REPORT TO THE SUBCOMMITTEE ON LEGAL AND MONETARY AFFAIRS 09596
COMMITTEE ON GOVERNMENT OPERATIONS 74-0475
HOUSE OF REPRESENTATIVES

Improvements Needed In The Overall Management Of HUD—Held Multifamily Mortgages B-114860

Department of Housing and Urban Development

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

MARCH 14, 1974

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114860

The Honorable William J. Randall
Chairman, Legal and Monetary Affairs
Subcommittee, Committee on
Government Operations
House of Representatives

Dear Mr. Randall:

Pursuant to your request of May 16, 1973, we reviewed the Department of Housing and Urban Development's management of its portfolio of assigned multifamily mortgages.

We orally presented the results of our work on October 25, 1973. As requested by your office, we are forwarding by separate transmittal detailed summaries of information we developed on five of the six projects which were included in our review. This report shows a need for the Department to strengthen its administration of its portfolio of assigned multifamily mortgages.

As you requested, we did not obtain written comments from the Department or project officials on the matters discussed in this report. However, during our review we discussed these matters with agency and project officials and incorporated their views in the report where appropriate.

As agreed, a copy of this report is being furnished to the Department, and we will advise you of the actions taken or planned by the Department as a result of the recommendations in the report.

Also, as agreed, copies of the report are being sent to the Chairmen of the House and Senate Committees on Government Operations and on Appropriations, and to the Director, Office of Management and Budget.

We plan to make no further distribution of this report unless you agree or publicly announce its contents.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

Contents

ABBREVIATIONS

GAO	General Accounting Office
HUD	Department of Housing and Urban Development
MAI	Member American Institute of Real Estate Appraisers
MNA	mortgage notes assigned
PMM	purchase money mortgage

COMPTROLLER GENERAL'S REPORT TO THE SUBCOMMITTEE ON LEGAL AND MONETARY AFFAIRS COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

IMPROVEMENTS NEEDED IN THE OVERALL MANAGEMENT OF HUD-HELD MULTIFAMILY MORTGAGES
Department of Housing and Urban Development B-114860

DIGEST

WHY THE REVIEW WAS MADE

At the request of the Subcommittee Chairman, GAO reviewed the Department of Housing and Urban Development's (HUD's) management of its portfolio of assigned multifamily mortgages, giving specific consideration to

--total outstanding indebtedness on mortgages and extent of delinquencies;

--adequacy of techniques developed by HUD for verifying a mortgagor's certification of rents and expenses;

--factors HUD considers in foreclosing mortgage loans; and

--suggestions for improving of HUD's management of its portfolio of multifamily mortgages. (See app. I.)

FINDINGS AND CONCLUSIONS

HUD insures mortgage loans made by private lending institutions on various types of housing, including multifamily rental housing projects. In mortgage defaults, mortgagees may acquire the deeds through foreclosure and convey titles directly to HUD for full insurance benefits or assign the mortgage to HUD and forfeit 1 percent of the outstanding principal.

As an assignee of a defaulted mortgage, HUD may

--hold the mortgage and give the mortgagor an opportunity for reinstatement or

--proceed with acquisition of the property title through foreclosure.

As of March 31, 1973, HUD held mortgage notes for 1,098 multifamily projects with outstanding principal balances of about $1.2 billion.

Since June 30, 1970, the portfolio of HUD-held mortgages had increased from 769 projects. Of the 1,098 mortgages, HUD records showed that 518 were current and 580 were delinquent. The outstanding principal balances for the delinquent mortgages was about $833.1 million. The delinquency for 528 of these mortgages was about $81.1 million.

GAO could not determine from HUD records the delinquent amount for the other 52 mortgages.

When defaulted HUD-held mortgages are placed under a reinstatement plan, HUD guidelines specify that cash received by the project from any source must be deposited in the project account and that disbursements must be confined to the payment of reasonable and necessary expenses for the actual physical operation of the project.

Tear Sheet. Upon removal, the report cover date should be noted hereon.

MARCH 14, 1974

HUD's field offices are required to service HUD-held mortgages extensively. Servicing primarily includes a review of the payment record and the financial accounting reports and physical inspections of projects under workout arrangements at least every 6 months to identify maintenance neglect and general project deterioration.

Field offices must also insure that receipts and disbursements are proper. To carry out their responsibilities, the field offices may request HUD's Office of Audit to audit projects' activities.

GAO examined selected activities of 15 projects. The major portion of GAO's review was directed to cash receipts and disbursements at six of these projects. For four of these plus two others, GAO examined HUD's administration of the workout arrangements. For seven additional projects, GAO reviewed the factors HUD considers in recommending foreclosure.

GAO's review disclosed problems indicating that the return on the Government's investment in multifamily mortgages obtained through assignment had been reduced and will result in substantial future losses unless corrected.

Controls over the receipt and disbursement of project funds are inadequate

GAO's review of the financial transactions of six projects with HUD-held mortgages--consisting of 2,453 rental units and one 500-bed nursing home--showed that HUD's field offices were ineffective in exercising control over project receipts and disbursements. Funds belonging to projects or under their control for the benefit of project occupants were not being properly accounted for after receipt and subsequent deposit into project accounts. Moreover, the lack of specific criteria defining the type of expenditures that are reasonable and necessary is resulting in the disbursements of funds for expenses not related to the actual operations of projects. For example, the owner of one project withdrew about $38,000 of project funds and used them to pay several personal notes which were not project debts. The owner of another project withdrew about $39,000 of project funds for his personal use. Under the reinstatement provision, these funds should have been returned to HUD and applied against the outstanding mortgage delinquencies.

GAO also found that management fees, which are paid by project funds, were excessive during the reinstatement period of mortgages. In addition, certain administrative expenses, which should have been paid from the management fee, were paid from project funds. In some cases the fees were improperly computed. (See p. 13.)

Inadequate monitoring by HUD

The servicing of eight HUD-held multifamily mortgages GAO reviewed in five field offices--Dallas, Fort Worth, Los Angeles, Phoenix, and St. Louis--was minimal. HUD area and insuring offices had not reviewed payment records and monthly financial reports of receipts and disbursements as required, and audits were not conducted to verify receipts and disbursements of funds. HUD's Office of Audit conducted audits of the projects only at the request of HUD headquarters or the field offices. (See p. 22.)

Lengthy workout periods were not improving financial condition of mortgages

HUD allowed the workout arrangements for five of the six mortgages GAO reviewed to continue for lengthy periods although no substantial progress had been made by the mortgagors to reduce delinquent interest, taxes, and service charges. One project was able to liquidate the entire interest, tax, and service charge delinquency. For three of the other five projects, interest, taxes, and service charge delinquencies increased about 32 percent, 183 percent, and 214 percent above the approximate balance delinquent at the start of the workout period. Reductions were made in the delinquencies on the remaining two projects over very lengthy workout periods. (See p. 26.)

Factors considered in foreclosing mortgage loans

GAO's examination of project records in three HUD field offices did not identify specific factors considered in foreclosure recommendations. HUD field office officials advised GAO that each project and the problems it was experiencing were unique; therefore, there were no specific factors which they consistently considered in determining whether to foreclose a mortgage loan. Generally, foreclosure was a last resort action resulting from the project owner's complete disregard of his financial obligation.

Some of the views expressed by HUD officials as to why foreclosure may not be appropriate follow.

--In inner-city areas where the market value of properties has declined below the mortgage loan values, a large loss would result from resale of the property.

--HUD field offices do not have the capability to manage extremely large projects.

--HUD policy governing the reinstatement of defaulted HUD-held mortgages precludes foreclosure when the project owner agrees to a plan of reinstatement designed to upgrade the property and agrees to resume total mortgage payments within a reasonable period of time.

--Decisions to foreclose subsidized projects raise serious social considerations in that, after foreclosure, assistance payments to tenants are terminated by law and tenants may be required to pay rent at a market rate or leave the project. (See p. 29.)

RECOMMENDATIONS

GAO recommends that the Secretary of HUD require a comprehensive evaluation of the projects discussed in this report to insure that the weaknesses noted at the six projects are corrected and that all disbursements of project funds are appropriate.

GAO also recommends that the Secretary strengthen the overall administration of HUD-held project mortgages by issuing regulations providing uniform guidance to the field offices. Such regulations should

--provide criteria for establishing management fees and define expenses to be covered as part of these fees,

--list the types of expenditures eligible for payment from project funds when a project is in default,

--require project owners to certify to the accuracy of their monthly accounting reports subject to the penalties of 18 U.S.C. 1001, and

--reemphasize the need for frequent monitoring and servicing by field offices and encourage field offices to make greater use of the Office of Audit.

GAO recommends that HUD officials be required to discontinue workout arrangements and seek other alternatives when it becomes apparent that the arrangements will not achieve timely reinstatement. (See p. 31.)

AGENCY COMMENTS

As requested by the Subcommittee, GAO did not obtain written comments from HUD. GAO did, however, discuss the matters in the report with HUD and project officials, and their views have been incorporated in the report.

CHAPTER 1

INTRODUCTION

The Chairman, Legal and Monetary Affairs Subcommittee, House Committee on Government Operations, requested us to review (see app. I) the Department of Housing and Urban Development's (HUD's) management of its portfolio of assigned multifamily mortgages (HUD-held mortgages), giving specific consideration to such matters as

--the total outstanding indebtedness on the mortgages and the extent of the delinquencies;

--the adequacy of the techniques developed by HUD for verifying a mortgagor's certification of rents and expenses;

--the factors considered in foreclosing mortgage loans; and

--suggestions for improving of HUD's management of its portfolio of multifamily mortgages.

BACKGROUND

The National Housing Act, as amended (12 U.S.C. 1701), allows HUD to insure mortgage loans made by private lending institutions on various types of housing, including multifamily rental housing projects. Parties to a multifamily mortgage insurance transaction are the mortgagee (the lender), the mortgagor (the project owner), and HUD.

The mortgagor's functions and responsibilities, and provisions for HUD's control of project operations, are set forth in either the regulatory agreement, the corporate charter, or the trust agreement.

The regulatory agreement is the document most commonly used by HUD. It is an agreement between HUD and the project owner (an individual, partnership, corporation, or trust) in which the project owner, in consideration of an insured mortgage, consents to HUD's regulation of rents, rate of return, and methods of operation.

If an insured mortgage default continues for 30 days, HUD requires the mortgagee to notify HUD in writing within a 30 day period. Mortgagees have 45 days thereafter (30 days for insurance written before August 13, 1954) to notify HUD of their intent to acquire title to the property or assign the mortgage note to HUD.

Under the mortgage insurance contract, the mortgagee may acquire the deed through foreclosure and convey the title directly to HUD for full insurance benefits or may assign the mortgage directly to HUD and forfeit 1 percent of the unpaid principal. The lengthy and expensive foreclosure process in most States influences a mortgagee in most cases to assign the mortgage to HUD.

There are two courses of action available to HUD as assignee of a defaulted mortgage. It can

--hold the mortgage and give the mortgagor an opportunity to work out his financial difficulties and subsequently reinstate the mortgage or

--proceed with acquisition of the property title through foreclosure.

Under the first course of action, HUD uses various plans to reinstate the defaulted mortgages. These plans include informal forbearance, modification of the mortgage, and a workout arrangement.

Informal forbearance is used when no more than two installments are due and the reasons for default are beyond the mortgagor's control. The contributing conditions of the default should be temporary.

When a mortgagor is prepared to resume mortgage payments--and service charges, interest, and escrows are current--the mortgage can be modified to spread the delinquent principal over the remaining term of the mortgage. Under HUD's policy, a modification to a mortgage is approved only when an orderly liquidation of the mortgage obligation is foreseeable.

A workout arrangement offers delinquent mortgagors maximum financial relief. The monthly workout payment is equal to the sum of monthly service charges (HUD's servicing fee), interest, and taxes plus an agreed-upon fixed dollar amount to be applied against delinquent interest. If the net cash balance in the project checking account at the end of the previous month is greater than the workout payment, this amount is to be paid to HUD.

The monthly payment under a workout arrangement depends on the project's financial condition. For example, a project experiencing serious occupancy problems may be required to pay monthly installments in an amount sufficient to meet only service charges and tax escrows.

HUD headquarters officials informed us that workout arrangements

- --establish a floor or minimum payment, for a stated period;
- --reinforce or bring back the mortgagor's payment habit;
- --provide a mechanism for demanding regular monthly accountings and identifying and capturing net cash from the previous month; and
- --curb further increases in interest so that the mortgage can be modified by spreading the delinquent principal balance over the remaining life of the mortgage.

Workout arrangements are intended to be used when the financial difficulties are related to a temporary condition of the project which can be cured and eventually allow the project to pay full mortgage installments. Examples of these conditions are slow initial rental of project units, a depressed local economy which is expected to reverse, and poor management which can be corrected.

Although HUD guidelines require that delinquent service charges, interest payments, and deposits to escrows for payment of taxes must be made current at the inception of the workout arrangement, certain exceptions may be granted that allow a mortgagor to make the interest and service charge accruals current over a period.

Workout arrangements do not usually provide a specific expiration date and may be continued on a month-to-month basis at HUD's election. HUD's policy requires, however, that it conduct a complete analysis of the mortgagor's performance, including a review of his payment record, maintenance and operating programs of the project, and local conditions affecting the demand for rental housing at least every 6 months. Continuation of the arrangement should depend upon favorable findings.

HUD headquarters officials advised us, however, that workout arrangements are sometimes extended or renewed when required monthly payments are not being remitted. Under these circumstances, an extension or renewal is granted if project conditions show that the mortgage can be reinstated. Such extension or renewal is influenced by considering:

- --current trends of occupancy and project income;

--the type of project ownership (few, if any, nonprofit sponsored projects have any source of additional outside funds);

--the reasons for financial difficulties, such as rising local taxes or a depressed or overbuilt local market; and

--the cooperation of the project owner in all respects other than ability to pay.

Field offices are required to list one or all of these factors in recommendations for extensions or renewal. HUD headquarters officials stated that in other instances delinquent mortgages are also continuously held under a workout arrangement because HUD's decision to initiate a foreclosure action could have an adverse effect on the local community during a particular period and because serious social considerations are involved in the decision to foreclose subsidized projects. (See p. 30.)

Under the second course of action available to HUD as assignee of a defaulted mortgage, HUD can acquire title to the property through foreclosure or through voluntary conveyance by deed in lieu of foreclosure.

After acquiring title to properties, HUD generally absorbs any operating losses and attempts to resell the properties. Losses from the sale of 46 properties during the first 9 months in fiscal year 1973 amounted to about $12.5 million. The average loss amounted to about 19 percent, or $2,539 per rental unit.

HUD PROGRAMS

The six projects with HUD-held mortgages included in our detailed review of receipts and disbursements of funds were assisted under sections 207, 220, 231, and 232 of the National Housing Act, as amended (12 U.S.C. 1713, 1715k, 1715v, and 1715w).

Rental housing

Under section 207, HUD insures privately financed loans for rental housing that serves the needs of a broad section of the rental housing market. The insured projects should provide rental accommodation suitable for family living and should be available at reasonable rents.

Urban renewal housing

Under section 220, HUD insures mortgage loans for new or rehabilitated single-family or multifamily structures located in areas receiving assistance under HUD's conventional urban renewal, concentrated code enforcement, and disaster rehabilitation programs.

Elderly housing

Under section 231, HUD insures mortgage loans to finance new or rehabilitated rental housing projects of eight or more dwelling units specifically designed for occupancy by the elderly or the handicapped.

Nursing homes

Under section 232, HUD insures mortgage loans for constructing or rehabilitating facilities accommodating patients requiring skilled nursing care and related medical services or needing minimum but continuous care by trained or licensed personnel. Before HUD can insure a mortgage on a nursing home or intermediate care facility, the appropriate State agency must certify that the facility is needed and that reasonable minimum licensing and operating standards are being applied.

PROGRAM ADMINISTRATION

HUD-held mortgages are managed at the headquarters and field office levels. The Assistant Secretary for Administration is responsible for preparing the billings for monthly payments and various types of affidavits containing fiscal data needed by a U.S. attorney's office in foreclosure proceedings. HUD's Assistant Secretary for Housing Management, with the assistance of area and insuring offices, is responsible for negotiating with mortgagors and approving modification and workout arrangements.

Each HUD regional administrator is responsible for the program in his region. The HUD area and insuring offices within the region carry out the day-to-day administration of HUD-held mortgages. The responsibility of the area and insuring offices with respect to servicing HUD-held mortgages includes analyzing project financial statements, conducting reviews and inspections of project operations, and recommending reinstatement and foreclosure actions. To carry out their responsibilities, HUD headquarters and field offices may request HUD's Office of Audit to perform audits of the activities of projects. Because of policy and legal considerations involved in the conveyance of title to properties and the assignment of mortgages to the Secretary, final decisions are rendered by HUD headquarters. Usually, HUD's headquarters decisions are based on the analysis and recommendations of the field offices.

CHAPTER 2

NEED TO STRENGTHEN MANAGEMENT

OF HUD-HELD MULTIFAMILY MORTGAGES

We examined selected activities of 15 projects. The major portion of our review was directed to cash receipts and disbursements of six of these projects. For four of these plus two others, we examined HUD's administration of the workout arrangements. For seven additional projects, we reviewed the factors HUD considers in recommending foreclosure.

Our review disclosed problems indicating that the return on Government investment in multifamily mortgages obtained through assignment had been reduced and will result in substantial future losses unless corrected. The following specific weaknesses were noted and are discussed in subsequent sections of this chapter.

--Controls over the receipt and disbursement of project funds were inadequate.

--HUD has not adequately monitored the financial activities of defaulted projects in that (1) area and insuring offices have not reviewed payment records and monthly financial reports of receipts and disbursements as required and (2) audits have not been conducted to verify receipts and disbursements of funds.

--Workout arrangements have been allowed to continue long after it has become apparent that they are not successful.

HUD-HELD MORTGAGES

As of March 31, 1973, HUD held mortgage notes for 1,098 multifamily projects with outstanding principal balances of about $1.2 billion. Since June 30, 1970, the portfolio of HUD-held mortgages had increased from 769 projects. Of the 1,098 mortgages, HUD records showed that 518 were current and 580 were delinquent. Of the delinquent mortgages, 136 were under workout arrangements, 225 were in default and not under any kind of reinstatement plan, and 219 were in foreclosure. The outstanding principal balances of the delinquent mortgages was about $833.1 million. Of the 580 mortgages which were delinquent, 50 were purchase money mortgages (PMM) and 530 were mortgage notes assigned (MNA).[1] The delinquency for 528 of these mortgages was about $81.1 million. At the time of our review, HUD had not determined the amount of the delinquency for the remaining 52 mortgages.

Some of the underlying causes cited by HUD field offices for insured mortgages going into default were (1) low occupancy and (2) overstatement of operating income and/or understatement of operating expenses in the original loan application.

Our analysis of the 1,098 mortgages showing the total outstanding principal balance and the mortgage delinquency follows.

HUD-Held Mortgages
March 31, 1973

Type	Number of projects	Unpaid principal balance	Total delinquency
Current MNA	215	$ 165,152,711	-
Noncurrent MNA	479	740,636,824	$77,541,077
Noncurrent MNA	51	30,955,484	(a)
Total MNA	745	936,745,019	77,541,077
Current PMM	303	216,600,500	-
Noncurrent PMM	49	59,644,891	3,535,492
Noncurrent PMM	1	1,889,418	(a)
Total PMM	353	278,134,809	3,535,492
Total	1,098	$1,214,879,828	$81,076,569

[a]Information needed to determine the amount of delinquency was not available.

[1]When HUD sells a multifamily property, the mortgage note received as part of the purchase price is referred to as a purchase money mortgage. An insured mortgage, after it is assigned, is referred to as a mortgage note assigned. In both instances, HUD classifies these mortgages as assigned mortgage notes in their inventory reports.

As a result of aging the 479 MNAs, the delinquent mortgage payments ranged from 1 month at $162 to 92 months at $6.4 million. Likewise, the delinquent payments for the 49 PMMs ranged from 1 month at $1,000 to 63 months at $797,148. The statistical averages--mean, median, and mode--of the months and amounts delinquent are shown in the following schedule.

479 MNAs	Months delinquent	Amount delinquent
Mean	13.6	$161,881
Median	10	61,213
Mode	9	less than $10,000
49 PMMs		
Mean	7	$ 72,153
Median	3	18,284
Mode	1	less than $10,000

CONTROLS OVER RECEIPT AND DISBURSEMENT OF PROJECT FUNDS ARE INADEQUATE

When defaulted HUD-held mortgages are placed under a reinstatement plan, HUD guidelines specify that cash received by the project from any source must be deposited in the project account and that disbursements must be confined to the payment of reasonable and necessary expenses for the actual physical operation of the project. HUD, however, has not defined those expenses considered reasonable and necessary for operating defaulted projects.

We examined the methods HUD uses to control the receipt and disbursement of funds by reviewing selected transactions of six projects to determine whether (1) project income was properly accounted for and deposited into appropriate bank accounts in the name of the project and (2) cash disbursements were made pursuant to the reinstatement provisions of the projects.

Our review disclosed that funds belonging to projects or under their control for the benefit of project occupants were not being properly accounted for after receipt and subsequent deposit into project accounts. Moreover, the lack of specific criteria defining the types of expenditures that are reasonable and necessary had resulted in the disbursement of funds for expenses not related to the actual operations of the projects. Under the reinstatement provisions, these funds should have been returned to HUD and applied against the outstanding mortgage delinquencies.

Receipt and deposit of funds

Cash receipts include cash received from any source--rents collected, repayment of loans, advances received from the owners, borrowed funds, and proceeds of sales of project assets.

The deficiencies disclosed in our review of cash receipt transactions and the number of projects in which these deficiencies occurred follows.

Type of deficiency	Number of projects in which the deficiency occurred
Inadequate controls over writeoff and collection of doubtful accounts receivable	2
Inadequate controls over collection and deposit of rental receipts	1
Inadequate controls over:	
Trust funds	1
Security deposits	2
Loss of control over project funds during the sale of the project	1
Inadequate control over the recording of project income	1
Funds not deposited in project account	2
Books and records not maintained in reasonable condition for audit or for accurately showing the results of operations	1

One or more of the deficiencies shown above existed at each of the six projects examined.

Although the regulatory agreement between the project owner and HUD requires that the project's books and accounts be kept current, complete, and accurate with frequent postings made to the ledger accounts, we could not complete all phases of our audit at one project because the project management did not maintain complete and accurate accounting records. Erroneous entries were recorded in the cash receipts journal and checks and cash were manipulated to force agreement in the total between the bank deposit and the cash receipts journal. In addition, daily cash receipts from the cafeteria were not deposited intact and unreasonable delays occurred in depositing cash receipts.

Because the project's accounting records did not show a liability for certain trust funds or security deposits, there was no control to assure that funds were deposited in the project account. For example, we found an envelope in a filing cabinet containing cash and checks. When brought to the attention of project officials, a deposit of $6,416.93 was made to the trust fund account. The funds had been placed in the envelope by project employees. In addition to the cash found in the envelope, some of the checks had endorsements which made them negotiable. One check had been received in December 1972, 8 months before being deposited.

At another project, the owner ceased making the mortgage payments to HUD required under the workout agreement in October 1972. HUD's billing statements and the workout agreement showed that he was required to pay HUD about $272,338 during the period November 1, 1972, through March 31, 1973. Our review of the monthly cash receipts and disbursements disclosed that the project account had accumulated funds during this period and, as of March 31, 1973, the balance totaled $89,924. These funds could have been used to reduce the balance owed to HUD. However, HUD did not attempt to collect the workout payments until April 1973 when the insuring office notified the owner that delinquent amounts should be paid.

When HUD accepted an offer of $4.6 million for the sale of the mortgage note on this project in March 1973, the purchaser agreed to establish a "new" project checking account and deposit therein rentals collected after March 31, 1973. The account was established, and since that time rentals have been deposited in that account. We found no evidence of an agreement or understanding between the project owner, the purchaser, or HUD to insure that funds remaining in the "old" account ($89,924) would be turned over to HUD and applied against the delinquent mortgage.

In June 1973, HUD informed the purchaser that he was required to make mortgage payments of $39,402 a month (covering current interest, tax, and servicing fee accruals) from April 1, 1973, to the eventual closing date of the sale. The monthly payment and a supplemental payment of $15,347 a month (to be applied against delinquent interest) represented the mortgage payment which the owner was obligated to make under the previous workout agreement. Although the purchaser should have been required to make the supplemental payment, HUD failed to include this requirement in the new agreement.

The purchaser paid HUD $157,553 for the period April through July 1973. During this same period, $61,388 in supplemental payments would have accrued under the previous workout agreement. A HUD headquarters official advised us that, although the purchaser should have been required to make these supplemental payments in the June 1973 agreement, HUD cannot now demand payment. At the time we completed our field work, the sale of this property had not been finalized.

In two other projects, doubtful accounts receivable were written off by the projects without a reasonable collection effort. In one of these projects, an owner also owned an interest in a commercial business that leased space from the project. The project records showed that about $161,000 past-due accounts receivable were written off the project books for this space. Officials of the projects agreed to take action to collect this and other past-due accounts after we brought them to their attention.

Disbursement of funds

Cash disbursements include moneys paid out, disbursed or distributed to persons or entities for any purposes. Some of the more significant deficiencies noted during our review of cash disbursement transactions were unauthorized withdrawals of project funds, allowance of excessive management fees, improper computation of management fees, and project funds were used to pay expenses which should have been paid by project managers from management fees received.

Funds withdrawn from project while mortgage loan was being reinstated

In five of the six projects, funds were withdrawn from the project account without HUD's approval. These withdrawals violated the terms of the projects' reinstatement plans and regulatory agreements.

In one project, about $1,000 monthly was paid to a former owner. In another project, the present owner withdrew about $39,361 from the project account for personal use.

In a third project, about $26,050 was withdrawn in May 1973 from the project account and used as part of the owner's cash payment of $625,000 as a settlement on the outstanding balance of the mortgage loan. The funds withdrawn were accumulated in the project account from August 1972 to May 1973, and we believe these funds should have been paid to HUD under the workout agreement existing during this period. An additional $10,000 accumulated in the project account during the same 9-month period was withdrawn and deposited in a savings account for the purpose of paying interest on bonds sold to raise funds for the purchase of the project. These funds also should have been paid to HUD under the workout arrangement.

In a fourth project, the owner had written checks totaling $100,953.53 which were apparently intended for his personal use. Local HUD officials were not aware of these withdrawals until we brought them to their attention in September 1973. The first check, dated December 28, 1972, was written for $38,300.25 in favor of a local bank. The project records did not indicate that the funds were used for project purposes. The owner informed us that he used these funds to pay several personal notes which were not project debts. We brought this matter to the attention of HUD officials who agreed to take action to ensure that the funds were returned. The second and third checks, dated February 8, 1973, were written for $60,000 and $2,653.28, respectively. These checks were deposited in the project owner's personal bank account and later converted into cashier's checks. The cashier's checks were deposited 4 days later in the project operation account.

Management fees

Our review disclosed that management fees, which are paid by project funds, were excessive in two projects during the reinstatement period. In addition, certain administrative expenses, which should have been paid from the management fee, were paid from project funds. In some instances we found that the fees were improperly computed.

HUD guidelines provide that, when management firms are hired to operate projects, the paying of management fees is permissable at the accepted rate in the project's locality. In addition, these guidelines provide that the compensation, including fringe benefits of the resident manager, social services director, and all bookkeeping, clerical, and other managerial personnel should be borne solely by the management agent. Furthermore, all bookkeeping, clerical, and other management overhead expenses, including but not limited to the costs of office supplies and equipment, data processing services, postage, transportation for managerial personnel, and telephone services, unless otherwise provided for in the agreement, should be borne by the management agent out of his own funds. The management agreement must be submitted to HUD for approval.

Although HUD guidelines are very specific as to the expenses to be covered by management fees when a project is managed by an outside management firm, it is not clear whether these guidelines apply to a situation where the owner also serves as project manager.

In one project, the management agreement for the firm hired to manage the project, dated February 1, 1973, allowed a fee of 6 percent of gross collections of the project plus an administrative fee equal to 15 percent of gross project payroll for the preceding month. We found that the management fees for similar projects in this area ranged from 2.3 percent to 5 percent.

HUD headquarters officials advised us that they were not aware of any approval of the management agreement, and they were not aware that the agreement contained the 15 percent payroll charge. The prior management agreement had not included the 15 percent provision. They further advised us that they would not have allowed such a provision in the present agreement. Under the 15 percent provision, $42,374.90 was paid through June 30, 1973.

In addition to the fee paid on the basis of project payroll, beginning in June 1973, a fee of about $2,359 was paid based on 15 percent of the cost of guards, janitors, and maids for a 3-week period. These services have been furnished by an outside contractor since October 1972. The project manager contends that this is a proper charge since these contractor personnel are assigned to the project full time. On an annual basis, this fee would amount to about $41,000. We believe that it is not a proper charge, in that it is based on contractual services rather than gross project payroll.

Our review of project records showed that about $27,000 was overcharged under the 6 percent provision of the agreement through June 30, 1973. The overcharge occurred because the management fee was computed on total end of the month accounts receivable balances rather than actual collections for the months of August 1972 through January 1973 and on gross collections of parking garage operations. In May 1973, HUD advised the project that the method of fee computation in these instances was improper, but the management has continued to compute the fee on gross parking garage collections.

The management firm disagreed with our computation and maintained that the overcharge was only about $5,546. HUD headquarters officials informed us that collections from the parking garage should not have been considered in the fee computation because it was a contracted service.

We also found that project funds were used to reimburse a certain portion of the management firm's payroll costs which should have been covered by the management fee. The funds were to reimburse the firm for 47 percent of the total payroll costs incurred at the firm's two business offices. This charge is not contained in the management agreement. Officials of the firm advised us that they allocate their total payroll costs to all projects they manage based on the number of units in each project. They further advised us that they manage several projects with HUD-held mortgages from offices located in the project and in another city. They began charging these costs to the project in January 1973. Through June 30, 1973, these charges have amounted to about $12,148. Based on the management firm's June 24, 1973, payroll, they would collect about $37,000 annually from the project. HUD headquarters officials told us that this charge was also improper. We advised these officials that the management firm could also be collecting similar benefits from other HUD projects which they manage.

The management firm and its officials have received other benefits from the project. The firm:

--Occupies office space in the project rent free. The office space which should rent for $750 a month is also occupied by the project general manager. The portion of the $750 applicable to space used by the general manager would be properly chargeable as a project expense.

--Uses project telephones, including long distance service, at no cost. The telephone bill paid in May 1973 included long distance calls costing $637.40.

--Provides six of its officials with rent free apartments.

Our review also disclosed that project funds were used to pay the salaries and expenses of the project manager, comptroller, and clerical staff, and all bookkeeping, clerical, and other management expenses although HUD guidelines require that these costs be borne by the management firm.

Our review of another project disclosed that the project owner performed the management services for an annual fee of about $50,000. We questioned the payment of a fee of this magnitude since the mortgage loan is seriously delinquent and is being reinstated under a workout agreement. HUD guidelines governing workout agreements state that it is desirable for a project owner performing management services to forego the collection of a fee as an evidence of good faith while the mortgage is being reinstated under a workout agreement. Moreover, HUD requires its field offices to encourage this practice.

We found no evidence in the HUD records indicating that the project owner was asked to forego a management fee during the workout period. HUD records did not indicate the rationale used in allowing a fee of this amount; however, HUD officials at the headquarters and insuring office agreed that under the circumstances the fee was very large.

Because the project owner was also manager, HUD did not require a written management agreement. Instead, HUD allowed the owner under the provisions of the workout agreement, to collect a management fee of 5 percent of gross income, which amounted to about $164,888 from January 1970 through March 1973. The agreement did not specify the types of services or expenses to be covered by the fee or the method of computing the fee.

HUD approved the fee in the workout agreement without including a provision for the normal and usual costs of managing the project. The following expenses for the 3 years ended December 31, 1972, amounted to $72,198 and were paid from project funds rather than from the management fee: office salaries, $38,306; office expenses, $9,248; telephone and telegraph costs, $17,006; and miscellaneous expenses, $7,638. HUD guidelines for projects managed by outside firms specifically excludes the payment of these expenses from project funds.

Other expenditures

Other expenditures noted in our review which were either not authorized by HUD or appeared questionable for project mortgages undergoing reinstatement included legal and auditing fees; repairs and capital improvements; advertising expenses; contributions; and several miscellaneous items involving expenses incurred by project owners and employees.

For example, in one project, funds in the amount of $1,875 were used to pay for auditing services performed for the benefit of the project owner. The payment for these services was not authorized by HUD. We were advised by the project's management that $375 was reimbursed to the project account.

In another project, $2,500 was paid to one of the project owners in December 1972 for real estate and financing services. According to the project accountant, these expenses were in payment for services over a 2-year period involving efforts to get three of the project's creditors to settle for something less than the full amount of a debt, preparation of financial projections on the project, and attempts made to locate sources of funds for refinancing the project.

HUD guidelines state that disbursements during workout should apply to actual physical operation of the project as opposed to strictly administrative expenses pertaining to corporate or financial arrangements and rearrangements. Area office officials, however, said they had not questioned the propriety of these expenditures.

In addition, we noted several situations as discussed below where the area office had recommended that project expenses could have been reduced or eliminated with little or no effect on project operations. However, at the time of our review 2 years later, no action had been taken by the project.

1. At one project, the HUD area office had recommended in September 1971 that an infirmary maintained by the project be closed. The infirmary was incurring losses of about $22,000 a year and was not meeting minimum nursing care requirements. The infirmary was still operating at the time of our review.

2. The area officials found that the administrative staff of six individuals could be reduced to three. In addition, a computer service was duplicating work by the administrative staff and could be discontinued. The area office estimated that these actions would reduce administrative expenses by about $21,000 annually. However, at the time of our review the project had not implemented these changes.

3. The expenses incurred by the project for providing bus and automobile service for residents amounted to approximately $3,000 a year. The area office had recommended that these services be discontinued. At the time of our review, the project had not discontinued these services.

INADEQUATE MONITORING BY HUD

HUD's field offices are required to extensively service HUD-held mortgages. Servicing primarily includes a review of the payment record and the financial accounting reports and physical inspections of projects under workout arrangements at least every 6 months to identify maintenance neglect and general project deterioration. The field offices must also insure that receipts and disbursements are proper. To carry out their responsibilities, the field offices may request that HUD's Office of Audit audit projects' activities.

In the five field offices included in our review--Dallas, Fort Worth, Los Angeles, Phoenix, and St. Louis--the servicing of mortgages of the projects we examined was minimal and generally not performed in accordance with these requirements. HUD's Office of Audit conducts audits of defaulted multifamily projects only at the request of HUD headquarters or field offices.

HUD field offices exercise control over funds by monitoring a monthly financial report of receipts and disbursements, annual statements of income, and certified financial statements. The field offices are required to make prompt analysis and examination of the financial reports to insure that all disbursements are for necessary and reasonable expenses actually related to the project's physical operations. Even if criteria is established defining the types of disbursements that are reasonable and necessary, we believe that HUD field offices must intensify their monitoring of defaulted HUD-held mortgages to insure that available funds are returned to HUD.

The owners of two projects filed timely monthly accounting reports of cash receipts and disbursements during most of the workout periods; however, the field offices did not enforce the payment provisions of the arrangements. In addition, the most recent physical inspection of these projects was in October 1969. Officials in one field office said that, although required, the inspections were not made because of personnel shortages.

In a third project, we found that physical inspections were not performed every 6 months as required and that cash receipts and disbursements reported in monthly financial reports were not reviewed by the area office staff.

In a fourth project, we also found that the area office did not make physical inspections of the project every 6 months as required and HUD headquarters had to threaten foreclosure to encourage the project to make the workout payments. The workout payments were brought current in July 1972 after HUD headquarters initiated foreclosure. In August 1972 the foreclosure action was withdrawn and the workout period extended through October 1972.

In a fifth project, we noted certain practices which the HUD insuring office would have recognized had mortgage servicing been adequate.

--One of the project owners, a certified public accountant, made the annual project audits and prepared the certified statements. Such a conflict of interest is not authorized under HUD guidelines. His relationship with the project was disclosed in a disclaimer statement in the report.

--Monthly payments from October 1972 to March 1973 were not made.

--Monthly accounting reports were not submitted during the period August 1972 through March 1973.

The insuring office made physical inspections of the project in August 1971 and June 1972. The inspection in June 1972, in connection with the mortgagor's request for a modification of the existing workout arrangement, prompted the office to recommend (1) an audit of project financial operations, (2) an economic study comparing the project with other projects in the area, (3) a feasibility study to develop a workable expenses-rental structure, and (4) a complete appraisal of required maintenance and repairs. No further action on the request for workout modification was taken by either HUD or the mortgagor.

In October 1972, HUD questioned the accounting method used by the mortgagor for several items on the financial statements. No reply was received from the project management nor did the insuring office follow-up on HUD's questions.

Insuring office officials responsible for servicing the project said that servicing was inadequate because of the insuring office's workload. After calendar year 1972, the one man servicing staff--handling about 150 multifamily mortgages--was increased to three. The insuring office intends to obtain additional staff until a level of 30 projects per servicer is reached.

HUD does not require the project owners to certify under penalty of law the monthly accounting reports of receipts and disbursements. With this certification, HUD would have a basis to bring charges against project owners under 18 U.S.C. 1001 for any misrepresentation of information.

HUD audit activities

Three of the eight projects included in our review of cash receipts and disbursements and the administration of workout arrangements were audited by HUD's Office of Audit during the reinstatement of their project mortgage.

One project was audited twice by HUD's Office of Audit. The first audit, covering the period January through September 1971, was requested by the area office because of indications that approximately $65,000 in trust funds had been diverted to project operations. The area office director requested current information on the trust funds, an opinion on the reliability of the mortgagor's monthly financial reports, an evaluation of central parking activities and receivables relating to the exchange of apartments for services (trade-outs), and a review of the validity of tenant complaints relating to delays in receiving security deposit refunds.

The report, issued in December 1971, recommended that the mortgagor replenish the trust fund in the amount of about $56,139 and strengthen internal control over tenant and trade-out accounts receivable and security deposits. Also, the report stated that the tenant complaints were justified. Other findings disclosed that hotel and entertainment expenses were unsupported, reports submitted to HUD were incomplete, and trade-out advertising was ineffective.

The second audit, covering the period January 1967 through December 1971, was requested by headquarters officials. The report, issued in August 1972, contained comments and disclosures on revenue and expenses and on funds and benefits received by the general manager and other employees. Although the report stated that from available records a determination could not be made as to whether all expenses were essential to project operations, we found no evidence that HUD requested the mortgagor to provide such support.

An audit was performed at another project for the period April 1969 through March 1972 to determine the financial condition of the project, particularly whether income and expenses were properly accounted for.

Because the project's public accounting firm was making an audit at the same time, HUD's report did not include an opinion on the financial condition of the project. The report included a summary schedule of income and expenses for the fiscal years ended March 31, 1970, 1971, and 1972. This schedule showed a net loss of about $771,596 for the year ended March 31, 1972, and the HUD auditors rendered an opinion that this presented fairly the results of operations for that year, subject to the adjustments and comments included in the independent auditor's report. The certified statements furnished by the project showed the net loss for the same period to be about $661,921. The HUD audit report also pointed out that improvements were needed in the maintenance of accounting records and that security deposits of $16,347 were not in a separate bank account as required by the regulatory agreement.

The HUD audit report was furnished to the area office and to the project management. About 11 months after issuance of the audit report, however, we found that complete and accurate accounting records were not being maintained. Also, although a separate bank account was established for security deposits, there was no way of knowing whether the account was sufficient to cover the project liability without reconstructing all security deposit transactions.

At the request of another area office, HUD performed an audit of a third project for the period January through September 1970. A report issued in December 1970 pointed out that

--payments were not being made under the mortgage modification agreement,

--advertising and elevator maintenance expense appeared questionable,

--internal control over parking fees was inadequate, and

--annual project reports did not identify rent free units being provided to project employees.

At the time of our review, the last three deficiencies had been resolved by HUD. The first deficiency was subsequently resolved when HUD accepted a cash settlement on the project mortgage.

WORKOUT ARRANGEMENTS CONTINUED FOR PERIODS LONG AFTER IT BECAME APPARENT THEY WERE NOT IMPROVING THE FINANCIAL CONDITION OF MORTGAGES

HUD allowed the workout arrangements for five of the six mortgages we reviewed (see p. 33) to continue for lengthy periods although no substantial progress had been made by the mortgagors to reduce the delinquent interest, taxes, and service charges. One project was able to liquidate the entire interest, tax, and service charge delinquency. For three of the five projects, interest, taxes, and service charge delinquencies increased about 32 percent, 183 percent, and 214 percent above the approximate balance delinquent at the start of the workout period. Reductions were made in the delinquencies on the remaining two projects over very lengthy workout periods.

Project	Month of workout	Total mortgage delinquency	Interest, tax, and service charge delinquency: Amount	Interest, tax, and service charge delinquency: Percent of increase or decrease (-)
A	1	$ 271,379	$ 228,380	
	38	548,235	437,190	91.4
	75	834,456	646,045	182.9
B	1	601,685	453,615	
	28	674,230	406,498	- 10.4
	57	822,730	405,283	- 10.7
C	2	247,287	213,945	
	30	1,182,321	805,808	276.6
	69	1,583,007	672,288	214.2
D	10	703,342	334,020	
	18	765,107	247,241	- 26.0
	26	1,111,460	440,478	31.9
E	1	2,525,283	1,827,116	
	22	2,345,074	1,391,285	- 23.9
	42	2,733,318	1,519,664	- 16.8
F	1	167,559	108,699	
	11	146,268	29,312	- 73.0
	21	150,962	- 0 -	-100.0

For two of these projects, 32 and 24 months elapsed from the date of assignment before a workout arrangement was instituted. The remaining projects were placed under a workout arrangement from 1 to 8 months after the date of assignment.

When HUD accepted the assignment of one of the projects in March 1965, it was delinquent by $49,000 on its loan. HUD negotiated the first workout agreement in March 1967 when the total mortgage delinquency had increased to about $271,379 (about $228,380 represented interest, taxes, and service charges). The mortgagor made only token payments to HUD during the period of the first workout agreement which expired in February 1968. From March 1967 to June 1972, HUD allowed the mortgage loan to remain delinquent under subsequent workout and less formal arrangements; however, the mortgagor did not meet the payment provisions of these arrangements.

As of May 1973, the total mortgage delinquency increased to about $834,456 when HUD accepted a cash offer of $625,000 as a settlement on the mortgage note.

In another project, the mortgage delinquency totaled about $175,000 when the mortgage loan was assigned to HUD in February 1966. A workout agreement was not negotiated until October 1968.

When the arrangement expired in December 1969, the project owner had made 80 percent of the payments under the agreement. By January 31, 1970, the total mortgage delinquency had increased to $650,000. Although the project owner met most of the payments from January 1, 1970, through July 31, 1973, the total mortgage delinquency had further increased to about $822,730.

At another project, the mortgage was placed under a workout arrangement in November 1967. The total delinquency for interest, taxes, and service charges as of December 1967 amounted to $213,945. The project complied with the payment provisions of the workout arrangement and submitted timely financial reports to HUD.

Our examination of the project's payment record during the workout arrangement period showed that the mortgagor paid more than the minimum amount required by HUD; however, the interest, tax, and service charge delinquency increased about $592,000 by April 1970. Although the project was making the required payments, the increase in the delinquency is attributed to reduced workout payments allowed because of low occupancy and lower than anticipated rental rates.

HUD agreed to place the mortgage loan for another project under a workout arrangement in June 1971. During that period, the mortgagor failed to comply with the payment provisions of the arrangement and HUD initiated foreclosure in March 1972. However, in July 1972, HUD received a lump-sum of $144,000 that made the workout payments current. The workout arrangement was extended through October 1972.

In September 1972 the field office recommended the workout arrangement be further extended through December 31, 1972, to provide the office an opportunity to analyze the financial condition of the project and to determine a realistic payment schedule that would lead to a reinstatement of the mortgage.

In November 1972, HUD advised project officials that the arrangement would be extended to January 1, 1973, at which time they had to agree to

--make the mortgage loan current, including interest, within the next 12-month period;

--give HUD a deed in lieu of foreclosing; or

--submit a one time cash offer in final settlement of the mortgage debt.

Also, HUD gave these officials until December 22, 1972, to furnish the monthly accounting reports or foreclosure would be initiated on December 23, 1972.

As of February 1973, no accounting reports had been submitted and HUD again threatened to initiate foreclosure but deferred this action to enable project officials to obtain an appraisal of the property as a basis for a final cash offer. For the 8 months ended August 31, 1973, HUD received only one workout payment of $36,000. No accounting reports had been submitted by this date. Foreclosure was initiated in June 1973.

During the first 22 months of the arrangement for another project, some progress was made in reducing interest, tax, and service charge delinquencies. However, total mortgage delinquency increased from $2.5 million to $2.7 million after 42 months of the workout arrangement because the project owner failed to make several payments during fiscal year 1973.

FACTORS CONSIDERED IN FORECLOSING MORTGAGE LOANS

We examined project records in three HUD field offices--St. Louis, Dallas, and Los Angeles--to identify the factors considered in foreclosure recommendations. No specific factors were identified. Field office officials advised us that each project and the problems it was experiencing were unique; and therefore, there were no specific factors which they consistently considered in determining whether to foreclose a mortgage loan. Generally, foreclosure was a last resort action resulting from the project owner's complete disregard of his financial obligation.

Officials in one office informed us that they had recently changed their practice and had begun recommending foreclosure proceedings immediately after assignment unless the mortgage had an above average chance to be reinstated under a workout agreement. These officials believe that a plan for reinstatement should not be considered unless the project has qualified management and is in an area where housing demand is high, and the owner is willing to contribute his personal funds to the project.

Officials in another office informed us that foreclosure would be recommended when it would be in the best interest of HUD; however, they believed that HUD should not be involved in owning properties like private mortgage financing institutions. They stated that they would rather do everything possible to insure that a project survived and remained under private ownership.

Officials at HUD headquarters informed us that field offices were, at times, reluctant to recommend foreclosure because they were subject to local pressure and adverse publicity. Some of the views expressed by HUD headquarters and field office officials as to why foreclosure may not be appropriate are listed below.

1. In inner-city areas where the market value of properties has declined below the mortgage loan values, a large loss would result from resale of the property.

2. HUD offices do not have the capability to manage extremely large projects.

3. HUD policy governing the reinstatement of defaulted HUD-held mortgages precludes foreclosure when the project owner agrees to a plan of reinstatement designed to upgrade the property and agrees to resume total mortgage payments within a reasonable period of time.

HUD headquarters officials informed us that decisions regarding foreclosure of subsidized projects raise serious social considerations. When titles to these projects pass to HUD after foreclosure, assistance payments to tenants are terminated by law and they may be required to pay rent at a market rate or leave the project.

These officials stated that HUD has not been successful in attempting to reinstate subsidized project mortgages. As of June 30, 1973, only five out of 385 have been reinstated. In comparison, 187 out of 405 nonsubsidized mortgages have been reinstated.

One alternative to foreclosure that has recently been used by HUD is a cash settlement on the defaulted mortgage loan.

In November 1972, a Mortgage Disposition Committee was formed for evaluating and recommending actions on cash settlements for HUD-held mortgage loans in default.

HUD headquarters officials advised us that this technique provides a method of dealing with mortgages with large delinquencies in a manner consistent with sound business practices. In application, HUD used this procedure generally as the last step before foreclosing mortgage loans when the unpaid principal balances and interest delinquencies were greater than the current value of the property.

Under section 207 of the National Housing Act, the Secretary of HUD is authorized to pursue to final collection, by compromise or otherwise, all claims assigned and transferred to him. HUD has interpreted section 207 as the authority to write off part of an outstanding debt through a cash settlement.

It is the opinion of HUD headquarters officials that using final cash settlements averts lengthy foreclosure proceedings and eliminates costly property disposition programs. These officials said that HUD does not accept the final cash offer unless it is equal to or better than the return would be if the property was foreclosed and disposed of through resale.

The mortgagor is required to support his cash offer with a Member American Institute of Real Estate Appraisers (MAI) appraisal. This appraisal is compared with an appraisal by the responsible HUD field office. HUD officials advised us that MAI appraisals are generally accepted in the real estate industry and in courts of law. HUD had accepted four cash settlement offers from November 1972 through July 1973.

CONCLUSIONS

The field office servicing of defaulted HUD-held mortgages undergoing reinstatement is one means HUD uses to protect its financial investment in these mortgages. Effective servicing of these mortgages, particularly those in default, must include a thorough analysis and examination of monthly financial reports to insure that all income is reported and that expenses are confined to payments necessary only for actual project operations.

Field office servicing of workout arrangements could be improved if specific criteria were available to field offices which defined the types of expenditures eligible for payment with project funds. HUD field offices can also contribute to the effectiveness of workout arrangements by insuring that mortgage payments and monthly accounting reports are forwarded to HUD promptly.

Servicing activities must be supplemented with adequate audit coverage of defaulted HUD-held mortgages to insure that all funds remaining after payment of necessary and reasonable expenses are returned to HUD and applied against the mortgage delinquency. These audits, to be more effective, should be directed toward evaluating the reasonableness and necessity of project expenditures.

HUD acceptance of cash offers as settlement of the mortgage loan bypassed lengthy and costly foreclosure proceedings for several delinquent assigned mortgages that were not reinstated. Although this method might offer the best means for HUD to realize some return on its investment and eliminate potentially greater losses, it could discourage effective performance by other delinquent mortgagors under existing workout arrangements.

RECOMMENDATIONS

We recommend that the Secretary of HUD require a comprehensive evaluation of the projects discussed in this report to insure that the weaknesses noted at the six projects are corrected and that all disbursements of project funds are appropriate.

We also recommend that the Secretary strengthen the overall administration of HUD-held project mortgages by issuing regulations providing uniform guidance to the field offices. Such regulations should

--provide criteria for establishing management fees and define expenses to be covered as part of these fees,

--list the types of expenditures eligible for payment from project funds when a project is in default,

--require project owners to certify to the accuracy of their monthly accounting reports subject to the penalties of 18 U.S.C. 1001, and

--reemphasize the need for frequent monitoring and servicing by field offices and encourage field offices to make greater use of the Office of Audit.

We recommend that HUD officials be required to discontinue workout arrangements and seek other alternatives when it becomes apparent that the arrangement will not achieve reinstatement in a timely manner.

CHAPTER 3

SCOPE OF REVIEW

We made our review at HUD headquarters in Washington, D.C., and at the HUD field offices in Los Angeles, California; Phoenix, Arizona; Dallas and Fort Worth, Texas; and St. Louis, Missouri.

We interviewed HUD officials at the headquarters and field office levels, evaluated the review and monitoring activities by these offices, and reviewed and used information from pertinent reports issued by the HUD Office of Audit. We examined pertinent legislation, administrative regulations, and records. We also interviewed project owners and officials of firms providing management services.

The following six projects, selected with the advice and concurrence of the Subcommittee staff, were included in the segment of our review covering the techniques developed by HUD for verifying a mortgagor's certification of rents and expenses.

Mansion House Center	St. Louis, Missouri
Regency Inn Nursing Home	St. Louis, Missouri
Tucson House	Tucson, Arizona
Pacific Holiday Towers	Long Beach, California
Allen McDonald Foundation	Waco, Texas
St. Francis Village	Lake Benkbrook, Texas

Since the mortgages of the Mansion House Center and the Pacific Holiday Towers were under a modification agreement, they were not included in the segment of our review of HUD's management of mortgages undergoing reinstatement through workout arrangements. However, two additional projects, the Los Angeles Convalescence Center, Los Angeles, California, and the Towne House Apartments, St. Louis, Missouri, were selected.

For the segment of our review of the factors considered by HUD in determining when to foreclose, the following seven projects were selected.

Independence Square	Los Angeles, California
Sunset Apartment	Los Angeles, California
Bicentennial Civic Corporation	St. Louis, Missouri
Delor Park Apartment	St. Louis, Missouri
Holiday Park Gardens	Garland, Texas
Liberty Plaza Apartment	Troup, Texas
Olive Branch Apartment	Paris, Texas

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NINETY-THIRD CONGRESS

Congress of the United States

House of Representatives

LEGAL AND MONETARY AFFAIRS SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, D.C. 20515

May 16, 1973

Honorable Elmer Staats
Comptroller General
General Accounting Office
Washington, D. C.

Dear Mr. Comptroller General:

Over the last year the Department of Housing and Urban Development has acquired by assignment a large number of FHA-insured mortgages on multi-family housing properties on which the mortgagors have fallen into arrears in their payments. As of February 1973, according to figures maintained by HUD's Office of Administrative and Program Services, HUD had a portfolio of 1,275 such Secretary-held mortgages, representing 123,081 housing units.

HUD's management of these mortgages is a matter of concern to this Subcommittee. Reports have appeared in the news media indicating that some of these properties are luxury apartment buildings with very few vacancies, yet mortgage payments are not being made. The question arises whether rent proceeds are being diverted by the mortgagor for other purposes.

So long as the Secretary of HUD holds the mortgages on these properties the mortgagor is still entitled to enjoy tax shelter benefits associated with ownership of residential rental property. This, of course, results in substantial loss of revenue to the Treasury without compensating socially useful action on the part of the mortgagor, who is not fulfilling his obligations under his mortgage loan agreement.

We are requesting that GAO perform a review of HUD's management of its portfolio of acquired mortgages. Without any intention of restricting the scope of your inquiry, we would hope to obtain answers to the following questions:

1. What is the total outstanding indebtedness on the mortgages on multi-family housing properties held by the Secretary of HUD?

2. What is the total dollar amount of the arrearages on such mortgages?

3. What is the average amount of arrearage? (Please prepare an aging schedule showing the length of time these properties have been in default.)

4. What factors are considered by HUD in determining when to foreclose on such properties?

5. What techniques has HUD developed for checking on the mortgagor's certifications of rents and expenses?

6. Are the above-mentioned checks adequate? (Here we would request that GAO audit a number of certifications to determine their accuracy.)

7. What suggestions would GAO give to the Subcommittee for the improvement of HUD's management of its portfolio of acquired mortgages?

The Subcommittee realizes that GAO has extensive responsibilities. However, because of the serious deficiencies already uncovered in HUD operations and the large dollar amounts involved, we would request that, if at all possible, the results of this review be supplied to the Subcommittee by October 1, 1973.

Your continuing cooperation is appreciated.

Very truly yours,

Wm. J. Randall
Wm. J. Randall
Chairman

WJR:bg

PRINCIPAL OFFICIALS OF THE
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
RESPONSIBLE FOR THE ADMINISTRATION OF ACTIVITIES
DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
SECRETARY OF HOUSING AND URBAN DEVELOPMENT (formerly Administrator, Housing and Home Finance Agency):		
Robert C. Weaver	Feb. 1961	Dec. 1968
Robert C. Wood	Jan. 1969	Jan. 1969
George W. Romney	Jan. 1969	Jan. 1973
James T. Lynn	Feb. 1973	Present
ASSISTANT SECRETARY FOR HOUSING PRODUCTION AND MORTGAGE CREDIT AND FEDERAL HOUSING COMMISSIONER: (formerly Commissioner, Federal Housing Administration):		
Philip N. Brownstein	Mar. 1963	Feb. 1969
William B. Ross (acting)	Feb. 1969	Sept. 1969
Eugene A. Gulledge	Oct. 1969	Jan. 1973
Woodward Kingman (acting)	Feb. 1973	June 1973
Sheldon B. Lubar	July 1973	Present
ASSISTANT SECRETARY FOR HOUSING MANAGEMENT:		
Don Hummel	May 1966	Feb. 1969
Howard J. Wharton (acting)	Feb. 1969	Mar. 1969
Lawrence M. Cox	Mar. 1969	July 1970
Norman V. Watson	July 1970	Jan. 1973
Abner D. Silverman (acting)	Feb. 1973	Mar. 1973
H. R. Crawford	Apr. 1973	Present
INSPECTOR GENERAL:		
Charles G. Haynes	Jan. 1972	Present