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

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Dear Mr. Pelly:

Your letter of January 26, 1970, requested us to make a limited review at the Federal Housing Administration (FHA) insuring office in Seattle, Washington, to determine whether its practices in the sale of acquired single-family properties were contributing to the higher average loss on sales in the State of Washington than that experienced, nationwide, by FHA. Also, as subsequently discussed with you, we have given consideration to whether the losses incurred by the Seattle insuring office were attributable, in part, to the practice of making extensive repairs to the acquired properties.

The primary function of FHA, an agency of the Department of Housing and Urban Development (HUD), is the administration of mortgage loan insurance programs authorized by the National Housing Act, as amended (12 U.S.C. 1701 _et seq_.). When an FHA-insured mortgage loan is terminated for default, the mortgagee may transfer the collateral property to FHA in exchange for payment of the outstanding balance of the mortgage loan and related acquisition costs. FHA procedures provide that such properties be sold as promptly as possible at the highest price consistent with the current sales market.

The profit or loss on the sale of acquired properties represents the difference between the sale proceeds and the costs incurred by FHA for payment of the mortgagee's claim and for the maintenance, repair, and sale of the property. As of June 30, 1969, the total income received by FHA from assessment of premiums for insured mortgage loans on single-family properties and from fees, investments, and other sources had been sufficient to cover its expenses connected with the management and disposition of acquired single-family properties.

In our review, we compared the practices of the FHA insuring office in Seattle with those of three FHA insuring offices in adjacent areas—Boise, Idaho; Portland, Oregon; and Spokane, Washington—because the losses incurred by these offices were substantially less than those incurred by the Seattle office. In our view, such a comparison should indicate whether the higher loss experience of the Seattle office was attributed primarily to its practices or to other factors beyond its control.

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Of the 39 counties in the State of Washington, 22 are located within the jurisdiction of the Seattle office and include the cities of Seattle and Tacoma, 14 are located in the area of the Spokane office, and three are located in the area of the Portland office. The areas served by the Portland and Spokane offices also include some counties in Oregon and Idaho, respectively. Most of the home properties sold by FHA in the State of Washington in 1969 were located in the 22-county area of the Seattle office.

As part of our review, we examined the sales records for 53 properties sold by the Seattle office, 14 properties sold by the Boise office, 16 properties sold by the Portland office, and seven properties sold by the Spokane office during the 6 months ended December 31, 1969. The information obtained during our review is presented below.

Data obtained from HUD's records of property sales showed that FHA incurred an average loss of about $3,200, nationwide, on the sale of about 11,300 acquired single-family properties during the 6-month period ended December 31, 1969. The average loss of the Seattle office was about $4,500, or about 41 percent higher than the national average. The following table shows the number of properties sold and the average loss incurred by the Seattle, Boise, Portland, and Spokane offices for the 6 months ended December 31, 1969.

	Properties sold	
Insuring office	Number	Average loss
Seattle	224	$4,500
Boise	17	2,600
Portland	60	2,500
Spokane	43	2,500

FHA records for the property sales we examined in the four offices showed that certain conditions existed which tended to explain why losses in the Seattle office were higher than those of the other three offices.

The largest average cost item connected with the sale of an acquired property, other than the payment of the mortgagee's insurance claim, was for repairs. FHA instructions provide that:

> "***properties to be offered for retail sale shall include all repairs necessary to create maximum sales appeal and to eliminate existing or potential structural, mechanical and other deficiencies and in addition thereto such upgrading which because of type and location of the properties the director (of the insuring office) determines is necessary to generate sales, or to stablize or improve neighborhoods."

Officials at the Seattle office told us that, in accordance with these instructions, the extent of repairs to a property was determined on a property-by-property basis. Information in the sales records for the 53 properties that we reviewed at the insuring office tended to support this statement. These records showed that repair costs ranged from about $160 to $7,800 a property and averaged about $3,300.

According to the records we examined at the four offices, the amount of repairs generally increased with the age of the property, as shown in the following schedule.

	Average repair costs			
Age of property	Seattle	Boise	Portland	Spokane
Less than 10 years	$1,536	$1,907	$1,024	(a)
10 to 20 years	2,825	2,475	2,161	$2,823
21 to 40 years	3,555	3,060	2,124	3,360
Over 40 years	5,626	3,822	4,196	(a)

[a] No properties of this age were included in our test of property records.

Our examination of selected property sales also indicated that about 55 percent of the properties sold by the Seattle office were over 20 years old, whereas only 38 percent of the properties sold by the Boise, Portland, and Spokane offices were over 20 years old.

Most of the properties included in our review at the Seattle insuring office were located in the Seattle-Tacoma area. An insuring office official stated that labor and material costs were higher in that area than in the surrounding areas. Data we obtained from the Bureau of Labor Statistics showed that the pay scales for building trades involved in home repair were generally higher in the Seattle-Tacoma area than in the Boise, Portland, or Spokane areas. Also, information obtained from HUD showed that construction costs were higher in the Seattle-Tacoma area than in Boise, Portland, or Spokane.

Although the generally higher labor and material costs in the Seattle-Tacoma area seemed to be a contributing factor to the higher repair costs of the Seattle office, our examination indicated that more significant factors were the greater percentage of older properties sold by the Seattle office and the generally greater repair costs incurred for these properties. Because the repair work had been completed and the properties had been sold at the time of our review, we did not attempt to determine whether the repairs made to the properties were more extensive than those suggested by the FHA guidelines.

The average sales expense incurred by the Seattle insuring office was higher than that incurred by the Boise, Portland, and Spokane offices. The higher sales expense of the Seattle office appeared to be principally attributable to the payment of discount points in connection with a substantial number of sales which had been financed by private lenders rather than by the Government National Mortgage Association (GNMA). Sales financed by GNMA did not involve the payment of discount points.

During the 6-month period ended December 31, 1969, about 67 percent of the properties sold by the Seattle insuring office were financed by private lenders, whereas only 33 percent of the properties sold by the Boise, Portland, and Spokane insuring offices were financed by private lenders. The remaining sales generally were financed by GNMA or did not involve mortgage financing. For the property sales we examined at the Seattle office, the discount rates applicable to privately financed mortgage loans ranged from 4 to 5-1/2 percent of the mortgage loan amount and averaged about $700 per property.

An official at the Seattle insuring office advised us that the practice of placing mortgages with private lenders rather than with GNMA was in accordance with instructions from HUD headquarters in Washington, D. C. In this regard, the FHA instructions state that GNMA financing will be permitted only after diligent efforts have been made to obtain private financing.

We did not obtain formal written comments from officials of the FHA insuring offices; however, the information contained herein has been discussed with them and is based primarily on information available in FHA files or otherwise furnished by FHA officials.

We trust that this information will serve your needs.

Sincerely yours,

R. F. Keller

Assistant Comptroller General
of the United States

The Honorable Thomas M. Pelly
House of Representatives