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COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON D C 20548

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Dear Mr. Long:

Reference is made to your telegram of July 30, 1969, and the letter of September 19, 1969, from Mr. Christopher Pfrommer of your office requesting us to review the mortgage insurance applications before the Federal Housing Administration (FHA), Department of Housing and Urban Development (HUD), for two multifamily housing projects, Fox Ridge and Franklin Park, proposed for construction in Baltimore County, Maryland, pursuant to section 236 of the National Housing Act.

Mr. Pfrommer indicated in his letter that in our review we should include the following considerations: (1) the extent to which the builder of the proposed projects previously had participated in multifamily housing programs administered by FHA, (2) ownership and relocation of a road involved in the construction of the Fox Ridge project, (3) coordination of actions of HUD and the Baltimore County government which resulted in the issuance of conditional commitments to the Julio Brothers to insure the mortgage loans for the proposed projects, (4) whether HUD procedures were followed in approving the conditional commitments to insure the mortgage loans, and (5) the basis for the Acting Assistant Secretary-Commissioner's opinion that HUD was legally bound to carry through the conditional commitments to insure mortgage loans for the proposed projects. The results of our review and our discussions of these matters with responsible agency officials are summarized below.

Background

Section 236, which was added to the National Housing Act by section 201 of the Housing and Urban Development Act of 1968 (82 Stat. 498), provides a program for rental and cooperative housing for lower income families. Pursuant to section 236 of the act, HUD is authorized to insure privately financed mortgage loans on multifamily housing projects and to pay, on behalf of the mortgagors, the interest on the mortgage loans in excess of 1 percent and the mortgage insurance premiums. These payments--called interest reduction payments--permit a basic monthly rental for each housing unit to be established at a rate lower than would be applicable if the project received no Federal assistance. Section 236 provides that a tenant pay either the basic rental or 25 percent of his monthly income, whichever is greater. Section 236 provides also that a tenant's rental payment not exceed the rental which would be applicable if no Federal

As mentioned in the local housing assistance is in nature of a policy of rent, state to County etc

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assistance is given. Rental payments collected by mortgagors in excess of the basic rental charges are required by section 236 to be returned to HUD for deposit in a revolving fund for the purpose of providing future assistance under the program.

Contractual authorizations of \$70 million for interest reduction payments pursuant to section 236 of the act were provided by the Supplemental Appropriation Act, 1969 (82 Stat. 1193), and the Second Supplemental Appropriations Act, 1969 (83 Stat. 53), approved October 21, 1968, and July 22, 1969, respectively.

Under current HUD procedures, an application for insurance of a mortgage loan on a multifamily housing project must be submitted to FHA and processed through three stages involving (1) a study of the project's feasibility, (2) issuance of a conditional commitment to insure the mortgage loan, and (3) issuance of a firm commitment to insure the mortgage loan. Applicants for mortgage insurance may request HUD to initiate the processing of the application at any one of the three stages, depending on the extent to which the project plans have been developed in relation to the HUD requirements applicable to that stage and any preceding stages.

On behalf of ~~the~~ Julio Brothers, sponsor and builder of the proposed Fox Ridge and Franklin Park projects, the proposed mortgagees in December 1968 submitted applications to HUD which requested the issuance of conditional commitments to insure mortgage loans for the Fox Ridge and the Franklin Park projects. On July 10, 1969, HUD issued conditional commitments to insure mortgage loans of \$1,766,300 and \$3,626,600 on the Fox Ridge and Franklin Park projects, respectively. HUD issued firm commitments to insure mortgage loans of \$1,755,200 for the Fox Ridge project on October 21, 1969, and of \$3,626,600 for the Franklin Park project on November 7, 1969.

Previous participation in mortgage insurance programs

In connection with the submission of an application for mortgage insurance, HUD requires the sponsor to submit a certificate of its previous participation in multifamily housing programs administered by FHA. HUD instructions specifically state, with respect to completion of the certificate, that:

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*** Each principle, as defined in the certificate, must list every FHA insured multifamily or Title X project in which he has been, or is involved, identifying the name, location, FHA case number, and the nature of his interest***." (Underscoring supplied.)

Our review of HUD records disclosed no evidence that ~~the~~ Julio Brothers, at the time their applications for mortgage insurance for the Fox Ridge and Franklin Park projects were submitted (in December 1968,) were involved in any insured projects. We found, however, that eight other proposed projects of ~~the~~ Julio Brothers were being considered by HUD for mortgage insurance in December 1968. Information regarding these eight projects is shown in the enclosure.

Ownership and relocation of a road involved
in construction of Fox Ridge project

Our review of HUD project records and discussions with officials of HUD and Baltimore County revealed that the road requiring relocation to enable construction of the Fox Ridge project was owned by ~~the~~ Julio Brothers. We were informed by Baltimore insuring office officials that ~~the~~ Julio Brothers planned to relocate the road and that they had entered into an agreement with Baltimore County whereby ownership and control of the relocated road was to be transferred to the county upon completion of the project. Our review of HUD project records showed that the relocation cost was included in the project off-site cost of \$71,490 which was used in establishing the amount of the mortgage loan to be insured.

The Director of Public Works for Baltimore County informed us in December 1969 that the existing road would be closed to all traffic when construction of the relocated road was completed. The Director stated that construction permits for that portion of the project which was to be built on the site of the existing road would be withheld until the relocation of the road was completed by ~~the~~ Julio Brothers. The Director stated also that the relocation was being carried out in accordance with Baltimore County's master plan.

Coordination with Baltimore County government

HUD project records showed that, in accordance with HUD procedures for approval of mortgage insurance applications, the Baltimore insuring

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office ascertained that the land on which the proposed projects were to be situated was zoned by Baltimore County to permit the construction of the proposed Fox Ridge and Franklin Park projects. Officials of the insuring office informed us that, because the land had the required zoning classification, they did not consider it necessary to inform the County of the issuance of the conditional commitments to insure the mortgage loans for the projects. These officials pointed out, however, that, before the County would issue construction permits to ~~the~~ Julio Brothers, it would require the submission of construction plans for the purpose of determining whether the streets, water and sewer service, and other community facilities were adequate to serve the projects.

Instructions not followed by insuring office
in issuing conditional commitments to insure
mortgage loans

HUD procedures provided that a preliminary reservation of funds for interest reduction payments must be obtained for each project before notification is given a project sponsor of the feasibility of a project for insurance under section 236 and before issuance of a conditional or a firm commitment to insure a mortgage loan. This requirement was established by HUD to ensure that the subsequently approved interest reduction payments do not exceed the aggregate contractual authority to make interest reduction payments as authorized in appropriation acts.

On June 27, 1969, HUD changed the above procedures to allow insuring offices to issue notifications of the feasibility of projects for insurance without first obtaining reservations of funds for interest reduction payments. This revision, however, required that the notifications contain provisions that the feasibility of the projects be subject to funds being made available for interest reduction payments. We were informed by HUD officials that contractual authority of \$25 million provided by the Supplemental Appropriation Act, 1969, for interest reduction payments had been substantially allocated to various projects and that the revised procedures were established to permit an orderly processing of mortgage insurance applications pending passage of the Second Supplemental Appropriations Act, 1969, which increased by \$45 million the contractual authority to make interest reduction payments. We were informed also that the June 27, 1969, revised procedures were intended to apply only to the notifications of project feasibility.

We found, however, that the Baltimore insuring office issued on July 10, 1969, conditional commitments to insure mortgage loans for the Fox Ridge and Franklin Park projects, which contained provisions that the commitments were subject "to the reservation of funds being approved and allocated." We were advised by an official of the HUD Office of General Counsel that, in accordance with the above provision, HUD was not bound to complete the processing of the applications for mortgage insurance until reservations of funds were approved for the projects. HUD officials informed us that the insuring office had misinterpreted the revised instructions and the conditional commitments should not have been issued at that time.



The Second Supplemental Appropriations Act, 1969, was passed on July 22, 1969, and reservations of funds were approved for the two projects on August 8, 1969.

With respect to the legality of conditional commitments, HUD's General Counsel stated that a conditional commitment to insure a mortgage loan that did not include any provision for cancellation, was a binding contract that obligated HUD to issue a firm commitment to insure the mortgage loan provided that all the conditions contained in the conditional commitment were met by the applicant. In this regard, we were informed by HUD officials that the Acting Assistant Secretary-Commissioner, FHA, forwarded to you on October 1, 1969, a letter which included citations of law and precedent to support HUD's legal opinion that a conditional commitment was a valid contract.

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We have not obtained formal written comments from HUD officials concerning matters discussed in this report; however, the information contained herein has been discussed informally with HUD officials and is based on information available in HUD files or otherwise furnished to us by HUD and Baltimore County officials.

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We trust that the above information will serve the purpose of your request. In accordance with arrangements made with Mrs. Thomas of your staff, we plan to make no further distribution of this report unless requested by you.

Sincerely yours,

R.F.KELLER

Assistant Comptroller General
of the United States

Enclosure

The Honorable Clarence D. Long
House of Representatives

JULIO BROTHERS PROJECTS BEING CONSIDERED FOR MORTGAGE INSURANCE BY HUDAS OF DECEMBER 31, 1968

<u>Project</u>	<u>Location</u>	<u>Section of act</u>	<u>Stage of mortgage insurance approval</u>	<u>Mortgage amount</u>
Rockdale Manor	Baltimore County, Md.	221-d-4	Firm commitment issued ¹	\$2,993,900
Woodland Apartments	Baltimore, Maryland	221-d-3	Firm commitment issued ²	246,800
Mosher Court Apartments	Baltimore, Maryland	221-d-3	Firm commitment issued ¹	660,400
Bentalou Court Apartments	Baltimore, Maryland	221-d-3	Firm commitment issued ¹	434,600
Woodland Apartments II	Baltimore, Maryland	221-d-3	Firm commitment issued ²	241,000
Garrison Apartments	Baltimore, Maryland	221-d-3	Notification of project feasibility	Not determined
Arbuta Arms Apartments	Baltimore, Maryland	221-d-3	Firm commitment issued ¹	2,108,500
Pioneer City	Pioneer City Anne Arundel County, Md.	221-d-3	Notification of project feasibility-application for firm commitment being considered by FHA	1,290,000

¹ Under construction

² Construction not started