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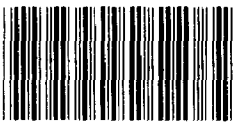
REPORT BY THE U.S.

General Accounting Office

Administrative Procedures And Controls Need Strengthening To Reduce Losses To HUD's Mortgage Insurance Fund

The Department of Housing and Urban Development could save millions of dollars annually by changing its procedures to eliminate paying interest on reimbursable foreclosure expenses before the expenditures are made. Additional savings are available if the Department's centralized claim processing system provided better control over the payment of costs for preservation and security, inspections, and taxes.

GAO reviewed payments made to mortgage investors by both the Department and the Veterans Administration to determine if opportunities exist to reduce losses to Federal mortgage insurance and guarantee programs. Recommendations are being made only to the Department because GAO found that the Veterans Administration was doing essentially what GAO is recommending.



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CED-81-29

DECEMBER 18, 1980

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION

B-197399

Secretary of Housing and Urban Development
Administrator of Veterans Affairs

Our Office recently completed a review of the Department of Housing and Urban Development's (HUD's) and Veterans Administration's (VA's) single-family insurance and guarantee payments made to mortgage investors. The purpose of the review was to determine if opportunities exist to reduce losses to Federal mortgage insurance and guarantee programs. The results of our review are summarized below and discussed in more detail in appendix I.

Both HUD and VA offer mortgage insurance and guarantee programs to help home buyers purchase new or existing single-family housing. Under these programs, lending institutions provide the mortgage money, and the Federal agencies insure or guarantee the lender or mortgagee against default by the home buyer or mortgagor. When a mortgagor fails to make the required mortgage payments, the mortgagee can foreclose on the defaulted mortgage and convey the property to the Federal agencies for the insurance/guarantee benefits. In fiscal year 1979, mortgagees received $707 million after conveying over 29,000 properties.

Our review showed that oppportunities exist for HUD to significantly reduce insurance fund payments by (1) not paying mortgagees interest on expenditures until they are made and (2) improving administrative controls to assure that mortgagees are reimbursed only for costs that are proper and justified. We did not find similar problems in guarantee payments made by VA. Specifically, our review showed that:

--HUD is paying mortgagees several million dollars annually in unearned interest because it calculates interest on certain reimbursable expenses from the date of the mortgage default rather than from the date the expenditures are made. Although HUD officials are aware of this situation, they have elected not to take corrective action and have cited legal

problems and increased administrative costs as reasons. We believe that there is sufficient legal basis for taking corrective action and that the administrative costs involved in making such a change are minimal compared to the millions of dollars in recurring annual savings that would result by calculating interest from the date of expenditure.

--HUD is paying mortgagee insurance claims for certain reimbursable costs without adequate justification or assurance that the payments are warranted. We found that because of inadequate supporting documentation and limited and centralized review of mortgage claims, HUD has (1) paid unreasonable costs to preserve and secure HUD-insured vacant properties, (2) erroneously paid mortgagees for fees to inspect properties, and (3) made duplicative property tax payments on HUD-acquired properties.

To correct the identified problems, we are recommending that the Secretary of Housing and Urban Development:

1. Revise HUD regulations and procedures to require that interest paid on mortgagees' insurance claims be calculated from the date the expenditures are made rather than from the date of default.

2. Establish a minimum dollar amount for preservation and security work that, if exceeded, would require the mortgagees to

   a. have the property inspected before and after the work is performed to ensure that the work is justified and satisfactorily completed and

   b. submit the inspection reports, along with the paid invoices for the work, to the HUD area offices for review and approval before HUD reimburses the mortgagees for the work.

3. Require mortgagees to submit documentation providing assurance that fees claimed are for allowable expenses, and emphasize to the staff responsible for reimbursing mortgagees that claims for inspection fees on occupied properties are not allowable under HUD procedures.

4. Reemphasize to all HUD area offices and mortgagees that HUD will not reimburse mortgagees for taxes paid after the date the mortgagee submits the notice of property transfer and application for insurance benefits (HUD Form 1025). Also, the staff responsible for reimbursing mortgagees should be instructed not to pay mortgagees' claims for taxes that do not appear on HUD Form 1025.

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Section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Henry Eschwege

Henry Eschwege
Director

APPENDIX I

ADMINISTRATIVE PROCEDURES AND CONTROLS NEED STRENGTHENING TO REDUCE LOSSES TO HUD's MORTGAGE INSURANCE FUND

INTRODUCTION

The Department of Housing and Urban Development (HUD) and the Veterans Administration (VA) have single-family mortgage programs to help home buyers purchase new or existing housing. Under these programs, lending institutions provide money for mortgages, and the Federal agencies insure or guarantee the lender or mortgagee against default by the home buyer or mortgagor.

If a mortgagor fails to make the required mortgage payments, the mortgagee may foreclose on the defaulted mortgage or accept a voluntary deed 1/ and convey the property to HUD or VA. HUD or VA, in turn, reimburses the mortgagee for the unpaid mortgage principal and the other costs incurred by the mortgagee during the foreclosure process. In fiscal year 1979, mortgagees conveyed over 29,000 properties and received $707 million in insurance/guarantee benefits from HUD and VA.

OBJECTIVE, SCOPE, AND METHODOLOGY

We reviewed payments made to mortgage investors to determine if opportunities exist to reduce losses to HUD and VA mortgage insurance and guarantee programs.

Our field work was performed at HUD's central office in Washington, D.C.; HUD area offices in Pittsburgh and Philadelphia, Pennsylvania, and Detroit, Michigan; and VA field offices in Pittsburgh and Philadelphia, Pennsylvania. We interviewed agency representatives at the locations visited and examined and compared agency records, regulations, and handbooks. In addition, we contacted, by telephone, the HUD field representatives in Atlanta, Georgia; Chicago, Illinois; New York, New York; and Cleveland, Ohio, to obtain their observations on insurance benefit claims filed by

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1/A voluntary deed in lieu of foreclosure occurs when a mortgagor chooses to sign over to the mortgagee all of his/her rights to the property. In return, the mortgagee cancels all claims against the mortgagor.

mortgagees and HUD's administrative control over these claims. As of September 1979, the seven HUD offices contacted had 56 percent of HUD's property inventory.

We reviewed 135 randomly selected insurance claim files of properties conveyed to HUD at the Pittsburgh and Philadelphia area offices. At the Pittsburgh location, we reviewed 94 randomly selected claim files representing over half the properties listed on Pittsburgh's March 1980 Inventory Status Report. At the Philadelphia location, we reviewed 41 randomly selected claim files representing about 4 percent of the properties on the March 1980 Inventory Status Report. We also reviewed 20 randomly selected claims for properties conveyed to VA at the Pittsburgh and Philadelphia field offices during fiscal year 1980. Each deficiency identified was reviewed in terms of existing policies and procedures to ensure that it had widespread application and was not just a misapplication of a good policy or procedure.

MORTGAGEES SHOULD NOT BE PAID UNEARNED INTEREST

HUD is paying interest on mortgagees' expenditures from the date of default rather than from the date such expenditures are made. Although HUD is aware of the problem, it has not taken corrective action, citing legal problems and increased administrative costs as reasons. Our review showed that there is a sufficient legal basis for HUD to amend current regulations to pay interest on reimbursable foreclosure expenses only from the time the expenditures are made. Moreover, the administrative costs involved in making the change are primarily one-time computer reprograming costs estimated by HUD officials at about $35,000. This cost is minimal compared to millions of dollars in recurring annual savings that could result if HUD calculated interest payable from the date expenditures are incurred.

When a HUD mortgage insurance claim is paid, a mortgagee receives the unpaid principal amount due on the mortgage as well as payment for a number of additional items. These items include funds advanced by the mortgagee for mortgage insurance premiums, hazard insurance premiums, taxes, ground rents, and water rates. To this subtotal is added two-thirds

of foreclosure and other acquisition costs, 1/ such as sheriff's costs, advertising and publication fees, attorney fees, title policy, etc. Reimbursable costs also include funds a mortgagee expends for protection and preservation of a property.

HUD contracts with mortgagees incorporate HUD regulations which require that interest on the total amount of the insurance claims be calculated from the date of default under the mortgage even though many reimbursable expenses are not incurred until months and sometimes years after that date, due to lengthy foreclosure proceedings in some States. Since 1964, when the Congress moved to further protect mortgagees by authorizing payment of interest on the mortgage principal from the date of default, HUD has also paid interest on foreclosure expenses as of the date of default even though the expenses are not incurred until months or years later. In contrast, VA pays interest from the date the mortgagee incurs the cost. VA field office officials contacted stated that it was not reasonable to pay mortgagees interest on costs not yet incurred.

1977 proposal to save millions of dollars by changing HUD regulations was not adopted

In July 1977, HUD's Assistant General Counsel, Home Mortgage Branch, proposed that HUD modify its policy of paying interest in settlement of mortgage insurance claims. Rather than paying interest from the date of default, the Assistant General Counsel recommended that interest on advances should legally be paid on single-family insurance claims only for the period beginning with the date of the payment of the advances through the date of settlement.

This proposal was subsequently recommended to the Assistant Secretary for Housing in a June 30, 1978, memo from HUD's General Counsel. A year later, HUD's General Counsel again raised the proposed change with the Assistant Secretary of Housing, noting that "we have no record of any

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1/According to HUD's Office of General Counsel, mortgagees are required to pay one-third of foreclosure costs in order to provide a financial incentive to avoid foreclosing prematurely.

follow-up on this matter either by OGC or your Office." Observing that the proposed change could save HUD several million dollars, HUD's General Counsel concluded that:

> "The proposal * * * simply entails changing the date from which debenture interest is calculated from the date of default to the date the mortgagee actually spends his funds on the individual items included in calculating the claim. Since the Secretary has the discretion under section 204(d) of the [National Housing] Act [12 U.S.C. 1710(d)] to establish the date of the issuance of the debenture, the authority to make the proposed change exists."

HUD's Assistant Secretary for Housing, however, raised two objections concerning the proposed change--the legality of applying the change to existing mortgages and the administrative costs involved in making the change. With respect to the legality of applying the change to existing mortgages, the Assistant Secretary pointed out that HUD's regulations, which are incorporated into the mortgage insurance contract, preclude any amendments to the regulations that may "adversely affect" the interests of a mortgagee on any mortgage or loan already insured. On the other hand, he foresaw no serious opposition "provided that the restriction is limited prospectively."

In response to the Assistant Secretary's objection to the retroactive application of the proposal, the Assistant General Counsel, Home Mortgage Branch, in a July 1979 memo, advised the General Counsel that he did

> "* * * not believe that the demanding of dates of payment with respect to expenses incurred by mortgagees is an adverse affect on the mortgagee. It is rather, a correcting of past errors on the part of the Department rather than a change in procedure which would adversely affect a mortgagee."

He further suggested that the proposed change to the regulations be published for comment and, depending on the comments received, be published in final form. In September 1979, HUD's General Counsel concurred in this suggestion, and the proposed regulatory amendment was forwarded to the Assistant Secretary for Housing with a request that it be published for comments. However, as of December 1980, HUD had taken no further action on the proposal.

Legal authority to implement change exists

We believe that the Secretary of HUD has the requisite discretionary authority under section 204 of the National Housing Act to effect the proposed administrative change. We also agree with HUD's Office of General Counsel's position that the change can be applied retroactively to existing mortgage contracts.

Prospective change

Historically, housing insurance claims were paid in debentures 1/ dated as of the date of institution of foreclosure proceedings. In 1964, the Congress amended section 204(d) of the National Housing Act (12 U.S.C. 1710(d)), to permit debentures to be "dated as of the date of default or as of such later date as the Secretary, in his discretion, may establish by regulation." Also, in 1964 HUD began to pay housing insurance claims in cash.

As noted earlier, when a HUD mortgage insurance claim is paid, a mortgagee receives the unpaid principal amount due on the mortgage plus reimbursement for a number of additional items. HUD regulations make clear that where mortgaged property is conveyed to HUD, the debenture issued in payment of the housing insurance claims shall be dated as of the date of default (24 CFR 203.410) and shall bear interest from the date of issuance (24 CFR 203.405). Where the housing insurance claim is paid in cash, the insurance benefits shall include an amount equivalent to the debenture interest that would have been earned on the portion of the insurance benefits paid in cash (24 CFR 203.402(k)).

The proposal to pay interest on reimbursable items of expense only from the date of expenditure can be implemented by amending 24 CFR 203.410. The language suggested by HUD's Office of General Counsel for public comment would add a new subsection (c) to 24 CFR 203.410 to read as follows:

"Notwithstanding paragraph (a) of this section, debentures issued as reimbursement for

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1/Debentures are registered transferable securities which are valid and binding obligations.

> expenditures made by the mortgagee after the date of default shall be dated as of the date of expenditures."

Since the Secretary of HUD has the clear discretionary authority to date debentures as of a date later than the date of default, and since no statute prohibits the issuance of separate debentures for separate items included in the insurance benefits, there appears to be no legal impediment to the prospective implementation of the proposed change. Whatever administrative difficulties that may exist in issuing separate debentures are obviated as a practical matter by the payment of the entire insurance claim in cash.

Retrospective change

The closer question is whether the proposed change can be implemented retroactively, effective against claims under existing contracts of insurance. Although not free from doubt, we believe it can.

The Secretary of HUD is vested with broad rulemaking authority "to make such rules and regulations as may be necessary to carry out the provisions" of title II of the National Housing Act (12 U.S.C. 1715(b) (1976)). The Administrative Procedure Act defines a "rule" as "an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy." (Emphasis added.) (See 5 U.S.C. 551(4) (1976).) Since the proposed retroactive change would be triggered by events occurring after the promulgation of the proposed regulatory amendment--that is, the mortgagee's submission of an insurance claim--the proposed change would be one of "future effect." (See Adams Nursing Home, Inc. v. Mathews, 548 F.2d 1077, 1080 n.8 (1st Cir. 1977); Summit Nursing Home, Inc. v. United States, 572 F.2d 737, 742 (Ct. Cl. 1978).)

There is the further question of whether HUD's regulation governing the effect of regulatory amendments precludes the application of the proposed change to existing contracts of insurance. The pertinent regulation states that:

> "The regulations in this subpart may be amended by the Commissioners at any time and from time to time, in whole or in part, but such amendment shall not adversely affect the interests of a mortgagee or lender under the contract of

> insurance in any mortgage or loan already insured and shall not adversely affect the interests of a mortgagee or lender on any mortgage or loan to be insured in which the Commissioner has made a commitment to insure." (24 CFR 203.499 (1979).)

Would the proposed change "adversely affect" the interests of existing mortgagees and lenders under their existing contracts of insurance? Clearly the mortgagee's financial interest will suffer. However, if "adversely affect" is to be understood solely in terms of financial detriment, HUD under its own regulations may be powerless to effectively remedy programmatic defects where some undefined financial interest would suffer. Such a construction of HUD's regulation could severely limit the effective administration of HUD's insurance programs and, absent a clear indication from HUD that such is indeed the effect and intent of its regulation, we will not so construe it.

Instead, we view the proposed amendment as curative, a correcting of past programmatic defects on the part of HUD rather than a change in procedure which would adversely affect a mortgagee. Since the mortgagee's continued expectation in the windfall from HUD's present policy is outweighed by HUD's interest in protecting the financial integrity of the housing insurance funds, and since the mortgagee's expectation of interest paid on reimbursable items of expense from the date of default is at best an incidental aspect of the contract of insurance, we do not believe that HUD should construe its regulation to preclude the application of the proposed change to existing contracts of insurance.

No constitutional bar
to the proposed change

Is there any constitutional impediment to the proposed retroactive change? Here again we think not. On the Federal level, retroactive legislation or regulations are attacked under the Due Process Clause of the Fifth Amendment that prohibits the deprivation of property without due process of law. The explicit constitutional prohibition against the impairment of contracts found in Article I, §10 of the U.S. Constitution applies only against the States. However, since contracts are a form of property, the Supreme Court has ruled that "Rights against the United States arising out of a contract with it are protected by the Fifth Amendment." (See Lynch v. United States, 292 U.S. 571, 579 (1934).)

APPENDIX I

Consequently, as a general rule, the analysis of retroactive Federal legislation or regulations under either an impairment of contract theory or a due process theory has merged into an inquiry into the reasonableness of the proposed action. (See Hochman, The Supreme Court and the Constitutionality of Retroactive Legislation, 73 Harv. L. Rev. 692, 694-695 (1960).)

Constitutional challenges to retroactivity have more often occurred in the context of legislation than in regulations. The Supreme Court has frequently sustained retroactive statutes where on balance the retroactive operation of such statutes is not considered unreasonable. (See Hochman, The Supreme Court and the Constitutionality of Retroactive Legislation, 73 Harv. L. Rev. 692, 694 (1960).) Indeed such statutes are entitled to the same presumption of validity as is other Federal legislation. (See Usery v. Turner Elkhorn Mining Co., 428 U.S. 1 (1976).)

Moreover, the strong public interest in the smooth and efficient functioning of Government has been a particularly effective counterweight to challenges to retroactive statutes where the statute seeks to remedy defects in the administration of, or the statutes outlining, a regulatory scheme. (See Hochman, supra at 705-706, who observed that "* * * the interest in the retroactive curing of such a defect in the administration of Government outweighs the individual's interest in benefiting from the defect.") Thus, for example, the Supreme Court has rejected a HUD-insured mortgagor's contention that a retroactive provision of the National Housing Act of 1954 prohibiting the use of new or existing federally insured multifamily housing for transient purposes was unconstitutional under the Due Process Clause of the Fifth Amendment. (See Federal Housing Administration v. Darlington Inc., 358 U.S. 84 (1958).) Said the Court:

> "* * * Congress by the 1954 Act was doing no more than protecting the regulatory system which it has designed. Those who do business in the regulated field cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end * * *." (Citations omitted.) (Id. at 91.)

Similarly, the fact that the regulatory scheme is embodied in contracts does not necessarily change the analysis since "Immunity from Federal regulation is not gained through forehanded contracts." (See Fleming v. Rhodes, 331 U.S. 100, 107 (1947).)

We know of no reason why the principles that the Supreme Court has developed to control the analysis of retroactive legislation should not also control the analysis of administrative rulemaking. Although perhaps not entitled to the same presumption of validity that would inure to retroactive legislation (see Davis, Administrative Law Treatise §5.08 (1958)), nonetheless the same framework of analysis should be followed.

An illustrative case, although using the language of an impairment of contracts analysis, is Thorpe v. Housing Authority of the City of Durham, supra, where a HUD circular requiring local housing authorities to give tenants the reasons for eviction supplemented the provisions of existing annual contributions contracts. The housing authority for the city of Durham decried the imposition of this new obligation as violative of the Due Process Clause of the Fifth Amendment. Finding that the circular was reasonably related to the purposes for which HUD's rulemaking was authorized, the Court concluded that the HUD circular impaired no obligation of contract since this only arises "'by a law which renders them invalid, or releases or extinguishes them * * * [or by a law] which without destroying [the] contracts derogate[s] from substantial contractual rights.'" (Id. at 279 quoting from Home Bldg. & Loan Assn. v. Glaisdell, 290 U.S. 398, 431 (1934).)

Stated differently, Thorpe shows that not every law or regulation that upsets expectations is invalid. Rather, the balance between the public's interest in the change and the private interest in the continuance of the status quo must be carefully weighed. As one court has suggested, a "central question" in this balance "is how the challenger's conduct, or the conduct of others in his class, would have differed if the law in issue had applied from the start." (See Adams Nursing Home, Inc. v. Mathews, supra at 1081.) Although HUD's present policy of paying interest from the date of the default without regard to when the mortgagee actually spends his money may be an additional inducement to participate in the program, we do not believe the conduct of mortgagees would differ had the proposed change applied from the start.

Rather, this can be characterized as an incidental aspect of the contract of insurance between HUD and the mortgagee; therefore, its modification would not, we believe, destroy a substantial contractual right. Even assuming that the continuance of HUD's present policy was the essential

inducement to a mortgagee to participate in the program, "it would seem to have nothing to recommend it other than the traditional desire to take advantage of a loophole." (Id.) And, as noted earlier, the mortgagees' expectations must be discounted by the knowledge that they are entering a regulated area where "small repairs" may from time to time be necessary to better achieve the regulatory purpose. Consequently, we feel the public interest in protecting the financial integrity of the insurance funds outweighs any expectations by a mortgagee of the continuation of this windfall benefit.

Potential benefits outweigh cost to make change

Excessive administrative costs were raised as an objection in the Assistant Secretary's testimony before the House Subcommittee on Appropriations. He stated that administratively the techniques to implement the proposed change would be difficult and costly, and the costs would exceed the benefits. In our discussions with officials of HUD's Office of Finance and Accounting, we were told that a complete cost analysis was not made to determine if the proposed change was cost effective.

In June 1978, HUD's Office of General Counsel, based on data provided by the Office of Finance and Accounting, estimated that HUD had paid unearned interest costs of $22 million in the past 5 years based on an estimated average unearned interest cost of $100 1/ per claim. The estimated average is probably conservative, since our review of 93 acquired properties at the Pittsburgh HUD area office showed an average unearned interest charge of about $130. Applying the $130 figure to the claims paid during the 5-year period would show unearned interest costs of $29 million. On the other hand, insurance claims have been decreasing, and in

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1/When we discussed our report with HUD officials, they referred to a more recent estimate showing interest savings of about $80 per claim. However, this estimate is substantially understated because it does not include interest savings related to costs directly associated with the foreclosure sale--that is, attorney and sheriff fees. In the cases we reviewed these costs amounted to about 36 percent of the reimbursable costs claimed by the mortgagees.

fiscal year 1979 only 18,995 were paid. In future years, however, the number of claims could decrease or increase depending on the economy and the housing market. In any event, even based on the number of fiscal year 1979 claims paid, the estimated annual unearned interest would be between $1.9 and $2.5 million, depending on whether $100 per claim or $130 per claim were used.

The Director of HUD's Automated Data Processing Systems Development stated that it would cost about $35,000 to reprogram the computer to compute interest from the date of expenditure. Based on our analysis, the computer reprograming cost is the major cost in implementing the change, and this cost is minimal compared to the millions of dollars in recurring annual savings that could result from making the change.

A concern raised by HUD officials in regard to additional staff needed to supplement the computer changes was whether our proposal intended for HUD to calculate interest on each and every expenditure. The officials stated that a claim could include many small preservation and security expenditures, such as lawn mowings, and if so, calculating interest charges on each expenditure could be time consuming and awkward. We believe that little additional time would be taken by listing each expenditure date since the computer would make the interest calculation. However, if HUD officials still believe this to be a problem, expenses under a certain dollar amount could be lumped together and the expenditures' midpoint date could be used for the interest calculation. The dollar limitation should be periodically reviewed to determine if it is effectively meeting the intended objective of reducing administrative costs while accurately reflecting interest charges.

Another concern raised by HUD officials was whether its computer personnel will be able to incorporate the proposed change in light of the completely new management information system that is currently being developed. The director of the project to develop HUD's new management information system told us that the new system can be readily adjusted to accommodate our proposed change as long as it is considered cost effective. He also stated that it would be advantageous to make such a change before the new system becomes operational.

APPENDIX I

TIGHTER ADMINISTRATIVE CONTROLS NEEDED OVER INSURANCE PAYMENTS FOR REIMBURSABLE EXPENDITURES

HUD was paying mortgagee insurance claims for certain reimbursable costs without adequate justification or assurance that the payments were warranted. We found that because of inadequate supporting documentation and limited and centralized review of mortgage claims, HUD had (1) paid unreasonable costs to preserve and secure HUD-insured vacant properties, (2) erroneously paid mortgagees for fees to inspect properties, and (3) made duplicative property tax payments on HUD-acquired properties. HUD needs to tighten its administrative control over such payments to ensure that mortgagees are reimbursed only for those costs that are proper and justified.

Preservation and security costs being paid without adequate review and documentation

HUD permits mortgagees to claim reimbursement for preservation and security expenses with only the mortgagee's certification that the costs were reasonable and justified. HUD's mortgagee reviews and our discussions with HUD field personnel at seven area offices show a need for better controls over claims made for presevation and security costs.

All HUD insurance claims are reviewed and paid by the Insurance Benefits Division in Washington, D.C. According to the claims processing supervisor, the headquarters staff conducts a limited review of claims to determine if they are valid. No supporting documentation of the costs is required. For some mortgagee expenses, such as property taxes and water/sewage costs, this is sufficient since such amounts are predetermined by utility companies and taxing authorities and passed onto HUD on mortgagee claims. However, mortgagees have direct control over costs incurred to preserve and secure vacant properties.

HUD requires mortgagees to take reasonable action to preserve and protect vacant or abandoned properties until conveyed to HUD. Such actions include securing and boarding up windows and doors, replacing broken glass, protecting plumbing fixtures and other operating systems (winterizing), removing debris from the property, and lawn care. These actions are designed to protect against vandalism and preserve neighborhood appeal.

Mortgagees are required to certify to the necessity and reasonableness of preservation and security costs. However, HUD leaves it up to the mortgagee to determine how the work will be done. HUD area office approval of expenditures is not necessary. In contrast, HUD's administrative controls--when it owns the property--and VA's controls over such payments are more stringent.

Area management brokers under contract to manage HUD's acquired properties are responsible for maintaining the properties in a neat, safe, and secure condition. The area broker must obtain area office approval of expenditures in excess of $200. Furthermore, he/she must inspect the work upon completion and document by an inspection report that the work was satisfactorily completed before approving payment. No such controls exist for costs incurred by mortgagees. To the contrary, HUD relies on mortgagees to determine the need and reasonableness of costs incurred to preserve and secure vacant properties. According to the headquarters claims processing supervisor, HUD relies on the mortgagees to certify the costs because of insufficient area office staff to implement controls similar to those used on HUD-owned property as discussed above.

Under the VA loan guarantee program, VA contractors perform preservation and security work, not the mortgagees, if property is vacated after foreclosure. Mortgagees perform the necessary work when properties are vacated before foreclosure. The VA field offices are responsible for evaluating mortgagee claims for preservation and security expenses to determine whether claims are reasonable. According to field office personnel contacted, the reasonableness of a mortgagee's preservation and security expenditures is determined by comparing the mortgagee's cost with VA's cost experience. The Pittsburgh VA loan servicing supervisor stated that about half of the mortgagee claims for preservation and security expenses have been found to be unreasonable and were reduced.

HUD officials we spoke to at the Atlanta, Detroit, New York, and Pittsburgh area offices stated that HUD is paying unreasonable amounts for preservation and security work done by mortgagees or their contractors based on area office knowledge of prevailing local area contractor rates compared to mortgagee claims. Philadelphia, Cleveland, and Chicago officials stated that they did not review mortgagee claims.

Although each of the seven area offices contacted established guidelines on maximum allowable fees 1/ and notified mortgagees of such fees, they 2/ stated that they have little control over the actual expenditures claimed by mortgagees since insurance claims are processed and paid by HUD headquarters. For example, the Pittsburgh area office notified mortgagees in November 1978 that the maximum fees permissible for cleanup of debris was $200--increased to $300 in November 1979. Our review of 35 case files in which claims were made and identified for cleanup fees showed that 23 (66 percent) exceeded that area office maximum allowable fee by over 50 percent. Amounts claimed for cleanup fees were as high as $672. The total claim for cleanup fees was $13,214, of which $5,913 (45 percent) exceeded the maximum dollar limit.

In addition, recent reviews of individual mortgagees by HUD's Cleveland, Chicago, and Detroit area offices and its Office of Inspector General found deficiencies on the part of many mortgagees in administering its property preservation and protection programs, including

--serious deficiencies in contractor work,

--reliance by some mortgagees on only one contractor to perform the preservation and security work,

--failure to obtain the lowest acceptable bidder, and

--ineffective or nonexistent inspection policies to ensure that contractor work is satisfactory and charges are reasonable.

1/The Philadelphia HUD area office set maximum fees for inspecting and securing properties but did not set maximum fees for cleanup costs.

2/Except for the Detroit office, which stated that it can control mortgagee security and preservation expenditures by requiring adequate documentation of costs, such as work orders and inspection reports, and notifying headquarters of unreasonable work.

The Detroit area office, which conducted numerous mortgagee reviews, recommended that the mortgagees inspect the property before and after the contractor work is completed, and prepare and forward to the area office a work order and inspection report along with paid invoices attached to HUD Form 1025--notice of property transfer and application for insurance benefits. HUD officials at the other six offices told us they also favor such a procedure.

In our discussion with HUD headquarters officials, they agreed with the need for such a procedure; however, they believed it was necessary to set a minimum dollar limit so that numerous small expenditures will not have to be reviewed. We agree. A possible minimum dollar amount could be the same as that required for area management brokers--$200. The minimum dollar amount should be periodically reviewed to determine its adequacy in monitoring preservation and security expenditures.

Mortgagees erroneously reimbursed for nonallowable inspection fees and taxes paid by HUD

HUD also needs to review claims more closely and require sufficient documentation to prevent payments for nonallowable costs. Our review of 135 mortgagee claims at the Philadelphia and Pittsburgh area offices showed that:

--Inspection fees totaling $3,369 for 55 claims were paid. Eighteen claims totaling $2,149 (64 percent) were for occupied properties even though HUD's handbook for the administration of insured home mortgages prohibits such reimbursement.

--Taxes totaling $41,347 were paid. Four of these claims included taxes ($1,092) already paid by the HUD area office, and one claim in Pittsburgh showed taxes ($285) being claimed twice.

These erroneous payments were identified only at the Philadelphia and Pittsburgh area offices because we limited our review of the costs to these offices. However, we believe the same problems may exist at other HUD area offices nationwide because of inadequate controls and/or lack of full enforcement of existing controls.

According to the supervisor of HUD's Insurance Benefits Division, inspection fees are to be paid only if the property

APPENDIX I

is vacant. He told us, however, that mortgagee claims and supporting documentation are not always sufficient to determine whether claims for inspection fees are only for inspections made on vacant properties. However, from available data submitted, we determined that HUD paid inspection fees on occupied properties for at least 18 of the 55 claims reviewed which showed inspection fees. 1/

In regard to taxes already paid by the area office, the HUD supervisor stated that the Insurance Benefits Division has no way of determining that taxes were already paid. By June 1976, HUD phased out headquarters' responsibility for tax payments on HUD-owned properties and transferred such responsibility to the area office. Mortgagees were instructed to list all taxes paid on the notice of property transfer (HUD Form 1025) sent to the area office. Any taxes due after the submittal date were to be paid by the area office. However, the HUD supervisor told us that the division has paid taxes claimed by the mortgagee even though the taxes were not shown on the HUD Form 1025. Thus, when this occurs the HUD area office, believing the taxes were not paid, would also pay the same taxes.

HUD's Pittsburgh area office was the only office of the two reviewed that was making duplicative tax payments. The Pittsburgh area office supervisor stated that his office was unaware of the double tax payments since they were relying on the HUD Form 1025 to identify the taxes paid by the mortgagee. He stated that they will attempt to recover the $1,092 in duplicate payments. According to the HUD supervisor in Philadelphia, they are aware that mortgagees are paying taxes after submitting HUD Form 1025. Therefore, they usually wait until the mortgagee submits his/her claim before paying the taxes. The supervisor stated that it is possible that late charges could be incurred by waiting for mortgagees to submit claims, but he believes it is preferable to making duplicate tax payments.

1/After reviewing the cases included in our review, HUD officials were concerned over the number of inspections performed on some of the properties. The officials told us that they planned to provide our case examples to HUD's Office of Inspector General to determine if any of the mortgagees had made fraudulent inspection claims.

In order to avoid duplicate tax payments, we believe HUD needs to reemphasize to its area offices and mortgagees its instructions that mortgagees not pay taxes due after the HUD Form 1025 has been submitted to the field office. Also, the Insurance Benefit Division should be instructed to delete any such taxes from the mortgagee's insurance claim.

RECOMMENDATIONS

In order to reduce losses to the insurance fund and to improve administrative controls over payments from the fund, we are recommending that the Secretary of HUD:

1. Revise HUD regulations and procedures to require that interest paid on mortgagees' insurance claims be calculated from the date the expenditures are made rather than from the date of default.

2. Establish a minimum dollar amount for preservation and security work that, if exceeded, would require the mortgagees to

   a. have the property inspected before and after the work is performed to ensure that the work is justified and satisfactorily completed and

   b. submit the inspection reports, along with the paid invoices for the work, to the HUD area offices for review and approval before HUD reimburses the mortgagees for the work.

3. Require mortgagees to submit documentation providing assurance that fees claimed are for allowable expenses, and emphasize to the staff responsible for reimbursing mortgagees that claims for inspection fees on occupied properties are not allowable under HUD procedures.

4. Reemphasize to all HUD area offices and mortgagees that HUD will not reimburse mortgagees for taxes paid after the date the mortgagee submits the notice of property transfer and application for insurance benefits (HUD Form 1025). Also, the staff responsible for reimbursing mortgagees should be instructed not to pay mortgagees' claims for taxes that do not appear on HUD Form 1025.

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