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Representatives

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COMMUNITY DEVELOPMENT BLOCK GRANT FORMULA

Options for Improving the Targeting of Funds

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Highlights of [GAO-06-904T](#), a testimony before the House Committee on Government Reform, Subcommittee on Federalism and the Census

Why GAO Did This Study

The subcommittee asked GAO to testify at this hearing whose purpose is to examine the Community Development Block Grant (CDBG) Program administered by the Department of Housing and Urban Development (HUD) and the Administration's proposal to reform this federal government program. This proposal would use a single formula and five variables to allocate funds. This hearing is a follow-up to a series of subcommittee hearings that GAO participated in during 2005 on the CDBG program. Based on the principles of formula design that GAO outlined in its 2005 testimony, the subcommittee had requested GAO to undertake a body of work to help the Congress explore alternative formulas to allocate CDBG funds among the nation's diverse communities. This work is underway. In this hearing, GAO addresses its ongoing work on options for improving the targeting of CDBG funding as contributions to these efforts and to determining next steps.

COMMUNITY DEVELOPMENT BLOCK GRANT FORMULA

Options for Improving the Targeting of Funds

What GAO Found

The CDBG is a significant direct federal-to-local grant program, supporting a wide range of local community development activities that benefit low- and moderate-income people. Since its inception in 1974, the program has provided about \$113 billion to help the nation's communities focus on challenges ranging from reducing economic isolation to the elimination of neighborhood blight.

Due to the long-term fiscal crisis the nation currently faces, GAO advocates a thorough assessment of all federal tax and spending programs and policies across the board. In particular, GAO has suggested that programs such as the CDBG be measured according to the degree to which assistance is targeted to those with the greatest needs and the least capacity to meet them.

Since 1978, real per capita spending for the CDBG has declined by almost three-quarters from about \$48 to about \$13 per person. Limited resources coupled with increasing concerns with effectiveness require better targeting to high-need communities. This involves a new look at the way the CDBG program assesses community needs and the capacity to meet those needs.

The significant economic and demographic changes that have occurred over the last three decades make this reassessment especially important. Not only have the economy and population changed, but we have a better understanding of community problems like concentrated poverty. In light of such change, the Administration introduced its latest CDBG reform proposal which would use a single formula and five variables to allocate funds. The Administration's proposal raises important issues regarding how to systematically allocate funds based on community need.

In ongoing work for this subcommittee, GAO is looking at additional options for the CDBG formula, focusing on 1) refining a set of indicators of the development needs facing the nation's communities, 2) assessing potential indicators of communities' capacities to address those needs on the basis of their own fiscal and economic resources, and 3) exploring ways to adjust such indicators for local cost-of-living differences. The objective is to design a set of options to assist the Congress in addressing critical policy choices in choosing a formula to allocate CDBG funds.

www.gao.gov/cgi-bin/getrpt?GAO-06-904T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Stanley Czerwinski at (202) 512-6806 or czerwinski@gao.gov.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our ongoing work on options for improving the targeting of Community Development Block Grant (CDBG) funds as the subcommittee examines the CDBG program and the Administration's proposed reforms. CDBG is a significant direct federal-to-local grant program, supporting a wide array of local community development activities that benefit low- and moderate-income people. Since its inception in 1974, the program has provided about \$113 billion, according to the Department of Housing and Urban Development (HUD), to help the nation's communities focus on challenges ranging from reducing economic isolation to the elimination of neighborhood blight. To do this, HUD is required to use a complex dual formula system to allocate CDBG funding. Under this dual formula approach, grants are calculated under two different formulas and grantees receive the larger of the two amounts. The formulas take into account poverty, older housing, population, housing overcrowding, and other factors.

Much has transpired over the past three decades and it is time to carefully consider whether the program's funds are directed towards those communities with the most compelling needs and the least capacity to address them from their own resources. As you have asked us, we have begun a body of work to help the Congress explore alternative formulas to allocate CDBG funds among the nation's diverse communities.

21st Century Challenges Drive Need for CDBG Formula Reassessment

As discussed in our 2005 report on 21st Century Challenges,¹ the federal government's financial condition and long-term fiscal outlook present enormous challenges to the nation's ability to respond to emerging forces reshaping American society. Given the size of our projected deficits, traditional incremental approaches to budgeting will need to give way to more fundamental and periodic reexaminations of existing spending and revenue policies and programs. A periodic reexamination offers the prospect of addressing emerging needs by weeding out programs and policies that are outdated or ineffective and updating those policies and programs that remain relevant by improving their targeting and efficiency. For example, programs such as the CDBG should be judged according to whether they target assistance to those with the greatest needs and the

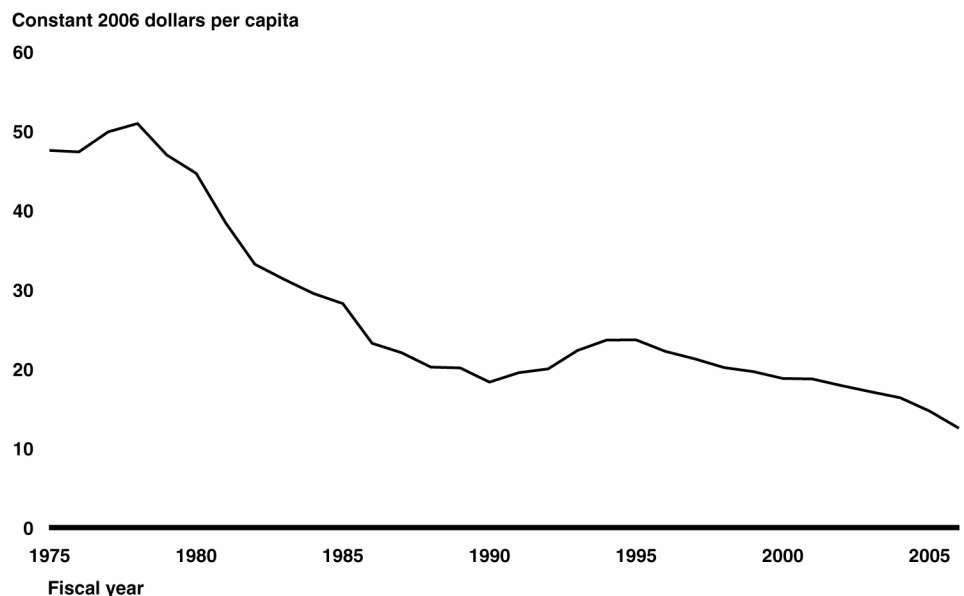
¹GAO, *21st Century Challenges: Reexamining the Base of the Federal Government*, [GAO-05-325SP](#) (Washington, D.C.: February 2005).

least capacity to meet them. While prompted by fiscal necessity, such a fundamental review also provides an opportunity to address the role and responsibility of the federal government in responding to challenges faced by communities throughout the nation. The Administration's proposal to restructure assistance for community development opens up important issues regarding systematically allocating funds based on community need.

Budget Resource Trends Underscore Need for More Effective Targeting of Available Funding

Since 1978, real per capita funding for the CDBG has declined by almost three-quarters from about \$48 to about \$13 per capita. (See fig. 1.)

Figure 1: Trends in CDBG Funding Per Capita 1975-2006



Source: GAO analysis of Census, HUD, and OMB data.

The number of communities receiving funds directly from the federal government through the CDBG formula grant has nearly doubled from 606 in fiscal year 1975 to 1,128 in fiscal year 2006. This trend can be expected to continue both because population will continue to grow and because new standards for designating metropolitan areas, as promulgated by the Office of Management and Budget and used by the program, are also likely to increase the number of eligible communities. In addition, provisions in the current formula allow communities to continue to receive funds even if they lose their eligibility.

The policy implications of these trends are that with more limited resources, increases in concerns with effectiveness require better targeting to high-need communities. This involves a new look at the program's uses and the way it assesses community needs and capacity to meet those needs. Given these implications, you have asked us 1) to review the use of CDBG funds and how HUD oversees the CDBG program and 2) to assess alternative formulas to allocate CDBG funds among localities, including evaluating formula options that take into account both community development needs and localities' abilities to fund their needs from local resources. In response to your first request, we will be issuing a report to you later this summer which will examine the uses and oversight of CDBG funds. Our work on your second request, which I will be discussing today, will focus on developing various formula options and highlighting the key policy choices that the Congress will have to make when selecting from among those options.

Changing Circumstances Call for CDBG Formula Reassessment

The CDBG program was originally designed to address the pressing urban problems the nation faced in the mid-1970s. However, as HUD has rightly noted, the formula for allocating CDBG funds is today no longer as good a measure as it once was of communities' needs. For example, the amount of pre-1940s housing no longer works very well as a proxy for community development need. Communities that embraced urban renewal and tore down their blighted housing—a statutory goal of CDBG—are penalized, while cities with older rehabilitated housing occupied by higher income families are rewarded.

At the same time, since the inception of CDBG in 1974, the understanding of the underlying problems facing the nation's communities has expanded.² For example, we have become more aware of the adverse consequences of geographic concentrations of very low-income households and the negative effects of growing up in a single parent household regardless of income. This greater awareness has led to a variety of federal programs such as HUD's "Moving to Opportunity" initiative, which allows low-income households to move out of areas of concentrated poverty, and a variety of efforts to keep nonresident fathers involved in their children's lives. It is now time to use the knowledge we have gained to reassess the CDBG program.

²See, for example, HUD's series of five studies on the CDBG program from 1976 through 2005.

Administration Proposes to Reform the CDBG Program

HUD is required to use a complex dual formula system to allocate CDBG funding.³ Under this dual formula approach, grants are calculated under two different formulas and grantees receive the larger of the two amounts. The existing approach takes into account poverty, older housing, population, housing overcrowding, and other factors. However, it provides widely differing payments to recipients with similar needs and funds going to the neediest communities have decreased over time on a per capita basis.

In recognition of the significant and dynamic demographic and socioeconomic changes the country has undergone since the mid-1970s, on May 25, 2006, the Administration introduced its latest proposal to reform the CDBG program. At the heart of the Administration's proposal is the use of a single formula. This proposed formula would use five variables to allocate funds:

- the per capita income (PCI) of the community relative to the PCI of its metropolitan area;
- the number of overcrowded housing units;
- the number of households living in poverty, excluding full-time dependent college students;
- the number of female heads of households with minor children; and
- the number of homes 50 years or older occupied by a low-income family.

Because we have not yet reviewed HUD's proposal in detail, we cannot comment on it as a whole at this time. However, we do have some observations on some of the variables that HUD has included. Although we recognize the potential value of introducing a relative PCI variable as HUD has done, we are concerned about HUD's decision to use metropolitan PCI. For example, if there were two identical communities located in different metropolitan areas, the community in a metropolitan area with a lower PCI would receive less aid than the community in a metropolitan area with a higher PCI. In another case, HUD's continued use of overcrowded housing, one of the variables included in the current formula, may be more indicative of a strong local economy that reflects strong demand pressures in the local housing market than it is indicative of economic decline. Nevertheless, HUD's proposal certainly represents a

³42 U.S.C. §5306.

significant contribution to serious discussions of options for allocating CDBG funds.

GAO Is Assessing Additional Options to Improve Targeting under the CDBG Formula

In response to your request that we assess alternative formulas to allocate CDBG funds among localities, it is our intent to build on the foundation created by HUD's work. Our ongoing work is focusing on 1) refining a set of indicators of community development need among the nation's communities, 2) assessing potential indicators of the capacities of communities to address those needs on the basis of their own fiscal and economic resources, and 3) exploring ways to adjust such indicators for local cost-of-living differences. Designing formulas to allocate CDBG funds among the nation's communities involves more than technical issues. It also involves difficult policy choices which are most appropriately the province of the Congress. Our objective is to design a set of formula options that will assist the Congress in making the critical policy choices inherent in choosing a formula to allocate CDBG funds.

In our work to refine indicators to more accurately capture key aspects of community need, we intend to take a fresh look at indicators that are being used in the current formula and those in the Administration's proposal as well as to explore the use of some new need indicators. Next, we will consider whether a CDBG allocation formula can be designed to reflect variations in local funding capacity in order to address local community development needs with local resources. This is because high-income communities generally have stronger tax bases from which to fund program needs without relying on federal assistance than lower-income areas do. Additionally, we plan to explore options for making cost-of-living adjustments within the formula, such as size of population in poverty based on poverty thresholds adjusted for variations in the cost of living. One area we intend to look at for arriving at a cost-of-living factor is the use of fair market rents.

In our analysis, we will use statistical techniques to calculate and weight the relative influence of the indicators, identifying a set of them that effectively represents community development need. Additionally, we will consider potential indicators of the ability of CDBG grantees to address their community development needs from their own resources. We will use the findings from these analyses to develop formula alternatives that link closely to need, incorporating appropriate variables and weights. For the formula options that we develop, we will highlight the key policy choices inherent in selecting a formula to allocate CDBG funds.

Fully recognizing the complexity and controversial nature of the work that lies ahead of us, we are reaching out widely for input and ideas. First, the National Academies of Science are assembling a panel of experts to provide input throughout our project on all phases of our work. The Academies are seeking individuals with both high levels of technical expertise and practical experience regarding community development in local communities. Next, we are working and will continue to work closely with representatives from national organizations of state and local governments and community development associations to obtain their uniquely related perspectives and to identify the concerns of those most responsible for making the CDBG program work. And lastly, but no less importantly, HUD staff have been generous in sharing their considerable expertise and knowledge with us on the CDBG formula and the work they have done. We will continue to consult and discuss technical issues with them.

Concluding Remarks

As we work through the ways that formula options could be shaped, the critical policy choices that will have to be made are most appropriately in the hands of the Congress. Our goal is to provide the necessary information and analyses so that the Congress can systematically examine the implications and make informed choices.

In closing, I would like to emphasize that the targeting issues raised by HUD's proposal are important no matter what level of financial support the Congress provides for community development activities. Additional formula options do need to be explored as part of the process of reaching a decision on how best to target CDBG funding, and we plan to continue to participate in that process with our work for you. Central to any reexamination is assessing how to better target federal assistance to those with the greatest needs and the least capacity to meet those needs.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions you or other members of the subcommittee may have.

For future comments or questions regarding this testimony, please contact Stanley J. Czerwinski at (202) 512-6806. Individuals making key contributions to this testimony included Michael Springer, Joyce D. Corry, Katherine Wulff, Sara Williams, Anna Maria Ortiz, Jerry C. Fastrup, and Bob Dinkelmeier.

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