Discussion and Analysis of Operations

HUD's major program areas fall into three categories:

HUD's grant, subsidy, and loan programs

The Federal Housing Administration (FHA)

The Government National Mortgage Association (Ginnie Mae)

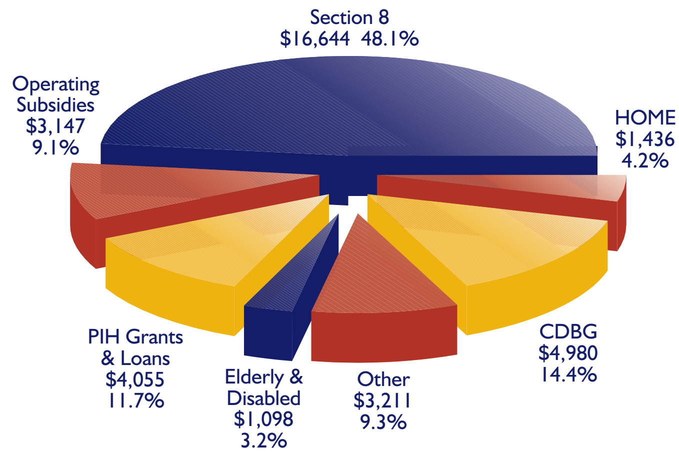
Grant, Subsidy, and Loan Programs

HUD's most significant grant, subsidy, and loan programs, in terms of expenses, are:

- Section 8 Lower Income Rental Assistance;
- HOME Investment Partnerships;
- Community Development Block Grants;
- Housing for the Elderly and Disabled;
- Public and Indian Housing Grants and Loans; and
- Operating Subsidies for Public Housing Agencies.

The consolidating financial statements provide information for each of the above programs. Expenses during FY 2001 for HUD's grant, subsidy and loan programs totaled $34.571 billion compared to $33.656 billion during FY 2000.

Grant, Subsidy, and Loan Program Expenses for FY 2001
(Dollars in Billions)



FHA and Ginnie Mae

FHA provides insurance on mortgages on one-to-four family residences, multifamily rental housing, and other qualified mortgaged properties. Ginnie Mae guarantees the timely payment of principal and interest to privately issued securities backed by pools of mortgages insured or guaranteed by FHA, the Department of Veterans Affairs, and the Rural Housing Service. The program objectives carried out by FHA and Ginnie Mae relate directly to developing affordable housing.

Strategic Goal 1: Increase the Availability of Decent, Safe, and Affordable Housing in American Communities

One of HUD's most important roles is to increase the availability of decent, safe and affordable housing for all Americans. Many HUD programs are dedicated to expanding opportunities for those who wish to become homeowners. In addition, HUD strives to improve rental housing affordability, availability and accessibility for low- and moderate-income individuals and families. Although the quality of U.S. housing has steadily improved over the past five decades, actions to reduce or eliminate remaining hazards and substandard conditions and make housing more resistant to disasters are still vital. These perspectives are summarized in the Department's three strategic objectives under this goal:

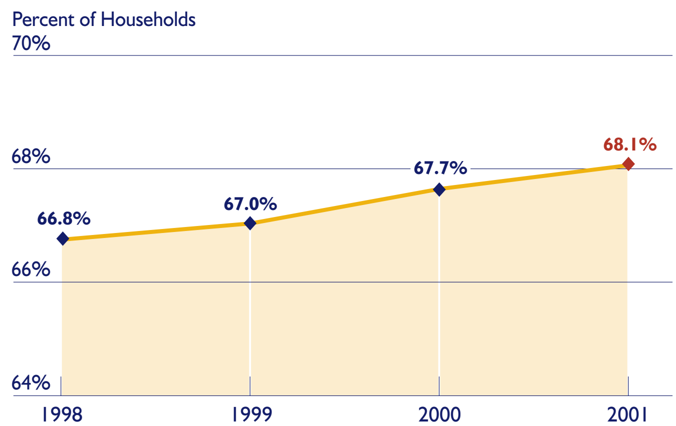
- Homeownership is increased.
- Affordable rental housing is more available for low-income households.
- America's housing is safe and disaster resistant.

Strategic Objective 1.1: Homeownership is increased

Through homeownership, an individual or family makes an investment in the future. A home is an asset that can grow in value and provide capital to finance future needs of a family, such as college for children or financial security for retirement. Additionally, homeownership helps stabilize neighborhoods, strengthen communities, and stimulate economic growth.

HUD has contributed significantly to the Nation's marked progress in raising the homeownership rate. Homeownership has risen steadily since 1993, and by the end of FY 2001 reached a quarterly rate of 68.1 percent. The achievement represented an all-time high for the fifth year running and exceeded the FY 2001 performance goal (1.1.1).[1]

Overall Homeownership Rate



HUD programs focus homeownership promotion on populations and geographic areas that lag behind. In a positive sign of regeneration, central cities have gained homeowners, in part through HUD efforts. In the fourth quarter of FY 2001, the central city homeownership rate was 52.3 percent, up from 51.9 percent in 2000 (performance goal 1.1.4). In addition, the minority homeownership rate, which has made steady gains over the past few years, reached a record 49.2 percent in the fourth quarter of FY 2001. This still lags far behind the national homeownership rate, and the Department will continue to expand its efforts to increase minority homeownership in FY 2002 and beyond.

HUD has a wide variety of programs that support homeownership. The programs with the greatest impact on homeownership are Federal Housing Administration mortgage insurance and the Government National Mortgage Association (Ginnie Mae). These organizations cut the costs of homeownership—including financing, production, and transaction costs and fees—to make homeownership more affordable and financing more

[1] *Performance goals in this section are referenced according to the FY 2001 Annual Performance Plan (APP). Performance is discussed in greater detail in Section III, and background information about the measure and data is presented in the APP.*

widely available. Other programs that contribute to homeownership are the Community Development Block Grants (CDBG) and HOME (Housing Investment Partnerships) programs, and the homeownership voucher program. Homeownership is further advanced through goals set by HUD for the housing government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac.

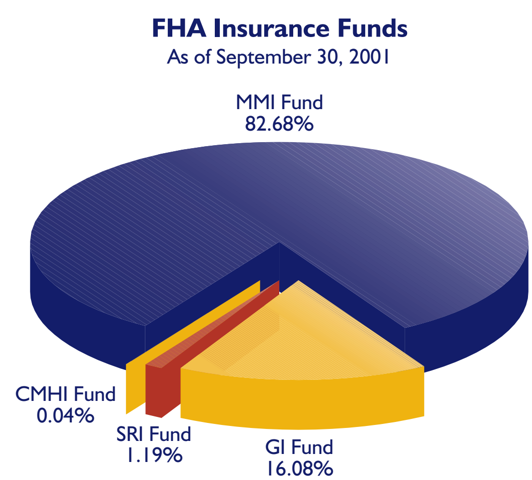
Overview of the Federal Housing Administration

The Federal Housing Administration (FHA) was established under the National Housing Act of 1934 to improve housing standards and conditions, provide an adequate home financing system by insurance of housing mortgages and credit, and stabilize the mortgage market. FHA was consolidated into HUD in 1965. FHA has been an innovator in housing finance from its introduction of mortgage insurance in the 1930s to reverse annuity mortgages for seniors in the 1980s. For over 60 years, FHA has successfully supported the availability of capital for single family and multifamily homeownership and for the development of affordable rental housing, stabilizing the housing markets and providing homeownership opportunities. FHA continues to serve families and markets that are not well served by the conventional mortgage markets.

FHA Funds. FHA insures private lenders against loss on mortgages that finance single family homes, multifamily rental projects and healthcare facilities. FHA also insures private lenders against loss on loans for property improvements and manufactured homes. Its activities are financed by the FHA Funds, which are supported through premium and fee income, interest income, congressional appropriations, borrowings from the U.S. Treasury and other sources. The FHA Funds are:

- The Mutual Mortgage Insurance (MMI) Fund, a historically self-sustaining fund that supports FHA's basic single family homeownership program.
- The General Insurance (GI) Fund, which supports a wide variety of multifamily and single family insured loan programs for rental apartments, cooperatives, condominiums, housing for the elderly, nursing homes, hospitals, property improvement, manufactured housing (Title I) and disaster assistance.
- The Special Risk Insurance (SRI) Fund, which supports multifamily rental projects and loans to high risk borrowers.
- The Cooperative Management Housing Insurance (CMHI) Fund, a historically self-sustaining fund that supports insurance on market-rate cooperative apartment projects. This fund is no longer active, except for refinancing.

Insurance-In-Force. At the end of FY 2001, the MMI Fund comprised 82.68 percent of the FHA Insurance Fund; the GI Fund, 16.08 percent; the SRI Fund, 1.19 percent; and the CMHI Fund, 0.04 percent. The total mortgage insurance-in-force in the FHA Fund was $555 billion, an increase of $11 billion, or 1.99 percent over Fiscal Year 2000 insurance-in-force. Specifically, the MMI Fund increased by $9.7 billion, the GI Fund increased by $1.4 billion, the SRI Fund decreased by $0.236 billion, and the CMHI Fund, the smallest of the four, decreased by $0.002 billion.



FHA's single family mortgage insurance business comprised 89.9 percent of its insurance-in-force. The multifamily and health care insurance comprised 9.6 percent. Title I property improvement and manufactured home insurance comprised 0.5 percent.

FHA Single Family Programs

FHA endorsed 1,067,000 single family mortgage loans in fiscal 2001 (including refinancing), compared with 921,000 in FY 2000 (performance goal 1.1.e). In FY 2001, FHA played a major role in achieving the record homeownership rate by endorsing 643,748 loans to first-time homebuyers, or 79.8 percent of new home purchase endorsements (performance goal 1.1.f). FHA activities contributed to the trend of record homeownership rates among families with incomes below the area median: 52.6 percent in the third quarter of 2000, compared with 52.2 percent in 1999 (performance goal 1.1.3). Approximately 36.5 percent of the new homeowners with FHA mortgage insurance in FY 2001 were minorities compared to 41.7 percent in FY 2000 (performance goal 2.3.a).

MMI Capital Ratio. The MMI Fund supports over 91 percent of FHA's single family insurance-in-force. The financial soundness of this fund is measured by the MMI capital ratio. The National Affordable Housing Act of 1990 requires an independent actuarial analysis of the economic net worth of the MMI Fund. The Act also mandates that the MMI Fund maintain a capital ratio (a measure of the Fund's cushion against unexpected insurance losses) of at least 2 percent. The cushion ensures that FHA's basic single family insurance program could withstand unexpected losses without exposing the taxpayers to financial risk.

Capital Ratio of the FHA Mutual Mortgage Insurance Fund

1998	1999	2000	2001
2.71%	3.66%	3.51%	3.75%

The MMI Fund's capital ratio was 3.75 percent at the end of FY 2001, compared with 3.51 percent in FY 2000 (performance goal 1.1.c).

Increase in Mortgage Limits. HUD continues to insure larger FHA home mortgages to keep pace with rising home prices—which helps additional thousands of families become homeowners each year. The higher loan limits particularly benefit first-time and minority homebuyers, who have traditionally been served by FHA. The new limits also better serve senior citizens who can now qualify for larger insured reverse mortgages.

Secretary-Held Mortgage Notes and Property. Prior to 1996, FHA-insured mortgage notes were assigned to the Secretary when FHA paid a claim prior to foreclosure and took possession of the note for servicing. In 1996 the program was terminated because of the high cost of servicing assigned notes. During FY 1999, notes held by borrowers who applied for the program before April 1996 were again assigned to HUD.

Between FYs 2000 and 2001, the overall unpaid principal balance of Secretary-held mortgage notes decreased by 5 percent to $2,850 million from $2,988 million while the number of notes increased by 6.04 percent. The overall increase in note inventory is mostly due to a 36.45 percent increase in single family notes related to implementing the loss mitigation program, going from 16,611 notes in FY 2000 to 22,666 notes in FY 2001.

The number of Multifamily notes in inventory increased by 26.90 percent to 1,684, and the number of Title I decreased by 6.53 percent (to 39,620 notes) due to a note sale.

FHA has reduced its single family note inventories from approximately $677 million in FY 1997 to $208 million in FY 2001 through bulk note sales.

Legislation passed in 1999 allows FHA to accept mortgage note assignments for single family properties again. FHA can either service the notes directly or transfer them to a third party for servicing. This program, Accelerated Claims Disposition Program, is expected to help FHA dispose of properties more quickly and with a better rate of recovery. A pilot of the new program is scheduled to begin in FY 2002 and to expand over time.

Single-Family Mortgage Notes Held by the Secretary as of September 30th
(Dollars in Millions)

	1998	1999	2000	2001
SF Mortgage Notes	$731	$699	$218	$208
Title I Mortgage Notes	$497	$469	$427	$395

FHA acquires single family and multifamily properties through conveyance claims, or by foreclosing on single-family notes that were assigned to the Secretary. Secretary-held property decreased almost 10 percent in FY 2001 to $3,177 million from $3,518 million. The decrease in property inventory reflects decreases in the number of both single family and multifamily properties acquired throughout this fiscal year

The table below shows that single family property holdings fell by 14 percent in FY 2001 to $2,421million. The Accelerated Claims Disposition Program, described above, is expected to reduce Secretary-held property over time, as notes are sold prior to HUD acquisition of properties.

Single-Family Property Held by the Secretary as of September 30th
(Dollars in Millions)

1998	1999	2000	2001
$3,254	$4,194	$2,827	$2,421

FHA has implemented a number of new policies to improve the acquired property disposition process.

The Management and Marketing (M&M) contracts continue to increase the net recovery of sales proceeds and to reduce the turnover time of acquired properties. The Asset Control Area (ACA) program addresses improving the acquired property disposition process.

- M&M contracts have resulted in a steady decline in FHA's inventory, from 36,000 homes at the end of FY 2000 to 29,000 at the end of FY 2001. The loss per claim has been cut from 37 percent to 32 percent.
- The Asset Control Area (ACA) program allows nonprofit organizations and local governments to purchase FHA-acquired homes in bulk within revitalization areas. The homes are then rehabilitated and sold to moderate- and middle-income households. There are 16 ACAs nationally.

Ginnie Mae

The Government National Mortgage Association (Ginnie Mae), mortgage-backed securities (MBS) program is authorized by Title III of the National Housing Act, as amended. The primary function of Ginnie Mae is to support the federal government's housing initiatives and to attract capital from the nation's financial markets into the residential mortgage markets.

This activity helps to keep mortgage rates lower and to make more mortgages available. Ginnie Mae guarantees the timely payment of principal and interest on securities issued by private institutions and backed by pools of federally unsured or guaranteed mortgage loans. The securitization of FHA-insured, Rural Housing Service, and Veterans Affairs guaranteed mortgages increases the liquidity of funds to lenders making these loans, and thereby decreases the costs of making and servicing loans. This, in turn, helps lower costs for homebuyers using these government housing programs.

Since inception of the MBS program in 1970, Ginnie Mae has guaranteed the issuance of approximately $1.8 trillion in securities, providing the capital to purchase or refinance 26.8 million homes for American families. In FY 2001, Ginnie Mae guaranteed the securitization of 97.9 percent of eligible FHA and VA loans, up from 86.2 percent in FY 2000 because of a slight decrease in competition (performance goal 1.1.a).

The new securitization increased the volume of outstanding single-family MBS securities to $604.3 billion by the end of FY 2001, an increase of $0.80 billion, a slight increase due to the refinancing boom in FY 2001.

Ginnie Mae issued commitments for $161.7 billion in new MBS guarantees during FY 2001, up 84.8 percent from FY 2000 commitments. Ginnie Mae issued a total of $153.8 billion of MBS guarantees, up 45.8 percent from FY 2000. Of these new securities, $148.2 billion were backed by single family mortgages and $5.5 billion were backed by multifamily construction and project loans. The single-family MBS included $0.1 million backed by manufactured housing loans.

FY 2001 was another year of very favorable financial achievement marked by increases in both revenues and assets. Ginnie Mae achieved record net income of $805.3 million, a 6 percent increase from $762.8 million in FY 2000. In FY 2001, Ginnie Mae production provided the capital to finance the purchase or refinance of homes for approximately 1.3 million homes.

Ginnie Mae Single-Family Mortgage-Backed Securities Outstanding as of September 30th

(Dollars in Billions)

1998	1999	2000	2001
$542	$570	$603.5	$604.3

Targeted Lending Initiative. Ginnie Mae implemented its Targeted Lending Initiative in 1996 to help raise homeownership levels in central city areas. The program provides financial incentives for lenders to increase loan volumes in traditionally underserved areas.

The Initiative was expanded in 1999 to include Indian lands, new Urban Empowerment Zones, and new Urban Enterprise Communities. The Initiative now includes Rural Empowerment Zones and Rural Enterprise Communities as well, supporting more competitive mortgage interest rates for properties in these areas. Under the Initiative, Ginnie Mae reduces its guaranty fee as much as 50 percent when approved issuers originate (or purchase) eligible home mortgage loans in designated communities and place them in Ginnie Mae pools.

By increasing lender activity in these targeted areas, Ginnie Mae provides underserved families and households with increased opportunities to achieve homeownership. In 5 years of operation (October 1, 1996- September 30, 2001), the Targeted Lending Initiative has issued $16.6 billion in securities, representing 171,454 loans in 10,835 pools. During FY 2001, $3.1 billion in targeted lending pools were issued.

Government-Sponsored Enterprises

Fannie Mae and Freddie Mac, the two Government Sponsored Enterprises (GSEs) that HUD regulates, help ensure that capital for mortgage lending flows freely by establishing a secondary market for securitized mortgages. HUD's regulations and performance goals for the GSEs establish standards for the share of mortgage purchases originated for low and moderate income households, defined for GSE purposes as those with incomes below the area median income. Beginning in 2001, the Department set higher goals for the GSEs, so that 50 percent of eligible units must be for low and moderate income households. The most recent data available, reflecting calendar 2000, show that 49.5 percent of Fannie Mae mortgage purchases and 49.9 percent of Freddie Mac mortgage purchases supported homes for families with low and moderate incomes (performance goal 1.1.g). These figures include mortgages for affordable multifamily developments. The GSEs together financed over 3.5 million units of housing in 2000. Of this, Fannie Mae financed mortgages supporting 1,054,349 homes for low and moderate-income families (with a principal balance of over $78 billion) and Freddie Mac financed mortgages supporting 788,324 homes for low and moderate income families (with a principal balance of $60 billion).

Strategic Objective 1.2: Affordable rental housing is available for low-income households

For households unable to purchase homes or those preferring to rent, HUD is charged with increasing the availability of decent, safe and affordable rental housing. Over the past 5 decades, the physical quality of rental housing has improved greatly, but housing has become less affordable overall, particularly for poor households. During the 1990s, growing numbers of low-income renters were paying more than 30 percent—in many cases more than 50 percent—of their income for housing expenses.

The latest available American Housing Survey data show that during the 1998-1999 period the Nation and HUD made substantial progress in reducing the severest rental housing burdens, or "worst case needs" for housing assistance. The number of unassisted very-low-income renter households with worst case needs declined from an all-time high of 5.38 million in 1997 to 4.86 million in 1999. Most of these families paid more than half of their already very-low income for housing. This substantial progress reflects a 12 percent decline in worst case needs among elderly households, to 1.03 million, and a 10 percent decline among families with children, to 1.79 million (performance goal 1.2.1).

However, in certain respects, the affordable housing shortage has worsened. For extremely-low-income households,[2] the need for affordable rental housing has actually increased. In 1999, only 75 affordable units were available for every 100 extremely-low-income renters, down from 77 units per 100 renters in 1997 (performance goal 1.2.5). In addition, the number of affordable units that were actually available to very-low-income renters decreased from 72 per 100 renters in 1997 to 68 per 100 renters in 1999 (performance goal 1.2.6). The primary cause of these decreases is the continued loss of affordable housing stock; the existing housing that becomes obsolete is exceeding the new housing stock that becomes available.

The supply of HUD-assisted rental housing continues to be insufficient to meet all of the affordable housing needs of extremely-low-income renters, as the ratio between those who report any form of housing assistance and those with worst-case housing needs (or housing assistance) was only 44.7 percent in 1999 (performance goal (1.2.a). The next American Housing Survey Data will be available in late 2002, covering 2001.

Overview of HUD Rental Assistance

HUD's three basic rental assistance programs—public housing, project-based assisted housing (including supportive housing for the elderly (Section 202) and for persons with disabilities (Section 811)), and Housing Choice Vouchers—provide the most direct means of ensuring affordable rental housing. Under these subsidies, assisted households typically pay 30 percent of income for housing. Other low-income households are helped by the rental assistance component of the Housing Opportunities for Persons With AIDS (HOPWA) program and the tenant-based rental assistance component of the HOME program, under which assisted households also pay 30 percent of their income for housing.

A variety of programs, including HOME, HOPWA and the Low-Income Housing Tax Credit (LIHTC, regulated by the U.S. Department of Treasury), provide subsidies that lower the costs of producing new rental housing or rehabilitating existing housing. Finally, the Rural Housing and Economic Development program provides grants for a variety of housing and capacity building activities, with a focus on the severe needs in reservations, colonias, and small towns.

NAHASDA. Native Americans have long suffered from a shortage of adequate housing. The Native American Housing Assistance and Self-Determination Act of 1996 (NAHASDA) provided Indian tribes with the opportunity to assess their tribe's housing needs and develop programs that are responsive to those needs. HUD provides block grants to Tribes and Tribally Designated Housing Entities (TDHEs) to conduct affordable housing and community development activities. Factors

[2] *Extremely-low income is defined as household income less than 30 percent of area median income, and very-low income is less than 50 percent of area median income.*

such as low incomes, lack of financial literacy, remote locations, lack of infrastructure and lack of access to capital prevent a significant number of Native American families from becoming homeowners, so tribes may elect to develop rental programs with NAHASDA funds.

Rental Assistance

The Housing Certificate Fund provides rental assistance to help low and very-low income families obtain decent housing at affordable rents. This fund works through two programs authorized by Section 8 of the Housing Act of 1937. They are known as the "tenant-based" Housing Choice Voucher program and the "project-based" Section 8 program.

The Housing Choice Voucher program works though state and local intermediary housing agencies (HAs). HAs provide families with vouchers that they can use to rent housing in the private market. Families with vouchers pay approximately 30 percent of their income for housing, with the government paying the balance up to a locally-determined maximum. Because this assistance is portable, families can use it to find housing in communities where poverty rates are lower and that are closer to educational and economic opportunities. The total number of units eligible for vouchers was approximately 1.966 million in FY 2001, up from 1.837 million in FY 2000 (see table and footnote on page 19).

The project-based program links rent subsidies directly to units. The program's objectives are to:

- encourage the construction and rehabilitation of rental units;
- stabilize the cash flow of FHA-insured or HUD-held multifamily projects which are in financial difficulty; and
- preserve the low-income use of certain multi-family projects.

Although HUD is not entering into any new contracts for construction or substantial rehabilitation activities, a sizable number of existing contracts for these projects continue to require funding for amendments and renewals. HUD provides project-based rental assistance directly to multifamily project owners through a number of programs.

Section 8 Obligations. Obligations relating to HUD's Housing Choice Voucher and Section 8 project-based programs totaled approximately \$42.4 billion and \$46.1 billion as of September 30, 2001 and 2000, respectively. For much of the life of the Section 8 program, HUD entered into multi-year contracts with housing agencies and project owners to provide rental subsidies over the term of these contracts. Many of these multi-year contracts have not yet expired. HUD presently renews voucher contracts for only a single year, and any multi-year contract renewals for the project-based program are made subject to annual appropriations. These obligations consist of the subsidies to be paid by HUD applicable to the remaining terms of these contracts.

The Department funds a significant portion of these Section 8 obligations through permanent indefinite appropriations (\$26.4 billion and \$28.6 billion as of September 30, 2001 and 2000, respectively). These obligations relate to future amounts due under subsidy contracts entered into prior to FY 1988 (primarily relating to the Section 8 and Section 235/236 programs) which operated under contract authority. Contract authority enabled the Department to enter into multi-year contracts with an annual draw against permanent indefinite appropriations to fund amounts due under these contracts.

Utilization of Vouchers. With high levels of worst case housing needs and limited budgetary resources, it is essential that budget resources be used efficiently to provide families with affordable housing. In the past several years, the Department and Congress have taken a number of steps to improve utilization of Housing Choice Vouchers. These include: merging the Section 8 certificate program with the voucher program; reforming the voucher program to make it more attractive to landlords; expanding flexibility for PHAs to raise voucher payment standards to respond to local market conditions; implementing a new Fair Market Rent policy that allows housing agencies experiencing low voucher success rates to base payment standards on the 50th rather than the 40th percentile of rents; and authorizing housing vouchers to be used for homeownership. As agreed in a negotiated rulemaking with relevant stakeholders, HUD has also recently instituted a process that will provide for the reallocation of unused vouchers from PHAs that fail to achieve an adequate utilization rate. However, the full implementation and impact of such reallocations is not anticipated to be experienced until FY 2002.

HUD's Section 8 Management Assessment Program (SEMAP) gives substantial weight to the extent of a PHA's utilization of the vouchers and voucher funding provided to it. For the purposes of SEMAP, a PHA's utilization rate is the higher of the share of budget authority spent or the share of units utilized during the PHA's fiscal years, excluding units under ACC for less than 1 year or reserved for litigation. An analysis of PHA fiscal year end statements indicates that the average PHA utilization rate for SEMAP purposes rose from 93.3 percent in 2000 to 94.6 percent in 2001.[3] To similar effect, the share of units administered by PHAs that meet the 95 percent threshold for acceptable SEMAP utilization rates increased from 44.6 percent in 2000 to 55.2 percent in 2001.

The SEMAP score is a weighted score of the composite of units leased and funds spent. In order to understand the composite score, it is important to look at the lease up and fund utilization separately. Unit lease up actually decreased by 1.5 percent during this period, while fund utilization increased by more than 3 percent. The increase in budget authority reflected changes made by HUD to improve leasing that resulted in a reduction in the actual number of families assisted. In order to maximize the number of units leased, HUD issued an administrative notice advising PHAs that HUD would provide additional funds to the extent necessary to allow PHAs to fully lease the units contracted with HUD.

Determination of Excess Rental Subsidies. Under HUD's rental assistance housing programs, tenants generally are required to pay 30 percent of their income towards rent, with HUD providing the balance of the rental payment. Because the amount of rental subsidies paid on behalf of a tenant is based on that tenant's income, failure of a tenant to report all income to the program administrator and failure of the program administrator to properly determine and certify tenants results in the Department paying excess rental subsidies. This issue applies to the Department's Housing Choice Vouchers, project-based Section 8 and Public Housing programs.

In support of HUD's FY 2001 financial statements, the Department developed statistical estimates of the extent of erroneous rental housing subsidy payments attributed to underreported tenant income and program processing errors by the public housing authorities, owners and agents (POAs) responsible for program administration. Estimates are based on prior year data from 2000, because this is the most recent period for which comprehensive independent sources of tenant income data are available for verification purposes.

HUD estimates of erroneous payments attributed to POA rent calculation and processing errors were based on a HUD study of "Quality Control for Rental Assistance Subsidies Determinations," which was published as a final report in June 2001. The study found that 60 percent of the calculations had some type of administrative or calculation component error contributing to a subsidy overpayment or underpayment situation. Errors were considered if they exceeded a $5 impact threshold on monthly subsidy payment amounts. The study projected, with 95 percent confidence, annual subsidy overpayments of $1.669 billion ± $251 million and annual subsidy underpayments of $634 million + $151 million that were primarily attributable to program administration error by POAs. The Department projects, with 95 percent confidence,

[3] This average is weighted by the number of voucher units at each PHA. The utilization data for 2000 is based on fiscal year-end statements from PHAs with fiscal years ending December 31, 1999; March 31, 2000; June 30, 2000; and September 30, 2000. The utilization data for 2001 is based on fiscal year-end statements from PHAs with fiscal years ending December 31, 2000; March 31, 2001; June 30, 2001; and September 30, 2001. A significant number of PHAs with fiscal years ending September 30, 2001 have not been included in the analysis of utilization rates in 2001 because their financial statements have not yet been fully processed.

HUD has developed this protocol to enable consistent reporting of changes in utilization across time. Past reports, which relied on the most recently available PHA fiscal year-end statement, did not provide the assurance of unduplicated time-series measures. In a number of cases, this new protocol has led to the calculation of new baselines.

that the amount of subsidy overpayments attributed to tenant underreporting of income was \$978 million ± \$247 million. Offsetting the overpayment and underpayment error estimates yields a net annual subsidy overpayment estimate of \$2.013 billion, which represents approximately 10.7 percent of the \$18.883 billion in total rental subsidies paid by HUD in FY 2000.

HUD is taking actions to address the causes of erroneous subsidy payments, and is instituting necessary controls to better assure that payments are made in the correct amounts, in accordance with program statutory and regulatory requirements. HUD's goal is to reduce processing errors and resulting erroneous payments 50 percent by 2005. It should be noted that the reduction of errors and improper payments may not have as significant an impact on budget outlays as anticipated. HUD's experience indicates that its efforts may have the possible effect of causing some higher income tenants to leave subsidized housing with the potential result that they would be replaced by lower income tenants requiring increased outlays. Additional information on this study is presented in Note 16 to the financial statements.

Operating Subsidies, Grants and Loans to Housing Agencies

There are an estimated 4,535 housing agencies of various types across the nation that manage HUD rental assistance programs (i.e. Housing Choice Voucher and Public and Indian Housing Programs). These HAs are primarily composed of Public Housing Agencies (PHAs) and Tribally Designated Housing Entities (TDHEs). Public Housing is the oldest federal low-income housing program. About 3,160 PHAs manage approximately 1.2 million public housing units that are homes for some 2.58 million persons (many of these PHAs also administer voucher programs). Another 1,020 HAs manage voucher programs but no public housing. In addition, approximately 355 TDHEs manage an estimated 70,000 to 80,000 housing units, but under the Native American Housing Assistance and Self Determination Act, TDHEs are not required to report to HUD. The rental income collected from residents is supplemented by federal funding to support the operating and capital needs of these units.

The Department provides funding to PHAs to support public housing through the following accounts:

- **The Operating Fund** appropriation in FY 2001 provided \$3.235 billion in operating subsidies through a formula distribution to PHAs to help them to meet their operating and management expenses. These subsidies are required to bridge the gap between operating expenses and income. As a result of negotiated rulemaking, the Operating Fund formula was revised in 2001 to improve equity, increase incentives for energy conservation, encourage resident self-sufficiency, and support resident participation activities.

- **The Capital Fund** appropriation in FY 2001 provided \$2.993 billion in funding to PHAs, through a formula distribution, to carry out capital and management improvement activities. PHAs use this funding to modernize and rehabilitate existing units, demolish obsolete units, relocate tenants, acquire or develop new units, implement management improvements, and support homeownership programs. In order to address the estimated \$20 billion backlog of capital needs, the Department has taken steps to ensure that the appropriated funds are utilized more quickly and has developed a new legislative proposal to facilitate the private financing of capital improvements.

Units of Housing Assistance Available Under HUD's Major Programs

	1998	1999	2000	2001
Section 8 Low Income Rental Assistance Program:				
Tenant-based Assistance	1,605,898	* 1,681,774	1,837,428	1,966,171
Project-based Assistance	1,395,037	*1,386,533	1,358,797	1,343,574
Total Section 8	3,000,935	*3,068,307	3,196,225	3,309,745
Public Housing Program	1,295,437	1,273,500	1,266,980	1,219,238
Sub-total	4,296,372	*4,341,807	4,463,205	4,528,983
Other Assistance Programs				
Homeownership Assistance Program (Section 235)	52,713	43,116	26,477	17,746
Rental Housing Assistance Program (Section 236)	476,451	464,020	446,300	414,576
Rent Supplement	20,860	20,860	20,261	20,161
Sub-total	550,024	527,996	493,038	452,483
Less estimated number of households receiving more than one form of assistance (double count)	(190,140)	(190,140)	(190,140)	(190,140)
Total, Public and Assisted Housing	4,656,256	*4,679,663	4,766,103	4,791,326
CDBG Households Assisted	157,417	158,280	187,500	172,445
HOME Tenant-Based Assistance	8,246	8,246	6,899	11,756
HOME Rental Units Committed	24,148	25,114	33,487	27,456
HOME New Homebuyers Committed	29,514	30,695	30,748	29,690
HOME Existing Homeowners Committed	13,415	13,952	14,731	12,566
HOME Total Households	75,323	78,007	85,865	81,468
HOPWA Households	43,798	41,670	43,902	49,515
Total of CDBG, HOME and HOPWA	276,538	277,957	317,267	303,428

** These numbers differ from those reported in the FY 1999 Accountability Report because of a prior period adjustment to Tenant-based Assistance units and to Moderate Rehabilitation units in the Project-based Assistance number.*

HOPE VI Neighborhood Investment Partnerships

The HOPE VI Program revitalizes severely distressed public housing developments and their neighborhoods using the strategies of public-private partnerships and mixed-income housing. Public housing agencies can use HOPE VI grants for a broad range of activities: capital costs of major rehabilitation, new construction and other physical improvements; management improvements; planning and technical assistance; self-sufficiency programs for residents; and demolition of severely distressed public housing. Through HOPE VI, HUD has renewed efforts to rid neighborhoods of obsolete or distressed housing units and replace demolished units with lower-density housing. HUD also is providing tenants of these units with rental vouchers that allow them to obtain affordable private sector housing.

HOPE VI Results. During FY 2001, the HOPE VI Program revitalization grants were awarded through 16 grants in 15 cities totaling $491 million. These grants will allow housing agencies to demolish 7,923 severely distressed and obsolete units, rehabilitate 24 units and create 5,371 replacement units. This compares with 18 grants in FY 2000, totaling $513 million. The $491 million investment is expected to help generate a record $1.76 billion in additional investment in housing and jobs programs at public housing developments. In addition to the grants awarded in 2001, the HOPE VI program relocated 6,923 families, demolished 12, 375 units, completed 4,044 new and rehabilitated units, and occupied 3,579 units.

FHA Multifamily Housing Programs

FHA's Office of Multifamily Housing continued to provide financing support for rental housing and health care facilities by insuring loans and risk-sharing mortgages. In FY 2001, FHA endorsed multifamily loans totaling approximately $5.1 billion. The 14,700 mortgages currently held in the portfolio have an unpaid principal balance over $54 billion.

FHA's largest multifamily programs in terms of insurance-in-force are Sections 221(d)(4), 223(f), and 221(d)(3). FHA completed initial endorsements of 758 multifamily loans in FY 2001, exceeding the goal of 700 loans, and substantially more than the 663 endorsements in FY 2000 (performance goal 1.2.L). Of these insured mortgages, 137 were in support of HUD's mortgage restructuring activity under the Mark-to-Market program, which supplemented the usual demand for insured multifamily mortgages. The large volume masks the effect of a shortfall in available credit subsidy, which ran out in midyear. FHA's Multifamily Accelerated Processing (MAP) initiative contributed to the demand by ensuring that mortgage applications submitted by some 100 MAP approved lenders were processed promptly, predictably and consistently. Since the implementation of MAP in August 2000, approximately 850 applications have been received even though there was a shut-down of credit subsidy during the fourth quarter of 2001. Of the approximately 850 applications, upwards of 241 received firm commitments and approximately 170 went to MAP closing (principally under the Section 221(d)(4) and 232 programs).

Multifamily Housing also contributed substantially to the supply of affordable housing for special needs populations—the elderly and persons with disabilities. In FY 2001, 301 projects were brought to initial closing under the Section 202 and Section 811 programs, up from 278 in FY 2000 (performance goal 1.2.g). Capital advances for these developments will help provide housing to thousands of elderly persons and persons with disabilities.

Secretary-Held Multifamily Mortgage Notes and Property. A note is assigned to the Secretary when FHA pays a claim prior to foreclosure and takes possession of the mortgage note for servicing. Mortgage notes in default were assigned to FHA for servicing until 1996, when the program was terminated because of the high cost of servicing assigned notes. However, in FY 1999, notes were assigned to HUD that were held by borrowers who applied for the program before April 1996.

Multifamily Mortgage Notes and Multifamily Property Held by the Secretary as of September 30th
(Dollars in Billions)

	1998	1999	2000	2001
Mortgage Notes	$2.108	$2.135	$2.343	$2.247
Property	$0.376	$0.527	$0.691	$0.756

Preserving Affordable Housing Assistance

In recent years, strong local markets have increased rents in some areas, leading a number of owners of multifamily properties to prepay their assisted mortgages and/or decline to renew their Section 8 project-based assistance contracts when they expire (i.e., to "opt-out" of the program). This market pressure has caused a decline in the number of households helped with project-based assistance. To prevent tenants from being displaced when owners prepay or opt-out, HUD provides enhanced vouchers on a "one-for-one replacement basis" that allow eligible tenants to remain in these properties or move to affordable housing elsewhere. Any vouchers that are not used by current tenants remain in the locality so that the total number of assisted households in a community is not reduced by the prepayment or opt out.

Two programs are also in place to help preserve the project-based assisted housing stock, Mark-To-Market and Mark-Up-To-Market.

Mark-To-Market. Starting in 1998, HUD began implementing the "Mark-to-Market" program. Many Section 8 properties with HUD-insured mortgages have assisted rents that are much higher than comparable market rate rental properties. Rather than renew these Section 8 contracts at above-market rents with above-market subsidies, HUD reduces rents to market levels and, where needed, reduces the existing mortgage debt to levels supportable by the lower rents. In FY 2001, the Office of Multifamily Housing Assistance Restructuring (OMHAR) completed 165 rent reduction agreements, 274 full debt restructuring agreements, and an additional 168 restructuring plans that had not yet closed, for a total of 607 project actions (performance measure 1.2.n).

Through FY 2001, this effort was administered by OMHAR, which was a separate entity in HUD. Beginning in FY2002, OMHAR activities will be the responsibility of the FHA Commissioner.

Mark-Up-To-Market. Beginning in 1999, HUD implemented a complementary preservation program called "Mark-Up-To-Market" for properties with below market rents. This targeted effort offers higher rents (not to exceed the comparable market rents for the area) to owners with expiring project-based Section 8 contracts if they renew their contracts. In exchange for these higher rents, owners are required to sign 5-year project-based Section 8 renewal contracts. Because tenant payments in project-based Section 8 are fixed at 30 percent of income, tenants are not affected by the higher rents.

Ginnie Mae Multifamily Housing

During 2000, Ginnie Mae developed a new mortgage-backed security for FHA-insured multifamily mortgages that are originated in connection with the Mark-to-Market program. Beginning in FY 2001, the new MBS instrument facilitated the flow of private capital to the Mark-to-Market program.

Ginnie Mae supported FHA multifamily mortgage insurance by securitizing 100 percent of the eligible FHA-insured multifamily mortgage volume in FY 2001, as it did in FY 2000 (performance goal 1.2.j). The total volume of Multifamily MBS outstanding has increased every year since FY 1996.

Ginnie Mae Multifamily Mortgage-Backed Securities Outstanding as of September 30th
(Dollars in billions)

1998	1999	2000	2001
$14.6	$16.5	$18.7	$21.6

Delinquency in repayment of multifamily mortgages has declined in recent years because of strong economic and rental market conditions. Serious delinquencies among multifamily mortgages are defined as loans delinquent two months or more plus foreclosures. As shown below, delinquency ratios for the MBS pooled mortgages in the multifamily housing programs increased in FY 2001, following several years of decline, primarily due to weak economic conditions.

Delinquency Ratio of Ginnie Mae's MBS Multifamily Portfolio

1998	1999	2000	2001
0.78%	0.58%	0.53%	1.30%

HOME Investment Partnerships Program

HOME Investment Partnerships provide funds to State and local governments to address their affordable housing needs. HOME encourages public-private partnerships by providing incentives to for-profit and non-profit developers for production of housing for low-income households. Eligible activities include the acquisition of existing housing; reconstruction and rehabilitation of substandard housing; construction of new housing; assistance to new homebuyers; and tenant-based rental assistance. HOME is one of the few programs at HUD that continue to have an affordable housing production component.

The HOME program assists low-income families, which are defined as those with an income at or below 80 percent of the area median, and helps ensure that rents are affordable in developments receiving a HOME capital subsidy by capping them at the lesser of the fair market rent or 30 percent of 65 percent of the area median income. At least 90 percent of families receiving HOME rental assistance must have incomes in the very-low-income range, below 60 percent of area median income. During FY 2001, the HOME program exceeded this statutory target, as 97.4 percent of households receiving HOME tenant-based rental assistance or occupying HOME-assisted rental units had very low incomes.

Several management initiatives during FY 2001 helped improve the performance of HOME grantees. HUD provided training and technical assistance, including web-based assistance, to participating jurisdictions. The Department posted monthly production reports on the web and aggressively followed-up with grantees that were not meeting production goals—including deobligating funds from those that failed to meet the 24-month statutory commitment deadline. As a result, participating jurisdictions committed $1.48 billion in HOME funds during FY 2001. HOME program outlays were $1.424 billion, compared with $1.479 billion in FY 2000.

Homeownership and Rental Assistance

The HOME program provides assistance for both homeowners and renters. During FY 2001, participating jurisdictions committed 81,468 new units of HOME-assisted housing and completed production of 55,148 units (performance goals 1.2.d and 1.2.e). Units completed include 20,453 rental units produced, 24,757 new homebuyers assisted, and 9,938 existing homeowners assisted. In addition to completed production units, 11,756 households received HOME tenant-based rental assistance during FY 2001. Beginning in FY 2002, through a $50 million budget allocation, HUD is launching the American Dream Homeownership Fund as part of the HOME program. Through this program, participating jurisdictions can provide downpayment assistance to homebuyers.

Housing Opportunities for Persons With AIDS

The Housing Opportunities for Persons with AIDS (HOPWA) program provides housing assistance and related supportive services for low-income persons with HIV/AIDS and their families. Grants are provided by formula allocations to States and metropolitan areas with the largest number of cases and incidence of AIDS and also by competitive selection of projects proposed by State and local governments and nonprofit organizations. In FY 2001, 105 communities received HOPWA formula allocations. FY 2001 expenditures were nearly $270 million; HOPWA provided 49,515 units of short-term and permanent housing in connection with supportive services.

Government-Sponsored Enterprises

Government-Sponsored Enterprises (GSEs) help increase the supply of affordable rental housing. The most recent available data show that during calendar 2000, Fannie Mae and Freddie Mac substantially exceeded their HUD-established “special affordable multifamily” goals for securitization volume (performance goal 1.2.i). Fannie Mae securitized $3.79 billion of multifamily mortgages, a decrease of 7 percent from 1999 levels, while Freddie Mac did $2.40 billion of multifamily business, up 6 percent from 1999.

Strategic Objective 1.3: America’s housing is safe and disaster resistant

A long-standing objective of Federal housing policy is to assure decent housing. HUD helps improve housing quality by providing funding in the form of CDBG and HOME block grants, rehabilitation loans, capital grants and lead-paint abatement grants. The Department works with public housing agencies and private housing providers to ensure that assisted housing meets housing quality standards. HUD also regulates the manufactured housing industry and works with public and private partners to develop durable, efficient and affordable housing technology.

Housing quality has improved markedly over the past 5 decades. The most recent data from the American Housing Survey (AHS) show that the share of low-income households who live in units with one of four hazardous conditions declined from 6.2 percent in 1997 to 5.8 percent in 1999 (performance goal 1.3.2).

Housing in need of repair or rehabilitation remains a frequent problem among the lowest-income renters and owners, who frequently must settle for inadequate housing to find units they can afford. The most recent data from the AHS show that the share of very-low-income renters living in units with moderate or severe physical problems declined to 14.8 percent in 1999, down from 15.2 percent in 1997 (performance goal 1.3.1). However, the share of very-low-income homeowners with similar problems increased from 7.2 percent in 1997 to 8.1 percent in 1999, in part because a substantial number of households with very-low incomes were able to become owners of "fixer-upper" properties, but also because more families were classified as having very-low incomes as overall income growth shifted the income limits. AHS data for FY 2001 is not yet available.

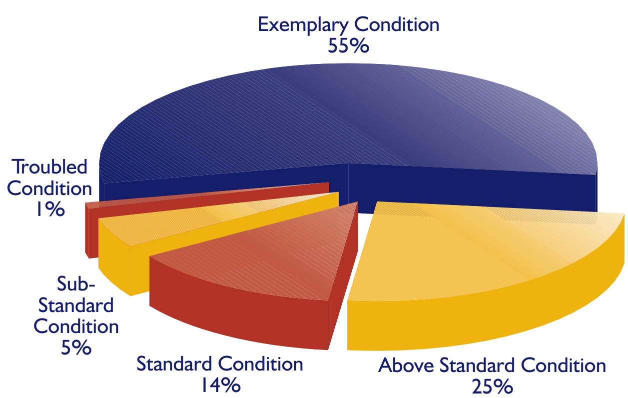
HUD-Supported Housing Quality

In September 1998, HUD published a uniform rule on physical condition standards and physical inspection requirements applicable to all HUD-supported multifamily (MF) housing and public housing stock. For the first time, HUD has baseline inspection information on the condition of the entire HUD-supported housing portfolio, and is using that information to improve living conditions for residents of that housing. Information and results from FY 2001 are provided in the following two sections.

Multifamily Insured and Assisted Housing

The results of the most recent physical inspections conducted on the MF housing portfolio provide the following profile on 28,647 insured and assisted projects with 2,531,677 housing units:

MF Housing Inspection Profile
28,647 Projects with 2,531,677 Units



On a rating scale of 100 points, projects scoring at least 60 are deemed to be in general compliance with HUD's physical condition standards. The current profile reflects that 94 percent of the MF projects are in general compliance with HUD physical condition standards, which is a substantial increase over the 87 percent that met HUD standards in the baseline profile reported last year. A comparison of the current and baseline profiles is as follows:

Project Conditions	Baseline Profile 28,038 Projects	Current Profile 28,647 Projects
Exemplary	37%	55%
Above Standard	24%	25%
Standard	26%	14%
Sub-Standard	11%	5%
Troubled	2%	1%

Based on the baseline project inspections conducted over the period 1999-2000, HUD instituted a "3-2-1" inspection policy, where projects in exemplary condition (at least 90 points) get inspected every 3 years, projects in above standard condition (80-89 points) every 2 years, and projects at or below standard condition every year. The current profile reflects the results of 10,649 new inspections that have been conducted since the reporting of the baseline profile last year. Following the "3-2-1" policy, the majority of these new inspections were on projects that had baseline scores below 80. There were some changes to the baseline physical condition standards used in 1999 that would account for modest project score increases of a few points in the current profile, but most of the increases in scores are attributed to actual improvements to project physical conditions. The significant increase in the percentage of projects scoring at least 80 in the current profile demonstrates the positive effects of a strong physical inspection program on housing conditions.

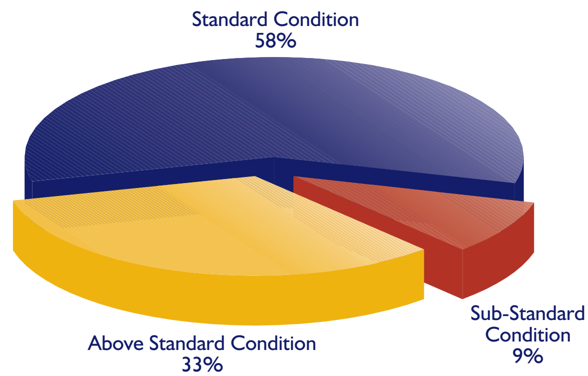
The less than 1 percent of projects that fell in the "troubled condition" (0-30 points) category were referred to HUD's Enforcement Center to better assure these more egregious conditions are appropriately addressed. For the other 5 percent of substandard performers (31-59 points) representing 6 percent of units, Office of Housing field staff follow-up to assure that Management Improvement Operating (MIO) Plans are negotiated and adhered to by project owners.

In addition, when "exigent" health and safety deficiencies are detected during HUD's on-site physical inspections, citations are issued to project owners and agents requiring corrective action and response to HUD within 3 business days. "Exigent" health and safety deficiencies are part of a larger number of "life threatening" health and safety deficiencies involving a few additional problems with fire escapes and electrical systems that are serious, but not deemed "exigent" deficiencies. The percentage of projects with any of the "life threatening" health and safety deficiencies dropped from 46 to 37 percent between the baseline and current profile. This is further evidence that HUD's physical inspection program is improving living conditions for residents of HUD-supported rental housing.

Public Housing

While the physical condition standards and on-site physical inspection requirements are the same for both public housing and MF housing, there are differences in how the information is used and acted upon, due to differences in the statutory, regulatory and contractual relationships between HUD and its respective PHA and MF project owner partners. While inspections at PHAs are conducted and scored at the project level, the results of project inspections are aggregated at the PHA level into a Pubic Housing Assessment System (PHAS) Physical Indicator score and reported as one of four components of the PHAS rule scoring process. Nevertheless, individual PHA project inspection results indicate a PHA's compliance with HUD's physical condition standards. On a 100 point scale, PHA projects scoring 90 or above are defined here as "above standard," and projects scoring below 60 as "sub-standard." The results of project inspections associated with the second cycle of PHAS scores (scores for PHAs with fiscal years ending September 30, 2000 to June 30, 2001) were as follows:

PHA Project Inspection Results
14,011 Projects with 1,238,768 Units



The following comparison of the Cycle II profile with the Cycle I profile reported last year shows a marked improvement in the overall condition of the PHA project portfolio:

Project Conditions	Cycle I Profile 13,569 Projects	Cycle II Profile 14,011 Projects
Above Standard	22%	33%
Standard	61%	58%
Sub-Standard	17%	9%

During Cycle II, HUD converted to a "2-1" inspection policy, wherein projects in PHAs with a PHAS Physical Indicator score of at least 24 out of 30 PHAS points (80 percent) are inspected every 2 years, while "standard" and "sub-standard" projects are inspected annually. Therefore, the Cycle II profile is a mix of new inspection scores on projects in PHAs with lower PHAS Physical Indicator scores (below 80 percent) from Cycle I, plus carry-over scores on projects in high scoring PHAs from Cycle I.

Overall, the percentage of projects complying with HUD's physical condition standards increased from 83 percent to 91 percent between Cycle I and Cycle II. There were some changes to the baseline physical condition standards used in 1999 that would account for modest project score increases of a few points in the current profile, but most of the increases in scores are attributed to actual improvements to project physical conditions. Many of the PHA projects failing to meet HUD's physical condition standards are larger projects, as the 9 percent of projects with sub-standard conditions represented 16 percent of the total housing units inspected. The percentage of inspected projects with "life threatening" health and safety deficiencies remained constant at 47 percent for both reporting cycles.

Office of Public and Indian Housing staff use physical inspection results to evaluate annual PHA plans to assure available resources are used to address problem projects and significant housing quality standards deficiencies. HUD looks for the number of PHA housing quality deficiencies to decrease, and inspection scores to continue to improve. HUD's independent physical inspection process is having the desired effect of improving living conditions for residents of HUD-supported public housing.

Public Housing Demolitions. As of the end of FY 2001, the Department had demolished 73,857 distressed public housing units (performance goal 1.3.b) up 14,144 from FY 2000. Demolition activity continues to be delayed by the need for PHAs to relocate tenants and abate hazardous wastes before proceeding. HUD plans to demolish an additional 13,000 units in FY 2002 and FY 2003.

Lead Paint and Other Hazards. One of the most critical housing safety issues is the presence of lead-based paint in homes with small children. As of 1994, approximately 890,000 children under the age of 6 were estimated to have elevated blood lead levels by the Centers for Disease Control and Prevention. Older housing, which is more often occupied by lower income households, is the primary source of lead-based paint hazards. During FY 2001, outlays of $64.7 million under the Lead Hazard Control Grant Program directly supported the completion of at least 8,212 lead-safe homes, increasing the cumulative total to 36,204 (performance goal 1.3.5). Subtracting all supporting program elements such as public education, temporary relocation, blood and environmental testing and program administration, the actual per-unit hazard control costs have declined from $9,440 per unit when the program began in FY 1993 to $4,095 for FY 1999 grantees (note that grants have a 3 year duration). To leverage additional private resources for local lead hazard control programs, HUD started Operation LEAP (Lead Elimination Action Program). Beginning in FY 2002, the Department will competitively award LEAP grants to organizations that demonstrate ability to leverage even more private funding for existing local lead hazard control programs.

HUD also is addressing health hazards in the Nation's housing stock through the Healthy Homes Initiative. Under the initiative, HUD awards grants to public and private organizations and makes agreements with other Federal agencies for evaluation studies and demonstration projects to address housing conditions responsible for diseases, such as asthma and injuries. (See performance goal 1.3.e).

In recent years, the serious destruction caused by hurricanes, earthquakes, and other natural disasters also highlights the need for housing that is as resistant as possible to such stresses. Significant amounts of disaster assistance funds have been appropriated for this purpose. Through the Partnership for Advancing Technology in Housing, HUD coordinates federal agency and private industry efforts to encourage the development and widespread diffusion of new disaster-resistant technologies throughout the housing industry. HUD also works through the CDBG program to improve local building codes and through CDBG and related housing grant programs to reduce vulnerability to floods.

Trends and Factors Affecting Strategic Goal 1

National and regional economic conditions, as well as the actions of many private and public players, exert a critical influence on increasing homeownership or achieving any of HUD's specific performance targets that measure progress toward that objective. For example, higher interest rates can reduce the number of first-time homebuyers, thus reducing the number of homes insured by FHA. Similarly, if the economy weakens and unemployment rises, fewer persons will apply for FHA loans, and FHA may experience a higher loan default rate. Conversely, *falling* interest rates might increase refinancing (as occurred from 1996 through 1998), thus reducing the share of new loans going to first-time buyers, even as their numbers rise. While greatly influenced by external factors, both FHA and the housing industry overall have maintained a high level of performance, even during weakened economic conditions.

Many external factors also affect the supply of affordable rental housing, including tax policy, local rental markets, building codes and land use regulations, State and local program decisions, and the actions of HUD's many other partners. Although rental vacancy rates nationally have been unusually high for at least 5 years, local rental markets vary in the availability of housing with rents below local fair market rents (FMRs), and many large metropolitan areas have severe shortages of units that would be affordable to extremely-low-income renters without Section 8 vouchers.

HUD's ability to provide access to affordable housing depends to a great extent on the state of the economy. Changes in unemployment rates, in the cost of developing and maintaining housing or in personal income—factors over which HUD has little control—all affect housing affordability. Because tenant-paid rents are established as a percent of income in HUD's rental assistance programs, lower incomes necessitate greater subsidies. With the number of renters with worst case needs far exceeding the number of deep subsidies available and with the pressure of welfare reform, the success of HUD's efforts in this area will be highly dependent on the ability of the economy to continue to generate jobs with decent wages.

A wide array of local factors, such as building codes and other regulations, affect the choices that builders make in constructing and rehabilitating American homes. While HUD can encourage local communities to improve and enforce building codes and regulations, and can encourage private builders and owners to improve their properties, the Department cannot mandate these changes. Increasing building density and other land use factors also have major impacts on the vulnerability to natural disasters and the magnitude of associated risk. Public awareness of hazards and of ways of reducing them is also important but often lacking.

Ensure Equal Opportunity in Housing for All Americans

In 1964 and 1968, Congress passed landmark legislation to ensure the civil rights of individuals, including the right of equal opportunity in housing. This Civil Rights Act contained two provisions related to housing:

- Title VI banned discrimination on the basis of race, color or national origin in federally assisted programs, including all HUD programs except for mortgage insurance and loan guarantee programs. It provides for HUD's investigation and remediation of discrimination complaints; and

- Title VIII, the Fair Housing Act, prohibited discrimination in the sale, rental and financing of dwellings based on race, color, religion or national origin. The law was amended in 1972 to prevent sex discrimination. Amendments in 1988 extended protections to persons with disabilities and families with children. It also required accessibility features in new multi-family dwellings.

HUD's strategic goal of ensuring equal opportunity in housing for all Americans has three objectives:

- Housing discrimination is reduced.

- Low-income people are not isolated geographically in America.

- Disparities in homeownership rates among racial and ethnic groups are reduced.

Every organization within HUD is responsible for furthering fair housing, but the primary responsibility rests on the Office of Fair Housing and Equal Opportunity (FHEO). FHEO has primary responsibility for investigating, conciliating and issuing determinations in cases involving discrimination. These goals are carried out through several means:

- Reducing discrimination in housing through aggressive enforcement of civil rights and fair housing laws, promoting substantial equivalency certification among State and local governments enforcing fair housing laws, and the administration of fair housing grant programs;

- Promoting geographic mobility for minority and low-income households;

- Requiring communities to integrate fair housing planning into Consolidated Plans, Public Housing Agency Plans identifying impediments to housing choice that affect results achieved with HUD formula grants, Capital Funds and HOPE VI; and

- Ensuring that other Federal agency programs that affect housing choice also further the goals of the Fair Housing Act.

Strategic Objective 2.1: Housing discrimination is reduced

Fair Housing Enforcement Under Title VIII

Despite the long-standing protections of the Fair Housing Act, studies on the incidence of housing discrimination conducted in 1978 and 1989 showed that alarming levels of illegal discrimination persisted. In FY 2001, HUD completed the first phase of the Housing Discrimination Study, the results of which will be released during 2002. The Department also has studied the extent of public knowledge of fair housing law to shed light on the factors that contribute to discrimination. To test public awareness of and support for fair housing law, HUD sponsored a fair housing awareness survey of a representative random sample of the American public. Although the survey found that there is widespread knowledge of the fair housing law, some areas of the law are still unclear to the public (performance goal 2.1.3). The report lends credence to the Department's efforts to reduce housing discrimination but also indicates areas in which public information and attention need to be directed.

Enforcement Efforts. In FY 2001, FHEO completed 623 enforcement actions, a reduction from the FY 2000 level of 725. A large part of the reason for the decline is that resources were reallocated to deal with a backlog of aged cases. State and local government agencies become HUD partners and automatically qualify for funding under the Fair Housing Assistance Program (FHAP) when they administer fair housing laws that HUD determines to be substantially equivalent to the Federal Fair Housing Act. During FY 2001, 7,872 cases were received, compared with 11,211 cases in FY 2000. The number of cases that HUD receives depends on the number of complaints. Changes from year to year do not necessarily reflect long-term changes, but HUD will monitor the level of new cases to ensure that fair housing groups and the general population have adequate awareness of fair housing laws and are able to file complaints when appropriate. Since FY 1996, the number of "cases received" has included a new category of "claims." A claim is a discrimination inquiry that raises issues of discrimination, but may not satisfy the statutory threshold to become a complaint under HUD jurisdiction when fully developed.

During FY 2001, FHEO and substantially equivalent state and local agencies closed 9,082 cases, compared with 10,589 closed in FY 2000. This decline is due mostly to the fact that fewer cases were received and closed in 2001 than in 2000.

In FY 2001, FHEO placed a major emphasis on reducing the number of aged cases within its inventory. Strict controls were put in place and a more aggressive target was established to take immediate action in reducing aged case backlog. Resources were also reallocated to deal with the backlog. As a result, the percentage of closed cases that had been open longer than 100 days declined from 82.0 percent in FY 2000 to 37.1 percent in FY 2001.

Closures of fair housing cases include administrative closures, conciliation/settlements and no-cause determinations, as well as cause determinations (investigative completions) and transfers of complaints to the Department of Justice (DOJ). (Certain categories of complaints, specifically those related to zoning and those involving criminal activity are statutorily required to be transferred to DOJ.) Some closures involve cases pending from previous years. During FY 2001, FHEO made a concerted effort to increase the number of complaint closures made by consensual resolution; as a result, 48 percent of complaint closures were by consensual resolution, compared with 37 percent in FY 2000.

Fair Housing Grants

In addition to its own enforcement activities, HUD has two main grant programs that fund fair housing enforcement and education activities: the Fair Housing Initiatives Program (FHIP) and the Fair Housing Assistance Program (FHAP). FHIP helps meet the objectives of the Fair Housing Act by providing funding to public and private entities carrying out programs to prevent or eliminate discriminatory housing practices. FHAP provides funds to state and local agencies that enforce fair housing laws that are substantially equivalent to the Federal Fair Housing Act. FHAP funds include money for agency capacity building, complaint processing, administrative and training costs, special enforcement efforts, and fair housing partnerships.

In FY 2001, 36 organizations were awarded 12-month Private Enforcement Initiative grants under FHIP to support efforts to investigate allegations of discriminatory practices. Two grants were awarded to fair housing organizations to provide comprehensive services in underserved communities, which included ethnic and language minorities, recently arrived immigrants, migrant and seasonal farm workers, and rural populations.

In FY 2001, the number of agencies certified as enforcing substantially equivalent fair housing laws and eligible for participation in FHAP increased by five, from 89 to 94 (performance goal 2.1.c) The increase represents progress in the Department's effort to build coordinated intergovernmental enforcement of fair housing laws and to allow States and localities to assume greater responsibility for administering fair housing laws.

Accessibility Provisions of the Fair Housing Act

Amendments to the Fair Housing Act have expanded protections for persons with disabilities by requiring that certain multifamily dwellings first occupied after March 13, 1991, be accessible. Nevertheless, multifamily dwellings are being constructed across the nation in violation of the design and construction requirements of the Fair Housing Act. A significant effort is needed to educate the building industry¾including architects, builders and owners¾as well as State and local governments and others about accessibility requirements in order to improve compliance with the Fair Housing Act. In FY 2001, a $1.0 million contract was awarded to carry out the training and technical assistance program for this purpose.

Fair Housing Enforcement Under Title VI and Other Laws

Compliance Reviews and Voluntary Compliance Agreements. Title VI and Section 504 of the Rehabilitation Act of 1973 require that HUD conduct compliance reviews of grant recipients. When grantees are found to be in non-compliance with the relevant laws, HUD must take appropriate action to obtain compliance by securing a voluntary compliance agreement. If the recipient fails to comply by voluntary means, then HUD may suspend or terminate funds and/or refer the recipient to the Department of Justice for enforcement.

FHEO executed 20 Voluntary Compliance Agreements (VCAs) under the above statutes for FY 2001, double that of FY 2000.

FHEO conducted 66 compliance reviews in FY 2001 under Title VI of the Civil Rights Act of 1964, Title II of the Americans with Disabilities Act of 1990 and Section 504 of the Rehabilitation Act of 1973. The FY 2001 accomplishments increased over 50 percent above the 43 reviews that FHEO conducted in FY 2000. Focused compliance reviews increase awareness and understanding of the above laws, thus increasing the probability and quality of compliance.

Complaints Investigated. FHEO investigated 860 complaints under the above statutes in FY 2001, a 16 percent increase over the 740 complaints investigated in FY 2000. FHEO continues to work with recipients of HUD funds to ensure compliance with the civil rights laws.

Architectural Barriers Act complaints. FHEO processed one Architectural Barriers Act (ABA) complaint in FY 2001, compared with two in FY 2000. The number of complaints the Architectural and Transportation Barriers Compliance Board (ATBCB) refers for processing drives the number of complaints that HUD processes under ABA. HUD resolves non-compliance findings under the ABA when they are concurrently processed under Section 504 through Voluntary Compliance Agreements.

Strategic Objective 2.2: Low-income people are not isolated geographically in America

The isolation of America's minorities and poor in distressed neighborhoods has increased in recent decades. When neighborhoods lose the amenities and conditions that sustain mixed-income and integrated communities, middle-income families may leave to protect their own interests and businesses have difficulty becoming reestablished. Neighborhoods with extreme poverty concentrations have difficulty meeting the needs of children and can have harmful influences on children who grow up there.

Revitalization. HUD helps revitalize distressed neighborhoods into mixed-income communities by helping to make them attractive to families with diverse economic circumstances and to create employment opportunities for the unemployed. The Community Development Block Grant and HOME Investment Partnerships programs allow communities to identify the needs of low- and moderate-income families and persons with disabilities and use funds flexibly to meet those needs.

Public housing has been both a cause and a victim of concentrated poverty and concentrations of minorities in American cities. A 1994 assessment of the location and racial composition of public housing showed that minority residents typically were segregated in predominantly minority and high-poverty neighborhoods. HUD is reversing decades of ill-conceived policy and practice by redeveloping distressed public housing and neighborhoods into mixed-income communities through the HOPE VI program.

Poverty Deconcentration in Public Housing. Following findings of discriminatory admissions patterns by Public Housing Agencies (PHAs), HUD increased Title VI enforcement. HUD also has taken steps to promote income diversity in general-occupancy public housing developments. In 2000, the Department published a proposed rule under the Quality Housing and Work Responsibility Act for deconcentrating public housing buildings and developments. This rule seeks to reduce concentrations of the poorest families in particular housing developments.

Deconcentration with Housing Choice Vouchers. One of HUD's best tools for dispersing concentrations of poverty and promoting integration is to encourage households assisted with the tenant-based Housing Choice Vouchers, especially families with children, to use their vouchers to move to neighborhoods outside areas of concentrated poverty. The initial findings of an ongoing study of the Moving To Opportunity for Fair Housing Demonstration (MTO) indicate that helping families move from highly concentrated areas of poverty with Housing Choice Voucher leads to wider opportunities, especially for the families with children.

The potential of tenant-based assistance for deconcentrating poverty is clear but has not yet been sufficiently realized. In FY 2001, the share of tenant-based families with children who lived in low-poverty neighborhoods, defined as census tracts with poverty rates below 20 percent, remained at 59 percent. (performance goal 2.2.2). In FY 2002, under the Housing Search Assistance Program, $10.0 million has been awarded to 11 PHAs and their non-profit partners, including faith-based grass-root organizations, to assist families to move from high-poverty neighborhoods to low-poverty neighborhoods.

Strategic Objective 2.3: Disparities in homeownership rates among racial and ethnic groups are reduced

Homeownership in the United States has many corollary benefits such as asset accumulation, tax advantages, neighborhood stability and stronger school systems. Homeownership has even been linked to better outcomes for children in terms of school achievement, dropout rates and other related dimensions.

Although different demographic groups may have different preferences for homeownership compared with rental housing, closing the gap in homeownership rates among these groups in many ways demonstrates that America is providing equal opportunity. The homeownership rate for minorities in the fourth quarter of FY 2001 was 49.2 percent—a record high, yet some 25.4 percentage points below the homeownership rate of 74.6 percent for non-minority households.

In order to promote homeownership among minorities, HUD employs a number of programs:

- The American Dream Downpayment Fund will provide grants to help make homeownership affordable to low-income families, including families in public and assisted housing.
- Section 8 homeownership vouchers can be used by families to cover the ongoing costs of a mortgage. Also, recent legislation allows families to use up to 1 year's worth of Section 8 assistance for the downpayment on a home.
- Housing Counseling helps minorities and other underserved groups move into homeownership and meet ongoing homeownership responsibilities.

Fair Lending. One of HUD's primary means for increasing the homeownership rates of minorities is to ensure equal access to mortgage lending. The most recent data collected from lenders under the Home Mortgage Disclosure Act show that in 2001, minority applicants (excluding Asian-Americans, whose denial rates differ little from non-minorities) were denied mortgages at a rate 76.4 percent higher than the denial rate for non-minority applicants (performance goal 2.3.2). This rate is slightly lower than the difference of 77.3 percent in 2000, although the apparent change may not be statistically significant. A substantial portion of the difference in denial rates between minority and non-minority applicants can be explained by finance- and credit-related attributes of the applicants. To improve results in this area, HUD will promote the Technology Open To All Lenders (TOTAL) scorecard. When used in an automated underwriting system, the TOTAL scoring system will ensure that mortgage applications are evaluated fairly and uniformly.

In addition to enforcing fair lending law through FHEO, HUD regulates the government-sponsored enterprises (GSEs)—Fannie Mae and Freddie Mac—and continually monitors their programs and practices to ensure consistency with fair lending requirements. Under the authority of the Federal Housing Enterprises Safety and Soundness Act, HUD seeks to ensure that the GSEs' underwriting guidelines, including their automated underwriting systems for determining creditworthiness, treat minorities and other protected classes fairly. These guidelines and systems have an enormous impact on the availability of credit for all mortgage applicants. HUD also has established geographic targets for GSE mortgage purchases in underserved areas, which include areas with above-average shares of minority households. In Calendar Year 2000, 31.0 percent of Fannie Mae mortgage purchases and 29.2 percent of Freddie Mac mortgage purchases were for properties in underserved neighborhoods (performance goal 4.2.b). Both levels continue an upward trend. Beginning in 2001, the goal for GSEs will be 31 percent.

Targeted efforts. HUD aims to increase the share of FHA single-family mortgage endorsements that go to minority homebuyers. Along with comparable goals for first-time homebuyers and central-city homebuyers—both disproportionately minority groups—this focus ensures that minority homebuyers have access to the lower interest rates of FHA-insured mortgages. In FY 2001, 36.5 percent of FHA home-purchase mortgage endorsements were for minority homebuyers, a decline from 41.7 percent in FY 2000 (performance goal 2.3.a).

Ginnie Mae's Targeted Lending Initiative has expanded to include Indian lands and new Empowerment Zones and Enterprise Communities in both urban and rural areas. The initiative supports more competitive mortgage interest rates for properties in these areas by reducing the guaranty fee for eligible home mortgage loans. By increasing lender activity in these targeted areas, Ginnie Mae provides underserved families and households, including many minority households, with increased opportunities to achieve homeownership.

Two programs, Indian Housing Block Grants and the Section 184 Indian Home Loan Guarantee program, likewise promote minority homeownership by serving Native American communities where severe housing shortages continue. A variety of other HUD programs that benefit urban or low- and moderate-income homeowners similarly contribute to increases in minority homeownership. These programs include HOME, CDBG, and Section 8 homeownership vouchers, as well as homeowner education efforts.

Trends and Factors Affecting Strategic Goal 2

Social, cultural and economic conditions influence the acceptance of minorities, persons with disabilities and other protected classes. In addition, disparities in wealth and income levels among groups contribute to the inability of some persons to purchase a home, obtain affordable and/or accessible rental housing, and realize economic opportunity.

HUD depends upon the Department of Justice as well as state and local government partners to assist in furthering fair housing. State legislation that is substantially equivalent to the Federal Fair Housing Act is critical to increase the Nation's capacity to effectively enforce fair housing laws. State regulation of finance, insurance and real estate also affects fair housing and homeownership within specific populations or neighborhoods.

Local policies, including land use controls and accessible building code enforcement, will continue to influence levels of discrimination, income isolation, and disparities in homeownership rates. The private sector likewise plays a central role in achieving fair housing outcomes. Businesses which adopt fair housing policies and practices go far to promote justice. Finally, some individuals continue to discriminate because they lack awareness of their fair housing responsibilities.

Strategic Goal 3: Promote Self-Sufficiency of and Asset Development by Families and Individuals

Stable, affordable housing promotes the health of families and communities. It supports self-sufficiency, the educational achievement of children, and treatment and services for persons with disabilities. Increased self-sufficiency and asset development improve the housing security of families by providing adequate income and a financial cushion in times of emergency. The relationship between housing and self-sufficiency is the focal point of HUD's efforts under this goal.

In FY 2001, HUD had the following objectives related to these outcomes:

- Homeless families and individuals become self-sufficient.
- Poor and disadvantaged families and individuals become self-sufficient and develop assets.

Strategic Objective 3.1: Homeless families and individuals become self-sufficient

As economic conditions have worsened, the need for housing resources has become greater. The U.S. Conference of Mayors reports that in 2001, demand for emergency shelter increased by 13 percent overall—and 22 percent among families—in the 27 major cities that were surveyed. Furthermore, 37 percent of the overall need and 52 percent of the need among families was unmet.

Addressing homelessness requires a comprehensive approach. Data from a December 1999 HUD report entitled *Homelessness: Programs and the People They Serve* demonstrate that most people who become homeless have suffered severe hardships—including physical and sexual abuse, childhood trauma, poverty, poor education, disability, and disease. When homeless persons get the housing assistance and needed services—such as health care, substance abuse treatment, mental health services, education and job training—76 percent of those living in families and 60 percent of those living alone end their homeless status and move to an improved living situation.

Continuum of Care

HUD has a history of providing support to homeless individuals and families. The McKinney-Vento Homeless Assistance Act of 1987 authorized HUD to operate several programs that help homeless individuals and families move to permanent housing. More recently, HUD and communities have partnered to employ a Continuum of Care (CoC) approach to addressing homelessness. This strategy is used by communities nationwide to organize and coordinate delivery of housing and services to homeless persons as they move off the streets, into stable housing, and towards self-sufficiency.

The needs of homeless persons vary; some need extensive and ongoing supportive services while others need only affordable housing with minimal services. The CoC process encourages public and private organizations to work together to identify the unique needs in their communities, seek alternative resources, and determine their priorities for HUD funding. In 2001, communities representing 89.6 percent of the Nation's population have come together in this manner, up from 88.2 percent in 2000 (performance goal 3.1.a).

The ultimate objective of Homeless assistance is to help homeless families and individuals achieve permanent housing and an appropriate level of self-sufficiency. During FY 2001, HUD helped approximately 30,000 formerly homeless persons move into HUD McKinney-Vento funded permanent housing (performance goal 3.1.2).

The number of formerly homeless persons who move to HUD funded permanent housing is a result of demand by communities for new permanent housing assistance and a Congressional directive and HUD commitment that 30 percent of homeless funds be used for permanent housing projects for persons with disabilities.

Transitional housing with supportive services can be an important intermediary step between emergency shelter and permanent housing. In 2001, HUD funded 5,020 new transitional beds linked to supportive services (performance goal 3.1.c), in addition to funding a substantial number of renewals projects.

Through the CoC, HUD also funded many supportive–services-only projects, including job training and mental health and substance abuse counseling. HUD also provided $150 million outside of the CoC process for emergency shelters across the Nation.

To streamline the provision of homeless assistance services, HUD will propose to consolidate several homeless assistance programs into a single program in FY 2003. This change will reduce the administrative burden associated with the current application process and provide communities with the flexibility they need to appropriately address homelessness.

In FY 2003, HUD is proposing to take over the Emergency Food and Shelter Program that has been operated by the Federal Emergency Management Agency. Locating this program in HUD will improve coordination between the various homeless assistance programs.

Beginning in FY 2001, HUD has been undertaking a Department-wide effort to increase the participation of faith-based and community organizations in HUD's programs. Increasing the already high level of participation of these groups in HUD's homeless assistance programs will introduce more partners in the overall effort to address homelessness.

A significant challenge in managing homeless assistance programs is the lack of detailed information about how people become homeless and what programs are most effective at helping them. To shed light on this issue, HUD is helping to develop the capacity of homeless providers to collect unduplicated client-level data. Analyzing details and trends affecting homeless people and programs will enable communities to target resources to the most effective methods of preventing and ending homelessness. As of FY 2001, 12 communities have implemented Homeless Management Information Systems that cover at least 75 percent of the homeless people served in their communities.

The Department expects that level to increase significantly in 2002, 2003, and 2004. Beginning in FY 2002, HUD will track the number of such systems and eventually obtain highly detailed information about the source of homelessness, and the programs and policies that alleviate homelessness.

Strategic Objective 3.2: Poor and disadvantaged families and individuals become self-sufficient and develop assets

Increasing self-sufficiency requires a multidimensional strategy that helps people improve their skills, increases the supply of jobs, facilitates job searching, and provides supportive services.

HUD's role in welfare reform stems from the significant overlap of families served by welfare and those served by HUD's programs. For example, at the beginning of FY 2001, there were over a quarter of a million families with children living in public housing or Section 8 housing whose primary source of income was welfare.

Public Housing

Over the past several years, HUD has been transforming public housing to reduce the geographic and economic isolation of low-income households. The HOPE VI program described under Objective 1.2 has rebuilt thousands of public housing units into mixed-income communities that are integrated with training and employment opportunities.

HUD also provides funding for microenterprise and small business development for public housing residents with an entrepreneurial spirit. In addition, Public Housing Authorities (PHAs) adjust their rent policies to reduce the financial disincentives to increasing a household's earnings. The escrow accounts established in the Family Self-Sufficiency (FSS) program also support asset development.

Between September 2000 and May 2001, 13.2 percent of families who lived in public housing moved from welfare to work. (performance goal 3.2.4). If extrapolated to cover a 12-month period, the level would be 19.9 percent, which is well below the 28 percent of households who made such a transition in FY 1999. A strong economy helped boost performance during the late 90's, but the recent economic slowdown has reduced the number of opportunities for public housing residents to become self-sufficient.

Section 8 Assistance

Tenant-based assistance provides households with flexibility to live close to employment opportunities and social supports. Project-based assistance increases the availability of affordable rental housing. Recipients of Section 8 assistance are also eligible for job training and employment services under the Family Self Sufficiency (FSS) program.

Between September 2000 and May 2001, 17.3 percent of families who lived in tenant-based Section 8 housing moved from welfare to work. (performance goal 3.2.5). If extrapolated to cover a 12-month period, the level would be 26.0 percent, which is below the 27.5 percent of households who made such a transition in FY 1999. The economic slowdown was again a major reason for the reduction.

During FY 2001, 22 percent of families residing in project-based Section 8 housing moved from welfare to work (performance goal 3.2.5.5). Since this is the first year HUD has used this measure, there is no prior level for comparison.

To improve the level of self-sufficiency in public and assisted housing, HUD will be increasing resident participation in the FSS program. FSS provides service coordinators to help residents of public and assisted housing transition to self-sufficiency. FSS also allows a portion of increased earnings to be deposited into an escrow account that can be used for purchasing a home, continuing education, or other personal goals.

HUD is also increasing the number of Neighborhood Networks in public and assisted housing, and is devoting $15 million in the FY 2003 budget proposal for this effort. There are currently over 800 Neighborhood Networks, which are computer centers located in public housing and assisted housing apartment complexes. These centers provide training and access to the Internet so that families can develop technical skills and access high tech job opportunities.

In addition to improving self-sufficiency, HUD is promoting homeownership among residents of public and assisted housing. The American Dream Downpayment Fund will provide grants to help make homeownership affordable to low-income families, including families in public and assisted housing. Increasing homeownership will provide an opportunity for such families to accumulate assets as the value of their homes increase.

Welfare to Work Vouchers

In FY 1999, Congress appropriated 50,000 Welfare to Work (WtW) vouchers that require coordination between local housing authorities and welfare agencies. Because stable housing is so critical for steady employment, and because many jobs are located in suburbs while the people leaving welfare are in central cities, these vouchers are an important tool in promoting self-sufficiency.

After an initial period of slow issuance and lease-up, HUD stepped up technical assistance and oversight efforts. By the end of FY 2000, 32 percent of WtW vouchers had been leased up. By the end of FY 2001, all WtW vouchers had been issued and 90 percent had been leased (performance goal 3.2.a).

To achieve this level, HUD has worked with the WtW PHAs to build PHA staff capacity, help them strengthen partnerships with service agencies and more effectively market the program to landlords. HUD has also taken steps to increase the Fair Market Rents/Payment Standards in high cost areas so that more units will be available to families, which will help families move closer to areas of job growth and deconcentrate poverty.

Efforts to further improve WtW voucher utilization dovetail with the overall effort to improve voucher utilization that is described under Objective 1.2.

Community and Economic Development

Increasing self-sufficiency requires investments in job training, economic development, supportive services, and other infrastructure needs. HUD's Community Development Block Grants (CDBG) provide a mechanism for making these investments while recognizing the unique needs of every community. Furthermore, the Empowerment Zones program (EZ) targets flexible assistance to the most distressed communities. Among the many eligible uses of the CDBG and EZ program related to self-sufficiency are:

- Job Training, including the Youthbuild program;
- Supportive services, including health care, transportation, and child care;
- Education assistance; and
- Job Fairs.

Trends and Factors Affecting Strategic Goal 3

Success in aiding the homeless to become self-sufficient is affected by a variety of factors beyond HUD's control. The incidence of homelessness is affected by macroeconomic forces such as unemployment levels, structural factors, including the supply of entry-level jobs, and the availability of low-cost housing. Personal factors such as domestic violence, substance abuse, disabilities, and the extent of a person's educational or job skills also may underlie homelessness.

Participation levels by partners in the provision of homeless assistance—including State and local agencies, nonprofit organizations, service providers, housing developers, neighborhood groups, private foundations, the banking community, local businesses, and current and former homeless persons—will substantially determine the success of homeless families and individuals in becoming more self-sufficient. State and local governments also make critical decisions about zoning and the use of funds from programs such as CDBG, HOME, and tax-exempt bonds for rental housing, which may affect the local housing supply.

The recent economic downturn has led to increased unemployment, which hampers self-sufficiency efforts. Recessions tend to affect homeless people and other low-income people disproportionately, because they are usually among the first to be laid off, and generally have few marketable skills. An economic rebound will make it easier for many low-skilled or inexperienced workers to enter the workforce in the coming years.

Opportunities for better paying jobs continue to be concentrated in technical fields for which many recipients of HUD assistance are not prepared. Jobs continue to grow faster in suburban areas, while families making the transition from welfare are more likely to live in inner-city or rural areas. Many of the educational, training, and service programs available to help families make the transition to self-sufficiency are operated by local recipients of Federal funds from agencies other than HUD.

Strategic Goal 4: Improve Community Quality of Life and Economic Vitality

In 2001, the unemployment rate increased from its previous level, which was a 30-year low. Concentrations of poverty and joblessness continue to degrade the social and economic fabric of communities across the country. A key to reviving these markets is expanding access to private equity investment in business and industries that serve these communities. The Nation's economic challenges are not confined to the cities and suburbs in metropolitan areas. Many rural communities are struggling as well—especially in Appalachia, the Mississippi Delta, Indian country and the borderland colonias.

In FY 2001, HUD had the following objectives related to these outcomes:

- The number, quality and accessibility of jobs increase in urban and rural communities.
- Disparities in well-being among neighborhoods and within metropolitan areas are reduced.
- Communities are safe.

Doubly Burdened Cities

One measure that captures changing conditions in urban areas is the number of "doubly burdened" cities. Doubly burdened cities are defined by HUD as cities that experience unemployment rates 50 percent above the national average, accompanied by either a population loss of 5 percent since 1980 or poverty rates of 20 percent or higher. The combined effects of population loss, high unemployment, and high poverty drain a city's fiscal capacity and limit its ability to improve aging infrastructure and invest in new economic opportunities. In 2001, 75 cities were doubly burdened, an increase of eight cities from the 67 in 2000. Reversing this decline will require a continuing and comprehensive investment in infrastructure, affordable homeownership and rental housing, and economic development.

Block Grant Assistance

The Community Development Block Grant (CDBG) is HUD's largest block grant program, and an important vehicle for improving the community quality of life and economic vitality. In FY 2001, CDBG outlays for States and more that 1,000 cities entitled to receive CDBG grants were $4.96 billion, a decrease of $16 million from FY 2000 outlays. Grantees have discretion to use this funding for a variety of eligible purposes including economic development, housing construction and rehabilitation, and infrastructure improvements. Several small categorical programs—Youthbuild, Resident Opportunities and Supportive Services, the Self-Help Opportunities Program and others—are also included in the CDBG total.

CDBG formula grantees are required to use at least 70 percent of this funding for activities that principally benefit low- and moderate-income persons. In FY 2001 they significantly exceeded this threshold. Cities used 94.9 percent of funds and States used 96.4 percent of funds for activities that principally benefit low- and moderate-income households (performance goals 4.2.d & 4.2.e).

The Department also measures the percentage of direct beneficiaries of CDBG assistance who have low incomes (below 50 percent of area median income). Direct beneficiary activities include job creation and retention and the provision and rehabilitation of housing. In FY 2001 this level was 51.0 percent, a decrease from the 2000 level of 62.7 percent (performance goal 4.2.f).

In 1994, HUD implemented the Consolidated Planning process to allow for the diverse needs of grantees and streamline access to four of HUD's formula block grant funding sources: CDBG, HOME Investment Partnerships, Housing Opportunities for Persons with AIDS (HOPWA) and Emergency Shelter Grants. Consolidated planning requires that every large city, urban county, and State develop a 3- to 5-year strategic plan, and annually produce action plans to describe how they will use funds in that year to meet their priorities. The planning process allows members of the community to be involved in allocating resources, and it provides HUD with a way to review grantees' funding decisions in the context of their needs. During FY 2002, HUD is considering a variety of options for further streamlining the Consolidated Plan requirements.

Strategic Objective 4.1: The number, quality and accessibility of jobs increase in low-income urban and rural communities

While the problems confronting struggling communities cannot be reduced to merely economic terms, increasing the number and quality of jobs plays a crucial part of any solution. Employment enables a working adult to purchase and maintain a home, better provide for his or her family, gain self-esteem, offer a positive role model for the next generation, invest in their community, and support local merchants. Moreover, strong, diverse, local economies are better able to handle the shocks and challenges of a changing global marketplace.

Communities use HUD funds for a variety of economic needs including:

- Physical development projects such as housing, roads, sewers and other infrastructure that make the community more attractive to businesses for investment and job creation.
- Loans and other financial assistance that go directly to businesses to create or retain jobs.
- Education, job-training and other services that improve the quality of the workforce in low-income communities to make the area more attractive to prospective employers.

Reducing poverty in central cities is one measure of HUD's progress towards improving the quality and accessibility of jobs, because that is where HUD has historically invested a great deal of economic development resources. In 2000, the most recent year for which data are available from the Current Population Survey, the poverty rate in central cities was 16.1 percent, a decrease from the 1999 level. Central cities failed to match the improvement in suburban areas, where poverty rates decreased from 8.3 percent in 1999 to 7.8 percent in 2000.

Poverty Rates In Central Cities

1997	1998	1999	2000
18.8%	18.5%	16.4%	16.1%

Consequently, the ratio of central city to suburban poverty increased from 1.98 in 1999 to 2.06 in 2000 (performance goal 4.1.4).

To capture the quality of the job market for entry level workers, HUD tracks the unemployment rate of young, entry-level jobseekers in central cities. The Bureau of Labor Statistics reports that in 2001, this rate improved substantially to 12.9 percent, from 16.4 percent in 2000 (performance goal 3.2.7/4.1.5). This decrease means that the percentage of young adults who are unemployed continued to shrink, but at an accelerated rate during 2001. This improvement was driven primarily by macroeconomic conditions, but also by improvements in central city economies supported by HUD programs.

Community Development Block Grants and Section 108 Loan Guarantees

HUD's primary investment tools for job creation and retention are the Community Development Block Grants (CDBG) and the Section 108 Loan Guarantee program. CDBG provides flexible block grant funding to states and metropolitan areas to meet a variety of housing, infrastructure, and economic development needs. Section 108 provides guaranteed loans to communities for economic development activities. In FY 2001, the 116,777 jobs created by CDBG and the 26,629 estimated jobs created by Section 108 yielded a combined total of 143,406 jobs created or retained (performance goal 4.1.e). This is a reduction from the FY 2000 level of 150,200 jobs.

Strategic Objective 4.2: Disparities in well being among neighborhoods and within metropolitan areas are reduced

Despite recent economic and social gains, many central cities and their residents remain disadvantaged. Higher levels of poverty and unemployment and decaying infrastructure induce middle class residents and businesses to leave struggling communities, which fuels further decline. While this scenario frequently has occurred in inner-city neighborhoods, it is beginning to affect older inner-ring suburbs as well.

Residents ultimately are best able to assess the quality and well-being of their own neighborhoods. Data from the 1999 American Housing Survey (the most recent available) show that low- and moderate-income residents had an improved opinion of their neighborhood (performance goal 4.2.4). Among people living in cities, 65.8 percent had a good opinion of their neighborhood (between 7 and 10 on a scale of 1-10). This is a 1.2 percentage point increase from 1997. Meanwhile, 78.1 percent of suburban residents had a good opinion, a 0.7 percentage point increase. There was no change in the opinion of residents in non-metropolitan areas, 79.5 percent of whom had a good opinion.[1]

Percentage of Residents with a Good Opinion of their Neighborhoods

	1997	1999
Central City	64.6%	65.8%
Suburb	77.4%	78.1%
Non-Metropolitan	79.5%	79.5%

Reflecting improvements in neighborhood conditions, the homeownership rate in central cities continued to increase in 2001, reaching 52.3 percent in the third quarter, compared with 51.9 percent in 2000. There are a number of economic and programmatic factors contributing to these improvements, including:

- Improved housing conditions supported by the CDBG, HOME investment partnerships, HOPE VI revitalization, public housing, and FHA programs.
- Improved economic conditions supported by the CDBG, Section 108, and Empowerment Zones programs.

Empowerment Zones/ Enterprise Communities

In 1994, 72 distressed urban communities across the country were designated as empowerment zones (EZs) or enterprise communities (ECs). In 1999, an additional 15 urban EZs were designated. The purpose of the EZ/EC initiative is to combine "seed" grants—for capacity building, workforce and business development, supportive services, and physical improvements—with tax incentives to encourage partnerships between the residents, nonprofits, governments, and businesses in a community. The EZ/EC Initiative is focused on the creation of self-sustaining, long-term development in distressed areas. It is based on a holistic, participatory approach whereby community stakeholders partner together to develop and implement innovative and comprehensive strategic plans for revitalization. HUD measures the percentage of completed EZ/EC programs and projects for which locally-defined goals in seven categories were achieved (performance goal 4.1.a). During FY 2001, local performance improved in only three of the seven categories of activity. Because the EZ/EC program has experienced slower obligation and expenditure rates, additional funding was not requested in FY 2003.

Percentage of EZ/ECs Meeting Locally-Defined Goals

Category	2000[2]	2001
Residents receiving homeownership assistance	81%	87%
New affordable housing completed	91%	88%
Rehabilitated affordable housing completed	88%	85%
Homeless residents served by homeless assistance programs	83%	88%
Residents served by social service programs	73%	86%
Residents find gainful employment	69%	64%
Residents served by public safety and crime prevention programs	91%	83%

[1] *Data from the 2001 American Housing Survey are not currently available, but will be reported in the FY 2002 Performance and Accountability Report.*

[2] *Values for FY 2000 have been adjusted slightly from what was reported in the FY 2000 Performance and Accountability Report. For a discussion, see indicator 4.2.b.5 in the Performance Information section of this report.*

The primary role of HUD's EZ/EC Initiative Office is to assist communities in the implementation of their plans. In that capacity, HUD staff work on a daily basis with EZ/EC directors, business persons, board members, citizens, non-profit organizations and others by providing program guidance and technical assistance. Managers of the EZ/EC Initiative Office have used the above data to target communities in need of technical assistance and to identify best practices that serve as models for other communities.

In December 2001, HUD designated 40 renewal communities (RCs) that will receive tax incentives for economic development. Performance for the RCs will be tracked beginning in FY 2003.

Leveraging Private Capital

The future prospects for many distressed communities are contingent on the amount of capital being invested today. HUD's programs, in addition to providing direct investment, are also a tool for leveraging other sources of public and private capital. In 2000, the latest year for which data are available from lenders under the Home Mortgage Disclosure Act, $5.339 billion of private capital was used to rehabilitate housing in underserved neighborhoods (performance goal 4.2.5). This was a significant decrease from the record activity of 1999.

Private Lending for Housing Rehabilitation in Underserved Areas
(Dollars in Billions)

1997	1998	1999	2000
$5.346	$5.737	$6.078	$5.862

FHA Lending

HUD also promotes investment by insuring loans for homeowners and multifamily housing developers. During FY 2001, FHA endorsed 412,192 mortgages in underserved areas, up from 357,059 in FY 2000 (performance goal 4.2.a).

FHA Single Family Mortgage Endorsements In Underserved Areas
(Numbers in Thousands)

FY 1998	FY 1999	FY 2000	FY 2001
389	449	357	412

The increase is partially a result of changes in the real estate market that affected most FHA single family programs, including lower interest rates. There was a general increase in FHA single family activity in FY 2001. As a percentage of all single family lending, the number of endorsements in underserved areas was relatively stable.

Other FHA activities during FY 2001 contributed to the quality of distressed neighborhoods. These include "Good Neighbor" discounts on HUD-owned properties for police officers, teachers and non-profit organizations, automated underwriting, efforts to prevent predatory lending, and a Credit Watch program to improve or suspend poorly-performing lenders.

FHA also insures loans to develop and rehabilitate multifamily properties in underserved neighborhoods. In FY 2001, about one-fourth of FHA multifamily mortgage endorsements were for properties in underserved areas. Multifamily properties that received FHA-insured mortgages for the first time during FY 2001 included 5,464 units in underserved areas, compared with 9,072 in FY 2000. Low interest rates during FY 2001 caused an increase in refinancing as a proportion of multifamily endorsements in underserved areas.

Rental Units in Newly Endorsed Multifamily Developments in Underserved Areas

FY 1998	FY 1999	FY 2000	FY 2001
11,709	5,480	9,072	5,464

Fannie Mae and Freddie Mac

The Department sets three types of public purpose goals for Fannie Mae and Freddie Mac. One goal for calendar year 2000 was that 24 percent of each GSE's mortgage purchases should support underserved areas (performance goal 4.2.b). During the 2000 performance year, Fannie Mae exceeded the goal by achieving 31.0 percent, up from 26.8 percent in 1999. Freddie Mac achieved a level of 29.2 percent, an increase from 27.5 percent in 1999. For 2001, pursuant to a HUD rule, the goal will be increased to 31 percent for each GSE.

Percent of Fannie Mae Mortgage Purchases in Underserved Areas

1997	1998	1999	2000
28.8%	27.0%	26.8%	31.0%

Percent of Freddie Mac Mortgage Purchases in Underserved Areas

1997	1998	1999	2000
26.3%	26.1%	27.5%	29.2%

Strategic Objective 4.3: Communities are safe

Reducing crime around public and assisted housing is essential to revitalizing these neighborhoods and retaining affordable housing. Even small actions like reducing trash and litter may affect crime. Reducing crime in public housing is a high priority to revitalize public housing.

The 1999 AHS data show that 14.3 percent of the Nation's residents reported that there was crime in their neighborhood (performance goal 4.3.1). This was a significant improvement from the 17.2 percent who experienced public safety problems in 1997.

In FY 2001, the Department made about $310 million available to PHAs under the Public Housing Drug Elimination Program (PHDEP). The formula-based grants went to housing agencies and their resident management councils for initiatives to reduce crime. Typical grants funded security personnel, physical investments promoting security, and drug treatment and other services at targeted housing developments. Among residents of developments targeted by PHDEP grants, the percentage who feel "safe or somewhat safe" increased from 57 percent in FY 2000 to 69 percent in FY 2001 (performance goal 4.3.2). Congress has merged HUD's drug elimination activities into the operating subsidy program in FY 2002. The prior grant program had experienced high unexpended balances.

HUD also provided funding through HOPE VI for the demolition and revitalization of the worst public housing developments and surrounding neighborhoods. HUD promoted "defensible space" designs that prevent the public safety problems that develop in urban no-man's land. The Department enforced a "one strike and you're out" policy to screen public housing applicants and evict residents who commit crimes or peddle drugs. Finally, through the Officer Next Door program, HUD helped improve public safety by creating incentives for law enforcement officers to live in distressed communities.

Trends and External Factors Affecting Strategic Goal 4

The country's recent economic growth has produced millions of new jobs, including many in central cities and other older communities. Still, there are sizable imbalances in the job market, with most jobs requiring high skill levels, while many persons seeking employment are looking for low-skill jobs. The changing structure of the global economy has made it challenging for communities to compete when capital is highly mobile, markets for goods and services are widely dispersed, and wages for low-skilled employment are much lower in many locations abroad.

Local shortages of low-skilled jobs are compounded by mismatches between the locations of available jobs and the residences of the unemployed. Many older communities across the country have adopted aggressive strategies to alleviate these mismatches, but face numerous barriers to success. Their tax rates generally exceed rates in newer communities because they struggle to provide quality services despite declining tax bases. Land development is complicated by scarcity of land, scattered and/or absentee ownership, real or perceived contamination, and the need for clearance or rehabilitation of existing physical structures.

Job development is complicated by large concentrations of poor residents. School systems attempt to provide the education and job skills essential for their students (who often face greater obstacles to learning), but in many cases, have fewer resources as tax bases decline and capital maintenance costs increase. Crime, whether real or perceived, deters businesses from locating in these communities. The extent to which residents of areas of concentrated poverty are increasingly minorities may add barriers of racial discrimination to the mix.

Rural communities face additional challenges because of the changing structure of the farming industry, under-investment, weak infrastructure, limited services, and few community institutions. Rural labor forces are more narrowly based and are more dispersed. Clearly, the ability of individual communities to control their own destinies in the area of job creation is limited. Both urban and rural communities are further affected by the extent to which their States provide financial assistance to overcome these obstacles. While ultimately job creation is dependent upon the investment decisions of the private sector, the coordinated efforts of all levels of government, along with the private sector, are needed to address these challenges.

Another factor that must be considered is that communities have a great deal of flexibility when using HUD funds to address their economic conditions. Many programs, including the Community Development Block Grants (CDBGs), may be used for a variety of eligible activities at the discretion of the grantee. When communities do choose to address job growth for lower-income individuals, there are a wide variety of approaches that are difficult to measure. Some communities may support infrastructure to increase business development in certain areas, while others may directly apply CDBG funds toward preparing individuals for employment. Thus the ability of communities to respond with discretion to local conditions also establishes constraints on assessing results at a national level.

Strategic Goal 5: Ensure Public Trust in HUD

HUD's stewardship of billions of Federal dollars requires the Department to continually earn the confidence of Congress and the public. HUD has a fundamental responsibility to build performance, customer service, ethical standards and accountability into every part of our operations.

GAO's High Risk Designation

In 1994, the General Accounting Office (GAO) designated all of HUD's major program areas as high risk, because of four major Department-wide deficiencies which undermined integrity and accountability: (1) internal controls; (2) information and financial management systems; (3) organizational structure; and (4) staffing. In its January 2001 report entitled "Major Management Challenges and Risk," GAO acknowledged that HUD has continued to make progress in addressing these problems. Although two major program areas—single family mortgage insurance and rental housing assistance—still remain designated as high-risk, the Department-wide designation as a high-risk agency was removed. This reflects the general improvement of HUD's management control environment. HUD's plans to address the remaining high risk areas are discussed in the Financial Management Accountability section of this report.

Customer Satisfaction

HUD's partners, which include government, non-profit and for-profit entities, provide service delivery for a majority of HUD programs. Between December 2000 and June 2001, HUD completed a survey of eight groups of partners to assess both partner satisfaction with the Department generally and perceptions of the recent management changes at HUD ("How's HUD Doing? Agency Performance As Judged By Its Partners," December 2001).

The partner groups surveyed included: community development directors, public housing agency directors, Fair Housing Assistance Program directors, mayors, multifamily owners (insured, assisted or Section 202/811), and non-profit housing providers. Overall satisfaction by partners varied greatly, with FHAP directors and mayors highly satisfied, and public housing agency directors and multifamily owners less satisfied. Similarly, partner assessments of the HUD 2020 management changes were mixed.

An important finding was that partner groups—or individuals within partner groups—were substantially more likely to hold unfavorable opinions if they perceived the Department's role as "mainly regulating" rather than "mainly support" or "equally providing support and regulating." Nevertheless, majorities within nearly every partner group expressed satisfaction both with the Department's programs and with the way they are run. The exception was PHA officials, many of whom were dissatisfied with the way HUD was running their programs.

FY 2001 Baseline Results of HUD Partner Survey

	Percent satisfied or very satisfied with "the HUD programs you currently deal with."	Percent satisfied or very satisfied with "the way HUD currently runs those programs."
Community Development Department partners	87%	73%
Mayoral partners	88%	79%
Public Housing Agency partners	59%	39%
FHAP Agency partners	85%	68%
HUD-Insured Multifamily Housing partners	69%	60%
HUD-Assisted Multifamily Housing partners	62%	53%
Section 202/811 Multifamily Housing partners	88%	78%
Non-profit Housing partners	62%	52%

In addition, the American Customer Satisfaction Initiative for Federal Government again surveyed some groups of HUD partners and calculated an American Customer Satisfaction Index (ACSI) that is comparable to private sector benchmarks. For 2001, the ACSI was completed for two major types of FHA partners:

- Lenders (who were not surveyed in HUD's study), and
- Multifamily managers.

The ACSI for lending institutions offering FHA loans was 66 percent, compared with an average score of 68.5 percent among the six agencies offering grants or financial services. The ACSI for owners' management agents of FHA assisted and insured housing was 59 percent, compared with an average index of 62.9 percent for the seven agencies engaged in comparable regulatory activities. The latter result of 59 percent provides reasonable validation of the findings of HUD's partner survey shown above (60 percent satisfaction for insured multifamily partners and 53 percent satisfaction for assisted multifamily partners).

Means and Strategies

REAP and Team. As recommended by the National Academy of Public Administration, the Department completed the third and final phase of the implementation of the Resource Estimation and Allocation Process (REAP) in December 2001. REAP results are being used to support a pending redeployment of HUD staff to better meet essential program processing and oversight needs. REAP results were also used to support the development of HUD's FY 2002 staffing plan and FY 2003 staffing budget request.

The results of the REAP, which involved establishing a baseline for estimated resource requirements and staff allocations, will be validated by the ongoing Total Estimation and Allocation Mechanism (TEAM), which was launched in January 2002. The combined REAP/TEAM effort will facilitate an overall Human Resource Management Strategy that will: provide for a more efficient and effective alignment of resources; establish a recruiting strategy; ensure leadership continuity for all grade levels; and provide a training and development blueprint for current and new employees.

EGovernment. HUD is utilizing information technology to transform its core business processes and advance its mission. The Department has developed and implemented an eGovernment Strategic Plan that provides a baseline of HUD's eGovernment capabilities, outlines short-term initiatives and the required capabilities to realize HUD's eGovernment goals, and recommends a phased implementation path. Significant eGovernment initiatives started or continued during FY 2001 include the following:

- Continuing 75 ongoing initiatives designed to meet the needs of HUD's stakeholders—including citizens, business partners and employees.
- Developing and issuing Enterprise-wide policies and procedures on electronic signatures and electronic records management.
- Instituting an annual eGovernment Day and a monthly eGovernment Champion Program that recognizes employees who are instrumental in meeting Government Paperwork Elimination Act (GPEA) requirements and eGovernment Strategic Plan goals and objectives.
- Developing a marketing strategy to increase eGovernment awareness.

HUD was recognized as a leader throughout Government for its implementation of GPEA. Major eGovernment accomplishments include:

- Developing mapping software for citizens' and program participant use in identifying and planning HUD-supported program activity.
- Redesigning HUD's web page to be more intuitive, citizen centered, and user friendly.
- Enabling mortgage lenders to obtain FHA case numbers on-line.

- Creating the Public and Indian Housing (PIH) Information Center (PIC) to provide real time data sharing between PIH and public housing authorities.

- Implementing a web-based disbursement processing and reporting application to support PIH's capital funding programs with PHAs (e-LOCCS).

Enterprise Architecture for Information Systems. HUD's Enterprise Architecture (EA) initiative is designed to provide a Department-wide definition of HUD's current business and technology systems architecture baseline in support of HUD's IT Capital Planning lifecycle. It is structured to ensure that HUD's investments support the agency's business objectives and to provide a reasonable return on investments. When it is fully implemented, it will provide a basis for improving the management of HUD's current information systems and the ability to meet future information systems needs.

HUD has developed an EA model that is comprised of five architectural layers. The model expands upon the Federal Enterprise Architecture Framework (FEAF) developed by the Federal CIO Council. These layers are:

1. the Stakeholder layer;

2. the Business layer;

3. the Data layer;

4. the Applications layer; and

5. the Technology layer.

HUD developed the Enterprise Architecture Management System (EAMS) as a web-based tool to track and analyze the layers of HUD's EA, and the relationships between those layers. It serves as a repository for the information necessary to define the Department's baseline architecture and plan the definition and design of the target architecture for the future. The EA process is being applied to all of HUD in the context of 17 specific business functions within the following 5 general business areas:

- Deliver Federal Housing Assistance;

- Support Community and Economic Development;

- Provide External Oversight;

- Support Delivery of Services and Products; and

- Manage Resources and Internal Operations

An EA high-level target is in place for two of HUD's key business functions: financial systems and grants management. EA targets are being developed for the remainder of HUD functions. HUD also plans to develop and implement an EA policy and to expand EAMS to include performance indicators, security considerations and accessibility issues for IT investments.

Data Quality. HUD has been cited for internal control deficiencies associated with data quality. In FY 2001, HUD launched its Data Quality Improvement Program (DQIP) to improve and resolve the data integrity issues. Significant actions include:

- Completing data quality assessments for seven mission critical systems.

- Certifying two of the seven assessed systems and nearly completing the certification process for two other systems.

- Submitting Data Quality Plans for seven mission critical systems.

- Developing Data Quality Policies, Standards, Procedures and Guidelines.

The agency continues to move forward in its DQIP initiative by certifying five additional mission critical systems and assessing eight additional mission critical systems in the future.

IT Capital Planning. HUD has been documented for an inadequate process to control, evaluate and select IT investments that conforms to best practices. Without a complete and disciplined information technology investment management process, HUD does not have adequate assurance that it is selecting the right projects or maximizing its returns on investments.

HUD has implemented an integrated, enterprise-wide performance measurement methodology and process. This process is to provide HUD the capability to assess cost, schedule and effectiveness of all IT projects. It involves; using an automated system, Information Technology Investment Portfolio System (I-TIPS), to track HUD's IT Portfolio; integrating IT Capital Planning process with the agency's budget formulation process; using an on-line scoring process; and submitting multiple year funding request and estimating out-year funding for proposed IT initiatives.

Also, the agency implemented performance measurements into its IT initiatives and projects as apart of its integrated, enterprise-wide performance measurement methodology and process. This allows the agency to prioritize IT funding decisions based on IT initiatives and projects that produce outcomes, to assess the condition of its IT portfolio and allows the department to best meet its mission and strategic goals. The cost, schedule and performance of the IT projects are assessed through quarterly control reviews. During the quarterly reviews, progress in meeting IT performance measures' are assessed, all lifecycle costs are identified and its cost of performance measures. The project managers are required to address any variances of the projects' performance goals.

HUD has future plans to align IT projects performance measurements' with HUD's Business processes through its Enterprise Architecture. EA will be utilized to establish a linkage between the process, functions and IT applications and initiatives. It will enable the Department to develop performance measures that focuses on its business functions and IT initiatives, and will allow HUD to effectively managed its IT portfolio.

Configuration Management. Since1996, HUD has reported control weaknesses in the area of Configuration Management (CM). CM is the ongoing process of identifying and managing changes to work products throughout the life cycle of information systems development and maintenance. CM also refers to the procedures used in controlling changes to the system's hardware or software, as well as identifying software configuration, controlling changes to the configuration systematically, and maintaining software integrity. HUD has implemented a Configuration management initiative to:

- Establish and maintain the integrity of software products throughout the software's lifecycle; and
- Improve HUD's Software delivery by implementing standardized CM practices.

HUD's planned actions to correct the outstanding deficiencies entail: (1) moving all IT systems under automated tools; (2) enforcing the principles of the Central Change Management Control Board; and (3) migrating toward Capability Maturity Model Practices defined by the Software Engineering Institute (SEI) Capability Maturity Model Integration practices.

In FY 2001, HUD installed CM software tools on its Unisys and Hitachi, LAN Client-Server, Web and Lotus Notes platforms and drafted policies and procedures governing HUD's software configuration. The OIG's audit of HUD's FY 2001 consolidated financial statements recognized HUD for its considerable strides to improve software configuration management for both mainframe and LAN-based client/server applications. In FY 2001, HUD secured over 70 percent of IT systems under an automated configuration management tool and closed the OIG's previous years' CM recommendations.

Systems Security. HUD's Enterprise Security Program provides protection for HUD's critical infrastructure, both physical and information systems. This entails developing and implementing effective security procedures, security awareness and training programs, disaster recovery/contingency planning, and monitoring compliance and effectiveness of security procedures, policies and standards. In FY 2001, significant accomplishments include:

- Identifying an inventory of all major applications and general support systems, as mandated by the Computer Security Act of 1987.
- Identifying and incorporating all sensitive and mission critical applications systems in the Critical Infrastructure Protection Plan.
- Developing security plans for all major application and general support systems.
- Implementing access control software for computer operations on all production servers in compliance with NIST 800-12 security requirements.
- Initiating the planning and program development for an entity-wide security awareness and training program;
- Implementing new user registration procedures for obtaining access to IT resources.

In addition, the OIG's audit of HUD's FY 2001 consolidated financial statements recognized substantial control improvements in HUD's mainframe environment. HUD is improving its system security by continuing with the following ongoing initiatives:

- Developing security policies and procedures;
- Assigning security responsibilities to appropriate personnel;
- Monitoring computer-related controls;
- Requiring aggressive completion of background investigations for individuals who have access to HUD's critical and sensitive systems;
- Reporting and correcting any unauthorized penetration attempt incidents; and
- Providing a comprehensive agency-wide security awareness and training program for all HUD employees and contractors.

Strengthening HUD's Oversight

The long-term and complex nature of HUD's relationships with our program partners necessitates extensive oversight to ensure high standards and quality service. HUD has established four offices that are responsible for assessing HUD's properties, enforcing standards, assisting partners, and ensuring sound financial management:

- The Real Estate Assessment Center (REAC);
- The Troubled Agency Recovery Centers (TARCs);
- The Departmental Enforcement Center (DEC); and
- The Financial Management Center (FMC).

Real Estate Assessment Center

REAC provides assessments of the physical condition, financial soundness, management capability, and resident satisfaction applicable to the HUD-supported rental housing portfolio. The Center regularly processes relevant information pertaining to over 28,000 multifamily housing properties, and 14,000 public housing properties at 3,100 Public Housing Agencies (PHAs). In addition, REAC provides computer matching and data sharing services related to select tenant income data sources for use in rent and subsidy determinations. Other remote monitoring systems were pilot tested by REAC for FHA mortgage insurance program lenders and housing appraisals.

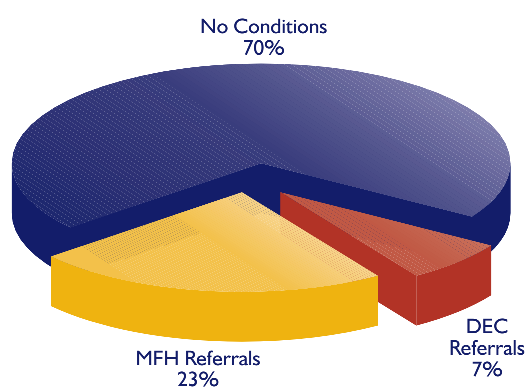
Resident Satisfaction. The recipients of HUD housing assistance constitute one of the largest groups of direct customers of HUD. During FY 2001, REAC conducted a random sample survey of 631,261 HUD-assisted renters and public housing tenants, 86 percent of who were satisfied or very satisfied with "overall living conditions" (performance goal 5.1.3).

Physical Inspections. REAC examined 18,272 properties in FY 2001, a planned decline from the 27,262 inspections conducted in FY 2000, which included baseline inspections that won't require reinspection for 2 or 3 years on projects with good baseline scores. The purpose of these inspections is to identify the extent to which public and MF housing properties meet HUD's physical condition standards, and to use inspection results as a basis for immediate correction of exigent health and safety deficiencies and overall improvement of compliance with physical condition standards. Details on inspection results are discussed under Strategic Goal 1, Objective 1.3.

Multifamily Financial Statements. All insured and some non-insured MF projects are required to electronically submit annual financial and compliance audit information to the REAC's Financial Assessment Subsystem (FASS). These submissions facilitate risk-based monitoring and management of program compliance requirements to reduce the financial and program risk related to the MF housing portfolio.

For the second submission cycle for project fiscal years ending 12/31/99 – 12/30/00 (Cycle II), 20,554 financial statements were required. Of this number, REAC received and reviewed 18,923 submissions through December 31, 2001; the number will increase as overdue submissions for this cycle continue to be received. REAC also received and reviewed an additional 1,189 non-insured project financial statement submissions that were not required to be submitted to FASS. The compliance deficiency conditions disclosed in the Cycle II submissions are summarized as follows:

Cycle II Financial Assessment Results



Of the 20,112 total submissions received for Cycle II, 19,989 were processed with 70 percent having no financial compliance deficiencies (restated performance goal 5.1.6). Of the 6,068 submissions with deficiencies, REAC referred 1,508 to the Departmental Enforcement Center (DEC) and the remaining 4,560 to MF Housing staff for additional action. Comparatively, 71 percent of Cycle I submissions had no conditions, and only 4 percent of submissions were referred to the DEC.

The slight increase in the total number of Cycle II submissions with conditions, and the higher percentage of cases referred to the DEC, is attributed to a number of factors, including: (1) the increased volume of submissions received in Cycle II; (2) the initiation of the pursuit of enforcement actions on "non-filers" or overdue submissions during Cycle II; (3) the application of several new compliance deficiency indicators that were not applicable in Cycle I; and (4) the cumulative effect of open DEC cases from Cycle I resulting in automatic referrals of Cycle II submissions on the same projects.

Tenant Income Verification. HUD's rental housing assistance programs are administered by about 4,500 public housing agencies and 22,000 private housing owners and their management agents (collectively referred to as POAs). The Department's rental subsidies are based primarily on the amount of income reported by tenants. To the extent that tenants under-report their income to POAs, the Department pays excess subsidies.

REAC uses computer matching to provide POAs with Social Security (SS) and Supplemental Security Income (SSI) information that REAC receives from the Social Security Administration. REAC electronically provides information each month to POAs for tenants who will recertify for rental assistance 4 months later.

The SS and SSI matching program is operational for all POAs. The POAs use this information to help ensure that tenants report all SS and SSI income as required. The program also reduces the burden on tenants to provide documents during the annual process of (re-) examining their eligibility and level of rental assistance.

REAC also performs computer matching of tenant-reported income maintained in HUD's tenant databases with Federal tax information, for purposes of subsidy payment error estimation and development of possible back-end program controls for payment error detection and correction. Through the Rental Housing Integrity Improvement Project (RHIIP), HUD is also focusing on increased upfront sharing of tenant income data to avoid subsidy overpayment situations due to underreporting of tenant income. (See further information in the Financial Management Accountability section of this report.)

Public Housing Assessment System (PHAS). During FY 1999, HUD began replacing the Public Housing Management Assessment Program (PHMAP) with the new Public Housing Assessment System. Under the PHMAP, PHAs self-certified as to their performance, and the process came under criticism as inadequate and lacking integrity. PHAS was developed to provide a more comprehensive and independent assessment of a Public Housing Agency's (PHA's) performance and risk to HUD. PHAS aggregates the scores of the following four component indicators:

1. Physical Condition, based on independent annual HUD project inspections (30 points);
2. Financial Condition, based on independent annual financial and compliance audits (30 points);
3. Management Performance, based on annual PHA certifications (30 points); and
4. Resident Satisfaction, based on annual resident surveys (10 points).

The scores of each of the four component indicators are aggregated in conjunction with a PHA's fiscal year-end to arrive at an integrated or combined PHAS "score" and "designation" in one of the following categories:

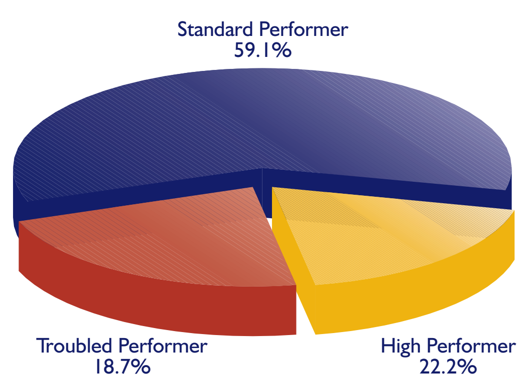
- **High Performers:** Overall PHAS Score of 90 or greater.
- **Standard Performers:** PHAS Score of 60 to 89 with no score less than 18 for the component indicators for Physical Condition, Financial Condition or Management Performance (Indicator Nos. 1, 2 or 3).
- T**roubled Performers:** PHAS Score less than 60 or more than 60 with at least one major component (Indicator Nos. 1, 2 or 3) with a sub-standard score (less than 18).

PHAS scores and underlying information provide a basis for HUD staff to target risk-based monitoring efforts, as well as necessary technical assistance and program intervention. High performing PHAs receive less HUD oversight and can be eligible for certain funding preferences.

The PHAS rule was originally scheduled to be effective for PHAs with fiscal years ending September 30, 1999, and thereafter. At that point, HUD ceased PHMAP scoring and began collecting and assessing data on all four PHAS components. PHA fiscal years end on calendar year quarters, with a fairly even distribution of PHAs between each quarter. Due to delays in the formal implementation of the PHAS rule, the scores for FY 2001 are considered "advisory scores." During the PHAS advisory scoring period, PHAs cannot be referred to the Troubled Agency Recovery Centers solely on the basis of PHAS scores, except for PHAs that self-certify a troubled "management performance" indicator.

Nevertheless, the complete PHAS scores are the best available information on PHA conditions. The distribution of designations and scores for PHAs with complete PHAS scores for FY 2001 are shown in the following chart and table:

PHA Performance Assessment
2,714 PHAs with 1,100,830 Units



FY 2001 PHAS Designations
Advisory Scores for PHAs

	PHAs	No. of Units
High Performer	603	140,409
Standard Performer	1,603	683,900
Troubled – Physical Only	179	151,130
Troubled – Management Only	23	2,229
Troubled – Financial Only	240	69,071
Troubled – Overall*	66	53,691
Troubled – Total**	508	276,121
Total Scored	2,714	1,100,830

**PHA with a score less than 60 or with more than one sub-standard component*

***Troubled—Total is the aggregate of the 4 Troubled Categories just above this line; it is not included in the "Total Scored" to prevent a double count of Troubled Performers*

Complete PHAS scores were available for 2,714 or 86 percent of the 3,171 PHAs active during this cycle. Scores not yet available or reported are primarily due to filing extensions, waivers and pending appeals.

Troubled Agency Recovery Centers

TARCs assist public housing agencies in correcting major physical, financial and management deficiencies. HUD measures the performance of PHAs in major areas such as compliance with Uniform Physical Condition Standards, financial soundness, vacancy rates and unit turnaround time, and efforts to modernize units. HUD assesses PHA performance in these various areas in order to determine troubled agencies in need of technical assistance and program intervention. In worst-case situations, HUD can takeover a PHA or seek a court appointed receiver to replace PHA management.

Given the delayed implementation of the full PHAS rule as the replacement for the former PHMAP rating system, the TARCs' FY 2001 workload included resolving problem conditions at PHAs formerly designated as troubled under PHMAP, non-troubled PHAs with identified deficiencies, and PHAs more recently designated as troubled for the self-certified PHAS "management assessment indicator." At the beginning of FY 2001, 60 designated troubled PHAs were pending at the TARCs, of which 50 were reported as recovered by the end of FY 2001. Considering PHAs with a newly designated troubled "management indicator" during FY 2001, there were 21 designated troubled PHAs pending at the TARCs at the end of FY 2001.

In addition to assistance to designated troubled PHAs, the TARCs also worked with PHAs having difficulties in administering their Section 8 programs. Furthermore, the TARCs have been utilized by HUD Field Offices to conduct PHA assessments and provide technical assistance to PHAs that have deficient areas of operation that are not formally designated as troubled.

HUD continues to work with its PHA industry partners in defining an acceptable PHAS rating process. Following full implementation of a revised PHAS rating process in FY 2002, the number of designated troubled and sub-standard performers referred to the TARCs may increase substantially.

Departmental Enforcement Center

DEC addresses serious problems of distressed multifamily properties that have failed physical and financial inspections and require corrective action by owners, lenders and management agents. DEC also enforces administrative and regulatory business agreements through the debarment or suspension of individuals in non-compliance in single and multiple family properties. DEC is also charged with imposing monetary penalties in cases of serious non-compliance.

DEC was established within HUD to work in a collaborative fashion with all Program Offices in implementing necessary enforcement actions. The DEC aggressively pursues enforcement actions against owners, landlords, lenders, management agents, recipients, grantees and other participants who are in non-compliance or in violation of statutes, regulations and/or other program requirements relating to programs administered by HUD. DEC refers criminal cases to the Office of the Inspector General and civil cases to the Department of Justice. These actions bring resolution to the most difficult and significant non-compliance issues among recipients of HUD program resources and ensure compliance with legal requirements under HUD agreements to preserve decent, safe and sanitary housing for low- and moderate-income households.

Since its inception, DEC has made significant strides towards accomplishing its mission. These include over $71 million in Owner Contributions to improve properties and $43.8 million in Actual Repayment Recoveries returned to the properties. Furthermore, DEC actions have resulted in judgments, assessments of penalties, settlements of lawsuits and/or administrative actions or other agreements that obligated HUD participants to make payments to HUD or return funds to HUD insured/subsidized projects for a total of $51 million.

Since September 1998, DEC has received 4,149 referrals of multifamily properties, many of which are the most egregious cases in the Department's inventory. To date, the DEC has closed 2,672 cases or 64 percent. For FY 2001 alone, there have been 2,438 referrals of multifamily properties, an average of 203 referrals each month. Prior to FY 2001, DEC was receiving an average of 71 referrals each month. Average referrals each month have increased 185 percent when comparing FY 2001 to previous fiscal years. Most of the increase is due to referrals for financial reviews.

Processing times have improved from 529 days for a physical referral and 267 days for a financial referral in FY 1999 to 188 days for a physical referral and 116 days for a financial referral in FY 2001. DEC has caused an improvement of more than 42 points on average for every property referred having both a first and second REAC inspection.

Mortgagee Review Board actions have increased by 51 percent over FY 2000. In FY 2001, compliance actions (e.g., suspensions, proposed debarments and final determinations) have increased by 36 percent compared to FY 1999, while processing time for these actions decreased by 41 percent. Administrative sanctions (including debarments, suspensions, and proposed debarments) resulted in 2,191 actions taken in FY 2001. DEC enforcement actions this year have resulted in 224,945 housing units being restored to decent, safe, and sanitary conditions versus 41,344 reported for FY 2000.

In FY 2001, DEC put special emphasis on non-filers of annual financial statements. Civil Money Penalties resulting from settlements and judgments against non-filers have almost tripled in FY 2001 over FY 2000.

For FY 2001, DEC persuaded the owners of 130,322 multifamily housing units to reinvest $24 million to bring inferior properties up to HUD standards and to repay $34 million to the projects. As a result of these actions, there was a 194 percent improvement in the average score of the properties after enforcement action was taken.

DEC exceeded all FY 2001 management goals. We reduced the number of multifamily cases by 83 percent in FY 2001 and closed 80 percent of all cases received in FY 2001 that have been in the DEC for 180 days. Cases were closed in an average of 121 days. Sanction notices to participants for suspension and/or proposed debarment were completed for 80 percent of the cases referred for the fiscal year for indictment, civil judgment, conviction and fact-based cases.

For FY 2001, 791 administrative actions were taken to discourage predatory lending. This number consisted of 254 suspensions, 227 proposed debarments, and 310 debarments. A total of 92 actions were taken by the Mortgage Review Board. DEC imposed civil money penalties and accepted settlement payments and agreements for loan indemnifications for $19.7 million.

For FY 2001, there were 2,438 referrals of high-risk or troubled multifamily projects to DEC—an increase of 42 percent compared to the referrals of the previous two fiscal years. A total of 1,822 cases were closed—an increase of 114 percent compared to closed cases of the previous two fiscal years.

For FY 2001, there were 520 referrals (453 subjects and 67 affiliates) for administrative sanction action —suspensions, proposed debarments and debarments—an increase of 5 percent compared to FY 2000.

Financial Management Center

FMC is responsible for the financial management of the Public and Indian Housing (PIH) tenant-based and Office of MF Housing project-based Section 8 programs that HUD administers with Annual Contributions Contracts (ACCs). FMC provides financial management support for approximately 10,400 ACCs. HUD uses annual budgets and requisitions/payment schedules to advance funds to the Housing Authorities (HAs) and Contract Administrators (CAs) that administer these programs.

The Center must approve all budgets and payment schedules to allow for payment on the first date of the budget period. At the end of FY 2001, a total of only 91 active contracts nationwide (less than 1 percent) did not have their payments scheduled, compared with 234 ACCs (2.2 percent) at the end of FY 2000, which did not have their payments scheduled. The 91 active contracts included principally expired contracts for which the owners had not submitted their renewal requests and contracts for which budgets and requisitions for the new fiscal year had not yet been submitted.

HAs/CAs must also submit year-end settlements within 60 days of the end of the fiscal year to the Center, because the settlement is the only vehicle to identify and recoup excess advances made to the HAs/CAs and since it is the only source document that identifies excess reserves that HUD should recapture. In FY 2000, FMC modified its procedures to clearly identify settlements it has not received on-time, enable closer oversight, and ensure greater accountability and collection of excess advances. The most significant settlements are those relating to PIH certificate and voucher programs, as HUD must analyze reserves annually to determine excess, and because current procedures provide funding for only a one-year term. During FY 2001, settlements were due on 4,591 certificate and voucher programs and have not been received on only 22 of them (less than one percent). This compares to FY 2000 when settlements were due on 4,829 certificate and voucher programs and had not been received on 44 of them.

FMC has processes to review, reconcile, and approve year-end settlements within 60 days of receipt; to schedule underpayments for immediate payment; and to offset overpayments with the next scheduled payment(s). During FY 2001, FMC substantially improved on achieving this goal as compared to FY 2000. During FY 2000, the FMC was unable to close any settlements for a period of time due to recapture activities and accounting system anomalies, and FMC gave priority to closing all settlements for tenant-based Certificate and Voucher programs prior to the recapture and met that goal fully. In FY 2001, the most significant impediment to the goal was the Department's late publication of the administrative fee schedules effective October 1, 2000. Their publication in June, 2001 delayed closing settlement for fiscal years ending Decmeber 31, 2000, and March 31, 2001. In FY 2001, FMC did again focus on closing settlements in support of the tenant-based recapture, and met that goal. During FY 2001, a total of 4,591 settlements were due from housing agencies for the tenant-based programs. Of those received, whether timely or not, only 65 (1.3 percent) are not closed; this includes any held open for receipt of final payments, program reasons or technical problems.

HUD requires FMC to identify incidences of rejected payments and have them corrected within 3 business days. The Center has developed a process to identify all rejected payments. When it began this process in June 1998, FMC identified 248 of 6,025 tenant-based ACCs that had payments rejected. In November 1999, the Center reported only 47 of 10,400 tenant- and project-based ACCs had payments rejected. At the end of FY 2001, only one-half of one percent of contracts had rejected payments, which is fractionally lower than the FY 2000 figure. Rejections are infrequent and are generally due to insufficient budget authority or a technical problem.

FMC ensures that contracts are established for all reserved funds within 60 days of receipt unless delayed by some type of HUD action. The Center has unilateral contracting authority for all tenant-based ACCs (the Center's financial analysts contract these funds in a timely fashion). Since the contracting action for tenant-based incremental funding and MF project-based ACCs is less controllable, the Center has developed controls to identify uncontracted funds for these programs and to facilitate establishment of the contracts. FMC also maintains a status report on all MF contracts due for renewal in a given year and tracks progress via bi-weekly updates.

Trends and Factors Affecting Strategic Goal 5

Ensuring Public Trust in HUD requires that HUD both ensures operational consistency in reforms it has already instituted, and completes effective corrective actions on remaining material management control weaknesses and other concerns discussed in the "Financial Management Accountability" and "Management and Performance Challenges and Progress" sections of this report.

While GAO has acknowledged HUD's progress in improving its management control environment and reducing risks in major program areas, additional actions are needed to further reduce risks associated with HUD's single family mortgage insurance and rental subsidy programs, and to improve HUD's information systems and management of its human capital.

To better assure operational consistency, it is essential that HUD complete the implementation of a resource estimation and allocation process, to provide a more systemic means of estimating resource needs and managing workload. As it is unlikely HUD will receive any significant staffing increase, it is also essential that efforts continue to improve upon the use of risk-based monitoring techniques in HUD programs, to use existing staff and program resources more efficiently and effectively. When significant performance and compliance problems are identified—be they from single family mortgage lenders, MF project owners or agents, PHAs, local governmental entities, or other participants—HUD must act appropriately to address those problems to minimize the risk and further program objectives.

In the area of information systems, the Office of the Chief Information Officer has instituted many process improvements to better support the planning, development and maintenance of HUD's Information Technology (IT) investments. However, it is essential that HUD program managers assume a stronger systems ownership role in assuring that systems requirements and controls over data quality are properly established to better support their program delivery and mission.

To address material weaknesses in rental subsidy programs, HUD will need the cooperation of its program partners and tenant groups to push for simplification of program requirements and improved internal controls for assuring that subsidy payments go to those for whom they were intended, in the proper amounts. Statutory change may be required to simplify and standardize subsidy program requirements, thereby reducing administrative burdens and costs and the risk of payment errors.

Secretary Mel Martinez has stated that his "agenda starts with good strong management…the first thing is to get your house in order." Working as partners with Congress, HUD will continue to improve both program and financial accountability in order to ensure the public trust.