telephone calls; GPO sale of high-volume forms for public use; and reduction in record holdings and motor vehicle use. These and similar initiatives saved the Department approximately \$33.6 million between 1984 and 1988. The Administration accorded HUD recognition for its leadership in meeting or exceeding space reduction and telephone cost control goals.

HUD improved its procurement management controls, increasing the number of competitive, as opposed to non-competitive, procurement contracts. Also, through improved contract monitoring, HUD recovered more than \$1.9 million in unallowable costs from contractors. A Committee on Construction Document Reform was established to review all HUD construction documents to bring them up to date, simplify their formats, and make them more equitable.

Contracting With Targeted Business And Institutions

Like most agencies of the Federal Government, HUD purchases substantial goods and services from the private sector. An Executive Order issued by the President in 1981 required all departments and agencies to increase participation of small, minority-, and women-owned enterprises in this procurement process, and HUD achieved thorough compliance. HUD awarded about \$32 million in contracts to small and minority business in FY 1981; and during the next seven years purchased an average of nearly \$60 million per year in goods and services from similar concerns - nearly doubling the 1981 level.

HUD also surpassed all other government agencies in its commitment to the Treasury Department's Minority Bank Deposit Program, which was created to spur the growth and development of minority-owned financial institutions by increasing Federal deposits in such banks. HUD and its grantees maintained average daily balances of about \$150 million in minority banks - more than any other government agency.

HUD achieved these objectives by setting annual dollar goals and often surpassing them; issuing publications such as "Doing Business with HUD," which offered guidance to small, minority-, and women-owned enterprises interested in becoming HUD contractors; and sponsoring conferences and training sessions for those seeking such opportunities.

³See Chapter III, pages 42-43.

Small, minority-owned, and disadvantaged firms also participated in other HUD programs. Between 1981 and 1989 the Department awarded more than \$20 million in technical assistance contracts to minority-owned organizations. Minority ownership of projects assisted by Urban Development Action Grants (UDAGs) reached an all-time high of 338 out of a total of 2,225 projects. Small and disadvantaged businesses were given contracts to study HUD programs and, in the case of the Section 312 Rehabilitation Loan program, even to help administer it.

HUD also worked to increase the number of minority sponsors for Section 202 housing projects for the elderly and handicapped, nearly doubling the share of such projects awarded to minority sponsors from about 10 percent in 1982 to more than 18 percent by the end of the Administration.

During this period HUD also substantially increased its assistance to Historically Black Colleges and Universities (HBCUs), in compliance with a directive by President Reagan for all Federal agencies to establish annual plans to increase the participation of HBCUs in Federally-sponsored programs.

In 1982, to implement this policy, HUD developed the Community Development Block Grant Technical Assistance program, through which HBCUs could provide community and economic development assistance to eligible CDBG communities. At the same time, the Department developed other HBCU-related projects: the College Work Study program, personnel exchanges, a Small Grants program to encourage professors from HBCUs to conduct research using the Department's Annual Housing Survey data, and an initiative encouraging major corporations to support HBCUs in a public/private institutional effort.

HUD funding to assist HBCUs grew from about \$117,000 in 1981 to average annual outlays of approximately \$2 million from 1982 to 1989.

SUMMARY

During the 1980's HUD did, in fact, succeed in providing higher quality service to the Department's constituencies at less cost to the taxpayer. This required both changes in HUD's programs and streamlining of Departmental operations. Essentially, HUD management applied sound businesslike approaches in administering HUD's programs, and consequently saved millions of dollars while maintaining and even improving its services.

HUD realigned its organizational functions, both in Washington and in the field, to become more efficient. The Department implemented personnel management initiatives which allowed it to accomplish its mission with less highly paid staff. This was accomplished while maintaining or increasing the level of minority employment and providing training for personnel in changing roles.

During this period, HUD also succeeded in improving its accounting and financial management systems; exceeding expectations in collecting delinquent debt; attacking fraud, waste and mismanagement; automating many of its programs and administrative functions; disposing of the backlog of HUD-owned properties; and phasing out the New Community Development Corporation, which had proven unsuccessful.

The cost of HUD's operations also was cut by steps taken to reduce day-to-day organizational expenses.



Promoting and Strengthening Fair Housing

HUD is responsible for administering Title VIII of the Civil Rights Act of 1968, which states: "It is the policy of the United States to provide, within Constitutional limitations, for fair housing throughout the United States."¹ The Act prohibits discrimination in the sale, rental, and financing of housing, or the provision of brokerage services, on the basis of race, color, religion, national origin, or sex.

The 1968 law specifies procedures and a mechanism for private parties to seek judicial enforcement of fair housing rights. However, it was abundantly clear in 1981 - thirteen years after the law's enactment - that housing discrimination and segregation were still facts of life in many parts of the U.S. Neither HUD conciliation procedures nor the private judicial enforcement tools provided by the law had proved adequate. Under the new Administration, HUD officials turned their attention to the task of improving both.

To accomplish this, it was necessary to strengthen the enforcement provisions of the Fair Housing law; a task not easily accomplished. In 1980, less than two months before the Administration had taken office, an effort to amend the Fair Housing law had failed in Congress, but President Reagan called for new efforts. The new team at HUD set out to fight discrimination in housing in every way it could: to carefully develop an Administration initiative to strengthen the Fair Housing law; to use every available means to make the existing law work as well as possible; and to take advantage of new opportunities as they arose.

Fair Housing Amendments Act of 1988

Early in 1981 HUD officials began the task of finding ways to put teeth into the Fair Housing law. The law was weak in that it responded to complaints of discrimination principally through an informal process of conference, conciliation, and persuasion. All too often, this process did not work. The only alternative available to individual victims of discrimination under the existing law was a costly and time-consuming private lawsuit in Federal court. The law empowered the Attorney General to file suit against offenders only where it was possible to demonstrate a "pattern or practice" of discrimination. Since those who discriminated realized how difficult it was for their victim to gain redress, they had little incentive to enter into conciliation.

In order to address this basic weakness in the law, Secretary Pierce joined the Attorney General in preparing amendments, which they recommended to the President. Under their first proposal, submitted to the Congress in 1983, in cases where conciliation had failed, HUD would have been permitted to refer individual complaints of discrimination directly to the Attorney General for possible prosecution. This bill also proposed stiff penalties against offenders: \$50,000 for a first offense and \$100,000 for subsequent violations in addition to injunctive relief for the victim.

An alternative bill, introduced by Senators Mathias and Kennedy, authors of the defeated 1980 bill, differed in several respects from the Administration's proposal. It proposed to place jurisdiction for fair housing violations with administrative

¹Title VIII, Section 801.

law judges, subject to review by a three-member Fair Housing Review Commission appointed by the President. This proposal was similar to the one that had failed in 1980. No hearings were held on either legislative proposal and neither bill was brought to a vote in either the Senate or House.

In 1985 and again in 1986, the Administration resubmitted amendments to the Fair Housing Act to ensure equality of housing opportunity in America. Early in 1987 Secretary Pierce testified for fair housing amendments before the Senate Subcommittee on the Constitution on March 31, 1987, and the House Subcommittee on Civil and Constitutional Rights on April 29, 1987. At these hearings he outlined four basic objectives which new legislation should address. First was the need for strengthened enforcement through creation of an administrative enforcement procedure when conciliation failed. The second objective was to provide stiff penalties for those who break the law (\$50,000 for a first offense and \$100,000 for a second offense). The third objective was to obtain for HUD the power to initiate complaints in appropriate circumstances and to seek injunctions on behalf of complainants. A fourth objective was to expand the Fair Housing law to include disabled persons as a protected class.

As Secretary Pierce said in testimony before the House Subcommittee on Civil and Constitutional Rights:

"I recognize that there can never be true housing opportunity in this country until the Federal enforcement powers in Title VIII have been strengthened. At present, there is no forceful back-up mechanism which provides an incentive to bring parties to the conciliation table with serious intent to resolve issues then and there."

At the time, HUD and the Department of Justice were working on legislation that would be acceptable both to the Administration and to supporters of the Kennedy-Specter bill, introduced in 1986 as the successor to the 1983 Mathias-Kennedy bill, establishing an appeals process through the administrative law system.

The Secretary proposed to the Attorney General voluntary binding arbitration as a back-up to conciliation, instead of the administrative law process. Meanwhile consideration of Kennedy-Specter and its companion in the House, sponsored by Representatives Fish and Edwards, was complicated by the 1987 Supreme Court decision in *Tull v. United States*, which affirmed a defendant's Constitutional right to a jury trial when common law rights or remedies were at stake. It was, therefore, essential to ensure that any Fair Housing amendments would be consistent with this decision.

Early in 1988, the Administration sent a new Fair Housing Amendments bill to the Congress. It was similar to the 1983 Administration bill in that it retained the conciliation process. Where conciliation failed, it authorized the Secretary of HUD to refer the complaint to the Attorney General for appropriate action, and it gave the Attorney General independent authority to bring a civil action. Like prior Administration bills it also proposed extending protection to the disabled. Secretary Pierce observed that 1988, the 20th Anniversary of the Fair Housing law, was a fitting time to toughen and thereby improve that law.

Subsequently, on June 29, 1988, the Fish-Edwards bill came to the floor of the House. That bill failed to preserve the right to a jury trial for respondents in fair housing enforcement action. Moreover, the Fish-Edwards bill included a Federal building code requiring access for the disabled and added families with children to the classes protected by Title VIII, elements the Administration considered either

unenforceable or inadvisable complications to include in these long-awaited amendments.

Secretary Pierce, joined by the Vice President, asked Congressmen Michel and Fish to introduce an amendment that would preserve the right to a jury trial. The product of this effort was a Fish Amendment giving either party the right to remove an action from the administrative law judge to Federal district court. This approach was supported by the Administration, National Association of Realtors, and civil rights leaders.

The Fish Amendment, however, created two new problems. When either party to a Title VIII complaint opted for a jury trial, the Federal government was compelled to represent the complainants. This impinged on the Executive Branch's exclusive power to make prosecutorial decisions. Also, it provided that HUD and complainants be represented by HUD attorneys, rather than the Department of Justice, in fair housing litigation. This contradicted a long-standing principle that the Executive Branch be represented by the Justice Department in all litigation.

When the House-passed bill was placed on the Senate calendar for floor action without consideration by the Judiciary Committee, Secretary Pierce negotiated a compromise with Senators Kennedy and Specter, which resolved these problems and improved the Department's ability to enforce provisions protecting families with children and requiring disabled-accessible construction. The result was a substitute to the House bill that was fully supported by the civil rights community and President Reagan. It was this version that became the Fair Housing Amendments Act, passed by the Senate on August 2, 1988, by a vote of 94 to 3, accepted by the House on August 8, and signed by the President on September 13.

The Fair Housing Amendments Act of 1988 has six significant features.

First, it permits aggrieved parties to avail themselves, for the first time, of an administrative enforcement procedure, providing actual damages, equitable relief, and penalties of up to \$10,000 for a first violation, \$25,000 for a second, and \$50,000 thereafter against those who discriminate.

Second, in cases brought by the Department of Justice, the government, for the first time, is granted the ability to obtain monetary relief for discrimination victims, as well as civil penalties of \$50,000 for a first violation and \$100,000 for a second.

Third, the Act protects the Constitutional rights of all parties by offering both defendant and plaintiff the option of a jury trial or the faster, simpler administrative law procedure.

Fourth, the Secretary of HUD is empowered to initiate an investigation without a discrimination complaint from a private person.

Fifth, the Secretary of HUD can direct the Attorney General to obtain an injunction if and/or when the Secretary believes it is required.

Sixth, the 1988 law extends protection to persons with disabilities and families with children.

Spreading the Word

One feature of the 1968 Fair Housing law called for comprehensive, sustained national effort to promote public awareness of fair housing as a civil right for all Americans. To that end, HUD launched a series of fair housing promotional campaigns, including an annual observance of the anniversary of the Fair Housing Act of 1968. Secretary Pierce called on governors, mayors, the clergy,

boards of education, business and professional people and organizations, the entertainment world, school children, and the media to participate in activities connected with each anniversary celebration.

Community Housing Resource Boards

In consonance with the Administration's emphasis on using public/private partnerships to effect social change, HUD officials created and strongly promoted such alliances on behalf of fair housing. The Department had developed a vehicle known as Community Housing Resource Boards (CHRBs), locally based partnerships composed of representatives from a variety of community organizations selected by HUD to take part in a coordinated pursuit of specific fair housing goals.

In the last year of the Carter Administration, with very limited funding, CHRBs were initially established to assist local housing industry groups in developing activities to implement Voluntary Affirmative Marketing Agreements (VAMAs). HUD had entered into these agreements with such national organizations as the National Association of Realtors, the National Association of Real Estate Brokers, and the National Association of Home Builders. HUD officials saw a potential for greater achievement by the CHRBs, and began to provide technical assistance to help organize new boards and supply operational guidance to those in existence.

Over the years 1981-88, approximately \$13 million were provided by HUD to finance the CHRBs' activities. This support allowed them to help local industry groups achieve their VAMA goals; to conduct outreach and educational programs for housing and realty industry professionals; to identify and correct institutional barriers to fair housing; to establish complaint hotlines; to increase the number of minority-group professionals in the housing industries; and to implement techniques to prevent real estate agents from "steering" - that is, guiding clients to neighborhoods where one racial group or another was dominant, and away from areas dominated by other groups. Between 1981 and 1988 the number of CHRBs increased from 350 to about 600.

Localizing Administration

While the original Fair Housing legislation provided for a strong local role in combatting discrimination, previous Administrations had relatively little success in developing the localities' potential. However, during the 1981-89 period, HUD moved aggressively to increase State and local authority and responsibility for Fair Housing, and the result was dramatic.

The Fair Housing Law of 1968 allowed HUD to refer discrimination cases to State and local agencies if they administered laws which were "substantially equivalent" to the Federal law. Yet, between 1968 and 1980, only 22 States and the District of Columbia had enacted qualifying legislation.

In order to help the State and local fair housing agencies develop procedures, train staff, conduct outreach, build workload, improve processing, and take the other steps necessary to process complaints, HUD offered financial assistance to these jurisdictions. The funding encouraged "substantially equivalent" State legislation and was particularly significant since it occurred at a time when the Administration sought to contain the growth of the Federal budget. Yet, despite this constraint, HUD obligated \$35.9 million between FY 1981 and FY 1988 for this purpose, with the result that by 1988, the number of States that had enacted qualifying legislation had grown to 36 and the number of fully recognized local agencies had grown to 79. Concomitantly, the number of complaints which HUD referred to

State and local agencies soared: in FY 1980 HUD received 3,038 complaints and referred 434; in FY 1988 HUD received 4,658 complaints and referred 3,308.

Monetary recoveries for discrimination victims increased by 75 percent between 1980 and 1988, totaling well over \$5 million in that period. At the same time, monetary relief obtained by substantially equivalent agencies increased from a little more than \$6,000 in 1980, to more than \$375,000 in 1987. Moreover, between 1980 and 1987, fair housing enforcement efforts provided dwelling units to almost 3,500 families, at a rate considerably higher than the rate of the prior Administration.

Support for "Testing"

Increased local enforcement was not the only way HUD could help reduce the barriers of prejudice and fear that obstructed opportunities for minorities to move into better housing in neighborhoods of their choosing. The Department also worked to enforce the existing law by monitoring sales and rental practices through "testing."

A 1977 study by HUD of 40 randomly selected metropolitan areas had concluded that widespread unlawful discrimination practices continued. In fact, the report indicated, if a black American visited four rental agents, he or she had a 72 percent chance of encountering at least one instance of discrimination. A black person seeking to purchase a home could expect to encounter discrimination by about half of the sales agents visited. The problem was compounded by the difficulty of proving discrimination, and particularly of establishing the existence of a "pattern or practice" as required by the law.

A breakthrough in dealing with this difficulty occurred in 1982, when the Supreme Court of the United States decided the case, *Havens Realty Corporation v. Coleman*. The litigation had arisen when a private fair housing advocacy organization sponsored an investigation of housing discrimination practices by using "testers." The need for "testers" arose because housing discrimination had become increasingly subtle in form, leaving many applicants unaware or uncertain that they had been victimized by illegal practices.

"Testers" are pairs of individuals, one black (or other minority) and one white, otherwise similar in appearance, demeanor, family size, and financial status, who inquire about the same rental apartment on the same day. In the *Havens* case, the black "tester" was told no apartments were available; while the white "tester" was told that there were vacancies. The legal issue was whether the individual "testers" and the group that sponsored them had standing to sue under the Fair Housing Act of 1968.

On February 24, 1982, the Supreme Court, in a unanimous decision, held that "testers" had standing to sue, even though they were not truly seeking housing, and that the civil rights organization sponsoring them had a similar right under the Fair Housing Act. The Solicitor General, with the support of the Secretary of HUD, had submitted an *amicus curiae* (friend of the court) brief in support of testing.

The *Havens* decision meant that properly trained testers not only could provide evidence of individual discrimination critical to the successful resolution of a fair housing complaint, but also could randomly audit real estate practices to detect unlawful patterns of discrimination.

Havens proved to be a very useful enforcement tool. HUD established a Fair Housing Enforcement Demonstration, the first direct financing of private, local fair housing organizations to pursue the possibilities opened by the case and to

play a role in fair housing enforcement. The demonstration emphasized the use of "testing," and found it to be a highly productive device in identifying and developing hard evidence concerning the more blatant and pervasive forms of unlawful discrimination.

The project showed conclusively that HUD and local private fair housing groups, working together, could enforce fair housing laws effectively. Federal money had a multiplier effect on local fair housing agencies, in that one dollar in Federal demonstration funds generated two to three dollars in local financing. The demonstration also led to improvements in recordkeeping and performance measurement by participating groups.

The *Havens* decision, combined with the results of the Fair Housing Enforcement Demonstration, clearly established the value of public/private partnerships between private fair housing groups and State and local agencies. On that premise, HUD asked Congress to authorize ongoing financial support for such partnerships, which would be permitted to use fair housing testers to investigate allegations of discrimination. This new program was called the Fair Housing Initiatives Program (FHIP). It was first proposed in 1985, and sparked a major debate; but despite initial opposition, FHIP was enacted as part of the Housing and Community Development Act of 1987. As President Reagan signed the bill into law in 1988, he praised Secretary Pierce for leading the three-year fight for the program.

FHIP allowed HUD to fund private agencies, civil rights organizations, and local fair housing groups to help enforce the law. It also enabled the Department to develop innovative enforcement methods, and extend education and outreach efforts.

In 1988, HUD also launched a major new survey similar to the 1977 study. As with earlier studies, the objective was to determine to what extent discrimination existed in the sale and rental of housing. The Housing Discrimination Study (HDS) involved surveys of approximately 25 widely scattered localities, and was scheduled for completion in 1990. HDS was designed to serve as a renewed catalyst to future educational and enforcement efforts to eliminate housing discrimination in America.

Desegregation in Public Housing

HUD is also responsible for administering Title VI of the Civil Rights Act of 1968, which provides that no person shall, on the grounds of race, color, national origin, handicap, or age be excluded from participation, be denied the benefits of, or be subject to discrimination under any programs or activity receiving Federal financial assistance.

In the Fall of 1983, the problem of racial segregation in public housing was brought to the fore by a suit filed by Lucille Young of Clarksville, Texas, against HUD. Ms. Young, a black woman with six children whose only income was a monthly Aid for Families with Dependent Children (AFDC) check of \$248, was found eligible for public housing, but was not housed by the local housing authority. In her suit, Ms. Young claimed that the PHA was assigning units to tenants on the basis of race.

On October 11, 1983, a Federal court ruled in favor of Ms. Young and ordered the authority to provide her with a unit. The court also ordered the PHA to integrate its housing projects, achieving an approximately 50-50 distribution of black and white tenants in each development, adding that any tenant not desiring to transfer to a project where their race did not predominate, "shall be evicted."

In order to correct and forestall such practices elsewhere, HUD established a Public Housing Desegregation Task Force composed of the Assistant Secretaries of Fair Housing and Equal Opportunity and Public and Indian Housing, the Federal Housing Commissioner, and the General Counsel. It was charged with developing and implementing an urgent, comprehensive approach to the desegregation of public housing. Moreover, HUD ordered that any public housing authority found to be in violation of the civil rights law must promptly prepare effective plans to bring its practices into compliance with the law. This was aimed particularly at those PHAs that maintained dual tenant selection and assignment systems; i.e., separate "black" and "white" tenant lists.

HUD also determined that, in some cases, housing authorities were spending less to repair, maintain, and/or improve projects with largely black populations than those with mostly white residents. The Department, therefore, ordered that the PHAs' desegregation plans should provide for equality of physical conditions. HUD officials subsequently reviewed and approved many desegregation plans, and met with housing authorities throughout the country to advise them of HUD's seriousness about eradicating public housing segregation.

HUD field offices were instructed in the procedures to assure that compliance agreements, once signed, were in fact carried out and produced the intended results. By FY 1989, about 80 PHAs were covered by such agreements, exclusive of those East Texas PHAs involved in the *Young* litigation.

The Department also launched a Voluntary Affirmative Compliance Agreement Program in which PHAs were to conduct self-assessments of their operations and provide HUD with detailed information on how their programs were operating. This also utilized the expertise and networking capacity of national regional organizations serving the PHAs, and civil rights organizations, to develop technical guidance materials and set up a clearinghouse to supply assistance to the PHAs.

SUMMARY

When the new Administration took office in 1981, it was clear that the Fair Housing Act of 1968 was inadequate to the task of ending housing discrimination in America. HUD officials set out to obtain amendments to strengthen the enforcement provisions of the law. Working with the White House, the Justice Department, and Congress, they succeeded where others failed, putting teeth into the Fair Housing Act.

HUD officials also launched a broad effort to educate the American people about the injustice of discrimination and the benefits of the converse: social strength through genuine neighborliness.

More housing discrimination complaints were lodged as more people became aware of their rights. Increasingly, the complaints were processed at the State and local levels, where local citizens' organizations received HUD support for their efforts to further equal housing opportunity for all Americans. Discrimination was not ended, but solid progress was made towards fairness and equality of opportunity. Most important of all, the 1968 Fair Housing law was amended to provide an effective and equitable enforcement mechanism.



International Affairs

The United States is signatory to a number of international agreements for exchanges of information on housing and urban affairs. During the Reagan Administration, HUD's international activities were emphasized for the opportunities they presented to contribute to the Nation's overall foreign policy goals. In addition, increased international contacts were recognized to offer the possibility of enhanced foreign trade, the expanded sale of U.S. housing-related products overseas, and a beneficial exchange of insights on policy and problem-solving among officials with similar responsibilities.

An example of the successful international activities of the Department during this period may be seen in the promotion of foreign investment in American mortgage-backed securities.¹ By offering GNMA-backed securities first on the Luxembourg Stock Exchange, and later on the Singapore Stock Exchange, as well as for sale in Tokyo and London, between \$10 and \$15 billion were attracted from abroad to increase the pool of capital available to finance American mortgages. This increased the opportunity for homeownership for more Americans.

HUD also worked to help the U.S. housing industry expand the sale of its products and services abroad, and insights gained from the experience of other nations formed the basis for several promising initiatives launched by the Department at home.

Opening Housing-Related Contacts With China

One of the Department's most important achievements in the international arena was the unprecedented expansion of contacts with the People's Republic of China (PRC). The governments of the U.S. and the PRC had entered into a U.S.-Chinese Protocol on Building Construction and Urban Planning as one of 22 implementing accords under the 1979 U.S.-Chinese Agreement on Science and Technology.

In 1982, at the invitation of the Housing Minister of the PRC, Secretary Pierce headed a U.S. delegation on Housing Construction and Urban Development on an official visit to Beijing. The delegation included top officials of five major American companies in housing-related industries.

The Secretary used the visit to China to meet with the Vice Premier, Wan Li, and with senior officials in the Ministry of Urban and Rural Construction and Environmental Protection, to discuss future cooperative activities between that agency and HUD. The trip also provided opportunities for first-hand observation of local planning and housing construction methods in Shanghai, Nanjing, Wuxi, and Guangzhou. The private sector representatives were able to discuss expanded business ties and building opportunities with the Chinese, who faced an enormous task in supplying adequate housing for their huge and increasingly urban population.

Chinese and U.S. officials also explored the concept of joint Sino-American ventures in other countries, and agreed to conduct at least one future symposium on housing and urban development. They further determined to move forward on projects such as the preparation of an English-Chinese Glossary of Terms in

¹See Chapter III, page 46.

Housing, Urban Planning, and Construction Management. This 400-page reference work became a reality in late 1987, and included bilingual definitions of 1,000 terms. It was disseminated among educational institutions, housing organizations, and others throughout the U.S. and abroad.

Public Housing in Singapore

Another stop-over on the Beijing itinerary was Singapore, one of the world's most compact and heavily populated city-states. A teeming, multi-ethnic enclave with the whole panoply of urban problems, Singapore had taken some creative steps to solving them. Its public housing program, for example, emphasized tenant ownership, and had been widely acknowledged as highly successful.

The concept of allowing public housing tenants to buy their units was beginning to receive some attention in the U.S., and the President and his advisors had discussed it with Secretary Pierce. The Secretary thus had a considerable interest in learning as much as possible about Singapore's experience.

To that end, he and his party visited major housing sites and took part in discussions with the Minister of National Development and his staff. The HUD team learned that, while approximately 70 percent of the Singaporeans lived in government-built apartments, two-thirds of them had become owners - and the government was working to increase the number of homeowners to 90 percent of the population by the year 2000.

While it was neither possible nor desirable to duplicate Singapore's highly subsidized program, some of its aspects - particularly the creation of opportunities for homeownership among low-income families - might be adapted to the American experience. The information gained in Singapore provided a useful perspective when HUD officials developed the Public Housing Home Ownership Demonstration Program.²

U.S. Housing Assistance to Egypt

On the return trip from Asia, the Secretary and his party also stopped in Egypt, where the U.S. Agency for International Development (AID) had long provided large-scale technical and funding assistance to help address that nation's serious housing and urban development problems. HUD was required by law to work with AID to help the Egyptian government make use of that assistance, and the visit provided an opportunity for Department officials to review the progress being made there with American help.

The HUD delegation conferred at length with Egyptian officials, including President Hosni Mubarak, the Prime Minister and the Minister of Housing, and with AID's country staff as well. They toured housing developments in Cairo and Alexandria, and discussed Egypt's needs for assistance in land-use planning. Among other situations, they reviewed a housing project called Helwan, which had been under way for six years and received millions of dollars in U.S. aid.

Solving Urban Problems in Industrialized Western Nations

The urban problems affecting industrialized nations throughout the world, but largely in the West, often have common roots, and are thus susceptible to similar solutions. Under the Reagan Administration, the U.S. implemented a number of initiatives, such as public/private partnerships and Enterprise Zones - the latter actually adapted from a British model - that could be applied in other nations.

²See Chapter II, page 26.

HUD officials used every available opportunity to solicit information on their experience from other governments, and to that end participated in international meetings of housing and urban development officials.

In 1983, Secretary Pierce was elected chairman of the Urban Affairs Ministers' conference of the Organization for Economic Cooperation and Development (OECD), at the group's first meeting in Paris. The two-day conference involved 156 delegates, including 19 with Cabinet rank, representing the 24 OECD nations and five international organizations.

The Secretary used his platform at the 1983 meeting and again in 1986, after an unprecedented re-election as chairman, to stress the importance of economic development through partnerships between the public and private sectors; and of decentralization to permit effective local decision-making. He also focused on the need to renew the employment and tax bases of the OECD countries; to encourage cities to take the initiative in working with other levels of government and the private sector; to create a better investment climate; to reduce public expenditure through better management; and to involve citizens more fully in the life of their communities.

The OECD meetings strengthened international cooperation in policy development and research in urban development strategies, cost-effective delivery of municipal services, and urban housing programs.

The exchange of ideas and information with this country's OECD partners was consistent with HUD's willingness to benefit from the experience of others, especially from other developed nations whose history of solving housing and urban problems is centuries longer than our own.

On his first official trip abroad in 1981, for example, the Secretary visited West Germany, where he observed houses a century or more old, periodically rehabilitated and maintained as multifamily housing. The German success in preserving and maintaining housing stock that considerably predated the American Revolution stood in sharp contrast to our own tendency to tear down and replace buildings only a few decades old. It was clear that housing low-income families (and others) in rehabilitated units was not only more feasible but - based on the German experience - far more cost-effective than new construction.

During the same trip, HUD officials also visited Denmark and Sweden, where they became interested in the use of district heating systems as an efficient and practical approach to energy conservation, even in the cold Scandinavian climate. The U.S. delegates recognized that the introduction of district heating in public housing could realize significant savings in the \$1 billion annual cost to HUD for energy use by the Nation's PHAs.

District heating involves the distribution of heat in the form of hot water from a central source to commercial, industrial, and residential customers up to 30 miles away. The heat source can be a boiler designed for the purpose, or a co-generation plant where hot water or steam from electrical generation plants is channeled into the district system. Alternatively, garbage or other wastes can be used as fuel, thus helping to solve waste disposal problems as well. Approximately two-thirds of the heat content of most fuels is wasted in the generation of electricity, but district heating can recapture up to 85-90 percent of the waste.

Although district heating was extensively used in parts of the U.S. during the 19th century, it was all but abandoned with the advent of cheap gas, oil, and electricity. The rise of OPEC and the resultant increase in energy costs renewed interest in the concept in Europe, and HUD launched an effort to test its applicability

in the U.S. By 1984, about 30 cities were receiving HUD seed money to develop district heating systems, attracting significant infusions of private investment capital as well. While the decline of oil and gas prices after 1985 made the idea less compelling, the district heating demonstration provided a potential response to the possibility of higher energy prices in the future.

Forging Commercial Ties with the U.S.S.R.

Early in President Reagan's second term, the Administration placed increased emphasis on improving U.S.-U.S.S.R. relations. Even before the 1985 summit meeting, the President had called for greater cooperation with the Soviet Union in non-strategic areas. At HUD, the Secretary and his team applied the new emphasis on improved relations to the Department's concerns. They began to seek ways to implement cooperative activity with the Soviets in construction and related areas, while simultaneously expanding trade opportunities for private industry.

After careful planning and preliminary negotiations with the Soviets in early 1985, the Secretary and a party of officials from HUD and other agencies went to Moscow that September to meet with the Soviet Chairman of the State Committee on Civil Construction (GOSSTROY) and other officials for a resumption of annual Joint Committee Meetings under the US/USSR Agreement on Housing and other Construction. The U.S. delegation also included six U.S. business leaders, several of them CEOs of prominent companies in housing-related manufacturing and building materials.

During that visit the two sides formally ratified a detailed four-year cooperative work program, which, in the Secretary's words, would

"...enable us in the U.S. to benefit from the Soviet expertise in construction in special areas... (and) from Soviet research in wood and concrete building materials and large utility systems.

"It is my sincere hope that the experience of the U.S. in other aspects of housing and industrial construction will be of similar interest and benefit to our Soviet colleagues."

The real breakthrough at the meeting was a new emphasis put on the commercial aspects of the U.S.-Soviet relationship. Construction and urban development had become important to General Secretary Gorbachev's restructuring of the Soviet economy, and the Kremlin officials were therefore unusually receptive to new building products and technologies. The U.S. delegation was quick to seize this opportunity.

When the Soviets announced plans for an International Construction Exhibition, known as "Stroyindustriya '87," to be held in Moscow in May 1987, HUD formulated plans for a significant U.S. presence there. Hundreds of American companies were contacted and encouraged to participate, and the interests of Soviet authorities in their products and services were assessed. To bring the U.S. business leaders and the Soviets together, Secretary Pierce led another delegation to the U.S.S.R. in November 1986. It included 23 top officials from 15 American firms, who met with the officials responsible for Soviet purchasing decisions.

This careful planning and preparation paid off handsomely. At the opening of Stroyindustriya '87, the U.S. was the only foreign exhibitor to have its own pavilion, and also had the largest number of exhibitors. A total of 116 firms from 26 States and the District of Columbia participated, ranging from such giants as E. I. duPont and American Standard to small firms such as ConCure and Ensar and start-up companies like High Tech Homes and Paragon Steel.

It was the largest American private sector presence ever at a Soviet Union trade show, and the first time in nearly 30 years that the U.S. had taken part in a housing and construction exhibition in the U.S.S.R. under a bilateral agreement. During the four-day exhibition, more than 20 American firms conducted about 30 technical seminars for Soviet ministers and technical specialists, and U.S. companies sold or donated most of the products and equipment they exhibited.

A number of firms were asked by the Soviets to prepare specific proposals, while others continued negotiations on contracts and joint ventures. Within months of Stroyindustriya, serious negotiations were well along for agreements potentially worth several hundred million dollars to U.S. companies.

SUMMARY

During the Reagan Administration, HUD's role in international affairs was refocused to stress innovative public/private initiatives, rather than merely routine international contacts. The impact of HUD's Office of International Affairs was substantially increased without a concomitant rise in its budget.

Major developments in the Department's efforts to foster international opportunities for the private sector included the expansion of commercial relations in housing-related fields between the U.S. and the Soviet Union and People's Republic of China. Although those initiatives had, by 1988, only begun to bear fruit, they offered considerable potential for further growth in the years ahead. Another important step was the introduction of GNMA-backed mortgage securities in important foreign markets.

HUD worked closely with a number of other nations in mutually beneficial exchanges of experience, information, and technology. In some instances, the Department passed along expertise to assist foreign governments; or to encourage replication in other countries of initiatives that had met with some success at home. In return, from other exchanges, the Department reaped the benefit of knowledge and experience accrued elsewhere.

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