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WASHINGTON, D.C. 20548

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RELEASED

The Honorable Floyd V. Hicks, Chairman  
Manpower and Housing Subcommittee  
Committee on Government Operations  
House of Representatives



Dear Mr. Chairman:

Congressman William J. Randall, Chairman of the Legal and Monetary Affairs Subcommittee--the Subcommittee previously having responsibility for housing programs--asked that we review the Department of Housing and Urban Development's (HUD's) procedures for allocating housing units to developers under the sections 235 and 236 subsidized housing mortgage insurance programs. He asked that we review HUD activities in Miami (Coral Gables), Florida; Philadelphia, Pennsylvania; and Jackson, Mississippi.

The Department of Justice was investigating HUD activities at the Coral Gables office, and at its request, we did not do any work at that location. By agreement with his office, we included HUD's Birmingham, Alabama, office in our review in lieu of the Coral Gables office.

He specifically asked that our review be directed to answering the following questions.

1. What are the criteria employed by these HUD offices in determining which developers shall be approved?
2. Has there been a pattern in these offices indicating a preference by HUD for a few select developers?
3. To what extent does HUD consider past performance by a developer who has previously received funds under the sections 235 or 236 programs? In this regard, has HUD approved commitments to developers to construct additional units when their past performance reveals they have encountered financial or management difficulties with previously insured projects?
4. What is HUD's role from the time of approval until the point of completion for a section 235 housing unit or a section 236 project?

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Our review showed that the HUD offices visited did not properly use HUD criteria in allocating many section 235 units. In addition, the Philadelphia area office did not effectively use the required criteria in allocating many of the section 236 projects. Despite these weaknesses, we found no pattern in any of the offices which would indicate a preference for any specific developer or developers.

Our review showed that HUD did consider the past performance of applicants, and we found no evidence that approved applicants had experienced financial or management difficulties in previous projects insured under HUD housing programs.

#### SCOPE OF REVIEW

We reviewed regulations and instructions covering the sections 235 and 236 programs; examined pertinent records; and interviewed HUD officials at the central office, Atlanta and Philadelphia regional offices, and Birmingham, Jackson, and Philadelphia area offices. We also interviewed several builders, mortgagees, and mortgagors who participated in the programs.

We selected for testing the allocations made during the period July 1, 1971, through January 5, 1973. This latter date is the date on which the President suspended these subsidized housing programs. See the enclosure for a list of unit allocations made during our test period.

Because we found that the Jackson area office had avoided the intent of central office instructions relating to the January 5, 1973, housing moratorium on the section 235 program (see p. 4), we expanded our review to include section 235 allocations made by that office between January 6 and July 31, 1973.

#### BACKGROUND

HUD began making unit allocations--a method distributing identified housing units that can be constructed within available funding under the sections 235 and 236 subsidized housing programs--in fiscal year 1969.

Through June 30, 1974, HUD had approved, nationwide, \$400.9 million of section 235 contract authority for estimated first-year assistance payments for 350,744 new and existing units and \$520.1 million of section 236 contract authority for estimated first-year assistance payments for 382,145 rental units.

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Under section 235, HUD is authorized to assist low- and moderate-income families in becoming homeowners by providing mortgage insurance and subsidizing portions of the monthly payments due under the mortgages for principal, interest, taxes, insurance, and mortgage insurance premiums. Under section 236, HUD is authorized to insure privately financed mortgage loans for constructing or rehabilitating multifamily housing projects and to pay, on behalf of the mortgagors, the mortgage insurance premiums and the interest on the mortgage loans in excess of 1 percent.

The field offices included in our review used four methods to allocate section 235 units. These methods were the (1) first-come-first-served over-the-counter method, (2) convertible commitment method, (3) priority registration method, and (4) preliminary reservation method.

The first-come-first-served over-the-counter method is used to allocate all requests for four units or less. Under this method mortgagees obtain conditional commitments from HUD under a nonsubsidized program.

The convertible commitment method is used for allocating requests for five or more units. Under this method the mortgagees obtain a conditional commitment from HUD under a nonsubsidized program that is convertible to section 235 when a buyer meeting the criteria for assistance is found. Under both the over-the-counter method and the convertible commitment method, the mortgagees submit applications for firm commitment and mortgagor approval when homebuyers meeting the criteria for assistance under section 235 are found. The primary difference between these methods is that, under the convertible commitment method, HUD in effect promises to provide the section 235 contract authority when the eligible homebuyer is found.

The preliminary reservation and priority registration methods are similar and are used to allocate units to builders requesting five or more units. A preliminary reservation is an actual commitment by HUD to provide the section 235 contract authority being reserved. A priority registration is a promise to the developer that a potential buyer will be given priority for contract authority, if and when that authority is available.

The only method used to allocate section 236 units is the simultaneous issuance of a feasibility letter and the preliminary reservation of contract authority to the project with the highest priority.

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Effective January 5, 1973, the President imposed a moratorium on funding subsidized housing programs, including sections 235 and 236. Commenting on the moratorium for sections 235 and 236, the Secretary of HUD said that these programs had too frequently been abused and had been made the vehicle of inordinate profits gained through shoddy construction, poor site location, and questionable financing arrangements. With some exceptions, the HUD area offices were restricted from making additional commitments and fund reservations under the programs.

Our response to his specific questions are presented in greater detail below.

WHAT ARE THE CRITERIA EMPLOYED BY  
THESE HUD OFFICES IN DETERMINING  
WHICH DEVELOPERS SHALL BE APPROVED?

HUD instructions specify that, in determining which developers or sponsors should be approved for proposed sections 235 and 236 projects, an evaluation rating system employing Project Selection Criteria be used. In the evaluation consideration is to be given to such elements as

- need for type of housing proposed in the area,
- housing opportunities for minority families,
- improved location for lower income families,
- relationship to orderly growth and development,
- relationship of the proposed project to the physical environment of the neighborhood,
- capacity of the sponsor to proceed promptly to construction completion,
- project potential for creating minority employment and business opportunities, and
- provisions for a sound housing management program, where applicable.

Contrary to HUD instructions issued in August 1971 and revised in March 1972, the Birmingham, Jackson, and Philadelphia area offices did not apply Project Selection Criteria to requests when allocating

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many section 235 units or did not appropriately evaluate the requests using such criteria. In addition, the Philadelphia area office had not prepared Project Selection Criteria evaluations for many approved section 236 projects. Philadelphia area office officials were unable to explain why these evaluations which should have been prepared were not in the files.

Field offices are required to apply Project Selection Criteria to all applications for five or more section 235 units and for applications of less than five if the units are part of a development that will ultimately have more than four units. The criteria must also be applied if the site is contiguous to a site that will accommodate more than four units and that will be developed by the same applicant.

Birmingham area office officials told us that Project Selection Criteria had not been applied in allocating section 235 units over the counter (involving less than five units) regardless of the circumstances because of the volume of cases and limited time available to process each case.

Jackson area office officials said that Project Selection Criteria had not been applied on a case-by-case basis because of limited time available to process each case; but in 1972 Project Selection Criteria were applied to some cases involving subdivision development in an attempt to comply with HUD central office instructions.

A Philadelphia area office official told us that Project Selection Criteria were not applied to some requests for section 235 preliminary reservations because the builders making these requests made no further effort to obtain commitments for construction of the requested units.

By not applying or not appropriately evaluating projects using Project Selection Criteria, field offices lessen assurances that projects meeting the needs of lower income families are funded in order of highest priority.

Section 235 units allocated without applying  
Project Selection Criteria

The Birmingham area office did not consider Project Selection Criteria for the 6,801 section 235 units allocated during our review period as convertible commitments or as over-the-counter conditional commitments.

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Our test of 1,401 section 235 units allocated either as over-the-counter commitments or as convertible commitments that were subject to evaluation through Project Selection Criteria showed that the Jackson area office did not consider Project Selection Criteria for 764 units, about 55 percent of the total units reviewed.

The Philadelphia area office applied Project Selection Criteria to only seven of the requests for section 235 preliminary reservations which involved 447 housing units. This was only 38 percent of the total units allocated during the period reviewed.

Section 235 units allocated without appropriately evaluating the request using Project Selection Criteria

The Birmingham area office did not prepare Project Selection Criteria evaluation forms for 787 units allocated, using the priority registration method, during our review period. Instead, the area office allowed builders to make their own evaluations and to submit the completed forms with their requests. For 151 units allocated, the builders did not submit the evaluation forms, and, for another 110 units allocated, the evaluation forms were incomplete. Also, the data provided by builders on many of the remaining evaluations was general in nature and it is doubtful that it was of much use in evaluating the requests. An area office official said that he supplemented information provided by the builders with personal knowledge of the proposed projects and information obtained by telephone. However, that data was not documented on the evaluations.

The Jackson area office approved priority registration to builders for 525 units of 641 units requested. The other 116 units were not approved because of limited funding authority. The area office evaluated the section 235 requests for priority registrations on the basis of Project Selection Criteria; however, supporting comments were not provided on the evaluation forms showing the basis for the ratings given. In our opinion, the Project Selection Criteria evaluations were not meaningful because comments supporting the ratings were not provided.

Section 236 units allocated without applying Project Selection Criteria

On the basis of our review of project files and discussions with Philadelphia area office officials, Project Selection Criteria evaluations were not prepared for 24 of the 39 section 236 projects for which

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the area office had approved preliminary reservations of contract authority. The area office approved firm commitments for 13 projects that had not been evaluated on the basis of Project Selection Criteria.

HAS THERE BEEN A PATTERN IN THESE OFFICES  
INDICATING A PREFERENCE BY HUD  
FOR A FEW SELECT DEVELOPERS?

We reviewed the allocation of sections 235 and 236 units under the various methods employed in each of the three area offices and found no patterns to indicate that the area offices had shown preferences in approving sections 235 and 236 allocations to builders or sponsors.

The Birmingham and Jackson offices did not keep records showing that section 235 over-the-counter allocations were actually made on a first-come-first-served basis. This precluded us from determining whether the units were allocated without preference on a first-come-first-served basis. The Jackson area office director said that the lack of records for the first-come-first-served over-the-counter allocations had never been a problem because it always had a surplus of section 235 units compared to units requested.

The Philadelphia area office allocated all section 235 units through preliminary reservations of contract authority. The area office approved a total of 46 preliminary reservations for 1,173 section 235 units, including 14 preliminary reservations for 73 housing units to be substantially rehabilitated. Firm commitments were made for only 52 units, including 51 units to be substantially rehabilitated. The remaining preliminary reservations were canceled in May 1973 as a result of the moratorium on section 235 funds.

The Philadelphia area office had rejected 14 section 236 applications for preliminary reservations. An area office official said that the files had been misplaced or lost for 7 of the 14 rejected applications. Our review of the seven available files for rejected applications showed that rejections had been made primarily because the sites were deficient, the proposed project lacked a housing market, or there was an oversaturation of the housing market for section 236 housing. Because the records had been misplaced or lost for the other seven, we were unable to make any final determination regarding whether these rejections were made to show favoritism to builders who were approved.

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TO WHAT EXTENT DOES HUD CONSIDER  
PAST PERFORMANCE BY A DEVELOPER  
WHO HAS PREVIOUSLY RECEIVED FUNDS  
UNDER THE 235 OR 236 PROGRAMS?

HUD provides each field office with a Joint Consolidated List of Debarred, Suspended and Ineligible Contractors and Grantees. Additionally, participants in HUD multifamily projects are required to file previous participation certificates disclosing their interest in the proposed project and their past participation in all HUD housing programs except the single-family home mortgage program. The HUD area offices are required to provide copies of previous participation certificates to regional administrators and to the HUD central office's Participation and Compliance Review Division. Regional administrators are required to report within 5 days any adverse information regarding a principal to the Director, Participation and Compliance Review Division. The Participation and Compliance Review Division is required to evaluate the information related to principals' previous participation in HUD programs and to advise the area offices whether or not the proposed project has been approved with respect to the participation of the principals who executed the certificates.

We examined the previous participation certificates for 27 of the 28 section 236 projects approved by the Birmingham area office, 18 of the 20 projects approved by the Jackson area office, and 10 of the 39 projects approved by the Philadelphia area office and found that none of the participating principals had encountered financial difficulties with projects previously insured by HUD. We compared the names of participants in the sections 235 and 236 programs with HUD's Joint Consolidated List of Debarred, Suspended and Ineligible Contractors and Grantees. This comparison disclosed that none of the three area offices had approved preliminary reservations or firm commitments for any builders, sponsors, or mortgagees who had been debarred or suspended or who were otherwise ineligible.

WHAT IS HUD'S ROLE FROM THE TIME OF APPROVAL  
UNTIL THE POINT OF COMPLETION FOR  
A 235 HOUSING UNIT OR A 236 PROJECT?

After approving the allocation of section 235 units, HUD field offices are required to inspect the construction of new housing for conformance with approved plans and specifications, to evaluate the proposed



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purchaser in terms of his ability to meet mortgage payments, and to determine whether the purchaser qualifies for housing subsidy payments. For existing housing, HUD field offices, in addition to approving the purchaser for mortgage credit and housing subsidy, are required to appraise the house to determine the maximum insurable mortgage.

After approving the allocation of section 236 units, HUD field offices are required to review plans and specifications for conformance with HUD minimum property standards. Also during construction HUD field offices are required to monitor the work of supervisory architects and the work in progress and to approve advances of funds from the lender to the builder. After construction, HUD field offices are required to certify the final cost before endorsing the mortgage for insurance. The sponsor may not charge higher rental rates than those agreed to by HUD field offices during application processing unless approved in advance by these offices.

#### OTHER MATTERS

We noted the following matters which we believe will be of interest to the Subcommittee.

#### Moratorium avoidance

The Jackson area office avoided the intended effect of HUD's central office instructions relating to the January 5, 1973, moratorium on funding new units under the section 235 program.

Jackson area office officials said that they heard of the impending housing moratorium in advance of the effective date. They told us that mortgagee firms were asked to provide lists of conditional commitments which builders planned to sell under the section 235 program. The officials said that mortgagee firms were then asked to bring in conditional commitments, and the commitments were stamped "convertible to section 235."

These commitments referred to as convertible commitments, represented binding obligations on the Government to execute the assistance payment contract provided all HUD requirements were met. Section 235 contract authority was obligated at the time of issuance. HUD Circular FHA 4441.15 shows that the convertible commitment procedure was in effect in December 1969; but, according to area office officials, they had not used the procedure before December 1972 when they heard there was going to be a moratorium.

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The area office obligated \$721,608 of section 235 funds for 843 convertible commitments and issued preliminary reservations during the week that ended January 5, 1973, amounting to \$169,526 for 208 units to be substantially rehabilitated. Therefore, a total of 1,051 units involving \$891,134 in funds were obligated for convertible commitments or were reserved for preliminary reservations in the week preceding the Secretary's notification of the housing moratorium. This was about 89 percent of the total section 235 contract authority available. This had the effect of avoiding the Secretary's hold on section 235 funding since the area office had already obligated or reserved most of their available funds.

Area office officials told us that the section 235 funds for convertible commitments were obligated by January 5, 1973, the cutoff date specified by the Secretary. However, we found several letters from various mortgagee firms dated from January 12 through February 8, 1973, requesting section 235 funds. The area office issued more than 100 convertible commitments to these mortgagee firms.

An area office official said that the mortgagee firms involved had advised the area office by telephone on or before January 5, 1973, of the cases to be covered by convertible commitments. There was no documentation to verify whether the area office had obtained the case numbers on or before January 5, 1973. But an official from one of the mortgagee firms that received 57 convertible commitments told us that he did not tell the area office about the convertible commitments before January 12, 1973, when he delivered letters requesting the section 235 funds. We noted that the mortgagee's letters were dated January 12, 1973. On the basis of available documentation, it appeared that the area office obligated some section 235 funds for convertible commitments after the January 5, 1973, cutoff date.

The Jackson area office also approved the transfer of eight convertible commitments in September and October 1973 from cases held by one builder to cases held by another builder. In April 1973 the area office had received a memorandum from the HUD central office concerning contract authority for subsidized housing programs which stated that the reuse of contract authority recaptured by cancellations or subsidy reductions was prohibited. When the area office approved the transfer of contract authority not used by one builder to another builder who used the authority, it violated central office instructions. In effect, the contract authority was canceled for eight cases and reused for eight different cases.

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An area office official said that, since there were no specific instructions prohibiting the transfer of convertible commitment funds from one case to another, he assumed it was permissible. The area office director said that the instructions related to the moratorium were confusing and that if the office violated the moratorium, it was an honest mistake. The Director, Operations Division, said section 235 funds were obligated in anticipation of the moratorium because it felt it had an obligation to help the builders after encouraging them to build under the program.

Housing sales price not limited to  
HUD's estimate of value

Our work at the Birmingham area office showed that five builders did not limit the sales price for section 235 homeowners to HUD's estimate of value. As a result, the buyers paid higher mortgage payments and HUD paid higher interest subsidy payments. This matter is being investigated further.

CONCLUSIONS

In approving many section 235 allocations, all three area offices failed to consider criteria the HUD central office had established for evaluating proposals under the program. The Philadelphia area office did not consider the criteria in approving many of the section 236 allocations.

As a result, there was less assurance in these offices that projects meeting the needs of lower income families were funded in the order of highest priority. However, this would not appear to be a continuing problem because, although the Congress extended the sections 235 and 236 programs through June 30, 1976, HUD has indicated that the section 235 program will not be used and that the section 236 program will be seldom used.

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As he requested, we did not obtain written comments from HUD on the matters discussed in this report. However, during our review we discussed these matters with agency officials and incorporated their views in the report where appropriate. As agreed with his office, a copy of this report is being sent to HUD.

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We are sending a copy of this report to Congressman William J. Randall. We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,

A handwritten signature in cursive script, reading "James B. Peets".

Comptroller General  
of the United States

Enclosure

Units Allocated During  
The Period July 1, 1971, Through January 5, 1973

Section 235:	<u>Area offices</u>		
	<u>Birmingham</u>	<u>Jackson</u>	<u>Philadelphia</u>
Method of allocation (note a):			
Over the counter	3,079	4,170	
Convertible commitments	3,722	843	
Priority registration	787	525	
Preliminary reservation	<u>-</u>	<u>1,287</u>	<u>1,173</u>
Total (section 235)	<u>7,588</u>	<u>6,825</u>	<u>1,173</u>
 Section 236:			
Method of allocation:			
Preliminary reservation	<u>3,202</u>	<u>1,792</u>	<u>6,398</u>
Total (sections 235 and 236)	<u>10,790</u>	<u>8,617</u>	<u>8,571</u>

<sup>a</sup>Defined on p. 3.