

CED-76-141

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*REPORT OF THE  
COMPTROLLER GENERAL  
OF THE UNITED STATES*

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Protecting And Disposing Of  
Single-Family Properties  
Acquired By The Department Of  
Housing And Urban Development

Many of the Department's single-family properties in the Chicago area have not been preserved and protected and have deteriorated badly. Many are now health and safety hazards in their communities. This situation contributes to the \$14,025-average loss the Department experiences on every Chicago property sold.

Although better supervision by area managers under contract to preserve and protect the Department's inventory of single-family properties would mitigate some of the problems, many of those observed by GAO were beyond the control and took place despite the efforts of either the area manager or the Department.

Given the magnitude of the losses the Department is incurring, the impact of such losses on the status of its reserve funds, and the immeasurable losses in terms of neighborhood deterioration, something must be done. One possible and partial solution might be through a broadened rental program, since occupancy appears to be good defense against the vandalism and deterioration now occurring.

CED-76-141

AUG. 31, 1976

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

B-114860

*R1*  
*cl* The Honorable William Proxmire, *5700*  
Chairman, Committee on Banking,  
Housing and Urban Affairs  
United States Senate

*R2*  
*com* The Honorable Adlai E. Stevenson III  
United States Senate

Pursuant to your June 23, 1975, request and later discussions with your offices, we reviewed the Department of Housing and Urban Development's single-family property management and disposition operations in Chicago, Illinois. We also reviewed the Department's mortgage loan origination practices.

We obtained Department comments and considered them in preparing this report. They are included as appendix I.

*C314*  
*C516* The report contains recommendations to the Secretary of Housing and Urban Development. As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House and Senate Committees on Government Operations not later than 60 days after *21500* the date of the report and the House and Senate Committees on *2300* Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. As agreed with your offices, we are sending copies of the report to the Secretary and the four Committees to set in motion the requirements of section 236. Copies of the report are also being sent to Members of Congress who have expressed an interest in it.

*Ryker*  
ACTING Comptroller General  
of the United States

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ABBREVIATIONS

GAO	General Accounting Office
HUD	Department of Housing and Urban Development
OIG	Office of Inspector General

REPORT OF THE COMPTROLLER  
GENERAL OF THE UNITED STATES

PROTECTING AND DISPOSING OF  
SINGLE-FAMILY PROPERTIES  
ACQUIRED BY THE DEPARTMENT OF  
HOUSING AND URBAN DEVELOPMENT 23

D I G E S T

The Chairman, Senate Committee on Banking, Housing and Urban Affairs, and Senator Adlai E. Stevenson III asked GAO to review aspects of the Department of Housing and Urban Development's single-family property management and disposition operations in Chicago, Illinois, including preservation and protection of properties owned by the Department and the disposition of such properties through the as-is sales method. GAO was also asked to provide information on the Department's monitoring of mortgagee loan origination practices.

PRESERVING AND PROTECTING ACQUIRED PROPERTIES

Many single-family properties owned by the Department of Housing and Urban Development in the Chicago area have not been adequately preserved and protected and have deteriorated badly. Many present health and safety hazards and contribute to physical deterioration of neighborhoods and the huge losses the Department has suffered on its single-family property sales.

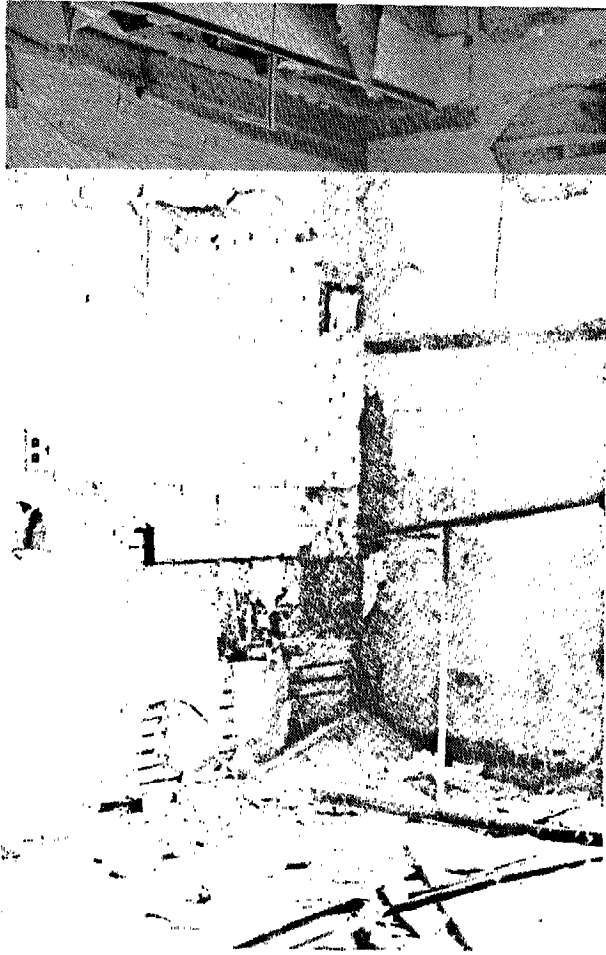
These losses have added to serious financial difficulties now faced by two of the Department's insurance funds. The two funds had a combined deficit of about \$2.1 billion as of June 30, 1975. For the 12-month period ended April 30, 1976, the Department lost \$610.4 million on about 65,000 single-family properties sold, or an average loss of \$9,341 for each property. During the same period, the Department's Chicago area office lost \$27 million on about 1,900 properties sold, or an average loss of \$14,025 for each property. (See p. 5.)

The Department's inventory of single-family properties grew from about 26,800 in December 1970 to about 78,000 in May 1974. Although the inventory had declined to about 45,000 properties as of

June 30, 1976, that of the Chicago area office continued to increase to an all-time high of 4,297 as of April 30, 1976. By June 30, 1976, this inventory had declined to about 4,000 properties. (See p. 3.)

GAO noted problems at 77, or about 86 percent, of the 90 vacant properties it inspected. These included

- missing or unlocked doors;
  - windows not fully boarded;
  - destructive vandalism, such as smashed toilets and sinks and walls partially or totally destroyed;
  - equipment, such as sinks, cabinets, furnaces, and water heaters, removed; and
  - hazardous conditions, such as open catch basins and porches with weak landings.
- (See p. 7.)



KITCHEN OF ONE PROPERTY GAO INSPECTED.

Causes of these problems involve

- vandalism, theft, and similar factors beyond the Department or area manager's control;
- area managers either not performing, or not performing expeditiously, required preservation activities; and
- the Department's failure to provide supervision and review needed to support area manager performance.

The Department's policy of discouraging occupancy of acquired properties may also be contributing to the damage and deterioration taking place. However, in March 1976 the Department proposed regulation changes that could, in some cases, permit tenants and former owners to continue living in Department-insured housing which has been foreclosed and turned over to it.

Of 71 properties only 29 showed evidence that area managers were making the two required monthly inspections. The managers attributed their performance to workload and labor problems and said they are now making the required visits. (See p. 29.)

The Department's supervision of its Chicago area managers has been inadequate. Realty specialists responsible for such supervision have not been making required inspections of properties and area manager records and have been devoting most of their time to other property disposition functions. One Chicago area office official said he had only 35 authorized positions to perform 48 staff-years of property disposition work. (See p. 31.)

Although better performance by area managers and better supervision by the Department would mitigate some of the problems, many GAO observed were beyond the control and took place despite the efforts of either the area manager or the Department. For example, an area manager had boarded 1 property 11 times in a 10-month period at a total cost to the Department of \$631. (See p. 9.)

#### RECOMMENDATIONS TO THE SECRETARY

To better preserve and protect single-family properties, the Secretary should:

- Emphasize to area managers the important work they do and the need for them to perform quickly all preservation and protection duties assigned.
- Insist on strict adherence by the Department's field offices to requirements regarding (1) property inspections, (2) reviews of area manager records, and (3) replacement of managers found not complying with contracts.



- Clarify instructions regarding hazardous conditions by defining such conditions more clearly and what the area manager is authorized to do to eliminate them.
- Examine the possibility of broadening the rental program to include those properties in HUD's inventory which are vacant and in areas where the turnover of properties is slow and the properties are subject to acts of vandalism and equipment removal. (See pp. 35 and 36.)

#### AGENCY COMMENTS

The Department agreed with the recommendations in the report and has actions underway or planned in response to them.

#### IMPACT OF AS-IS SALES

Nationally, and particularly in Chicago, the Department has in recent years emphasized selling its single-family properties as is--all cash without warranty and insurance. From the Department's point of view, this method is at times the best way to achieve its objective of returning the most moneys to its insurance funds.

Nationally, as-is sales have increased from 10 percent of total sales in 1972 to 55 percent in the first 5 months of 1976. For the same period, the increase in as-is sales by the Chicago area office has been even more pronounced, from 2 percent to 83 percent. (See p. 5.)

GAO examined 60 properties in the Chicago area sold as is. Of these, 51 (85 percent) were occupied, had been repaired to some extent, and equaled or exceeded others in the neighborhood in general appearance. (See p. 41.)

Some of the properties reviewed were vacant (6 of 60 properties, or 10 percent) and in GAO's opinion were detrimental to the neighborhood. Three had been demolished. (See p. 41.)

While GAO's findings regarding the as-is sales method in Chicago were generally favorable, Department studies in other locations have identified some conditions GAO considers limitations or drawbacks to the method. (See p. 52.)

The Department has taken a number of actions recently to insure that as-is sales do not affect communities adversely by increasing or contributing to neighborhood blight and deterioration, including (1) redefining its property disposition objective to recognize the nationwide need to preserve and maintain urban residential areas and communities, (2) implementing an urban homesteading demonstration program involving about 1,000 properties in 22 cities, and (3) developing, in conjunction with the city of Chicago, a plan for disposing of its acquired properties in the city. (See p. 53.) If properly carried out, these actions could lessen or avoid some of the limitations that have been associated with the as-is sales program.

#### MONITORING OF MORTGAGEE LOAN ORIGINATION ACTIVITIES

The Department's monitoring of mortgagee loan origination activities has not been as effective as it should have been. The Department recently has taken actions which should improve its monitoring. (See p. 63.)

## CHAPTER 1

### INTRODUCTION

In accordance with a June 23, 1975, request from the Chairman, Senate Committee on Banking, Housing and Urban Affairs, and Senator Adlai E. Stevenson III and agreements with their offices, we examined aspects of the Department of Housing and Urban Development's (HUD's) single-family property management and disposition activities in Chicago and its monitoring of mortgage lenders' loan origination operations. We were asked to:

- Determine if (1) HUD and its area managers are complying with requirements to preserve and protect defaulted properties pending disposition and (2) HUD is adequately monitoring the performance of its area managers to insure that Government interests are protected.
- Assess the community impact of HUD's practice of selling properties as is.
- Determine whether HUD adequately tries to identify mortgage lenders responsible for an excessive proportion of bad loans and makes certain that the underwriting officials closely supervise those lenders.
- Summarize the findings, conclusions, and recommendations contained in HUD's (1) Office of Inspector General (OIG) audit reports on loan origination activities followed by six mortgagees in the Chicago area and (2) Chicago task force report pertaining to the matters covered by our review.

The Committee and the Senator were concerned because, beginning in June 1975, the Chicago Tribune published a series of articles alleging waste and mismanagement in HUD's single-family property management operations. In response to these allegations, the Secretary of HUD established a task force to review and recommend solutions to the matters described in the articles. The Secretary also directed OIG to examine insurance application processing by six mortgagees operating in the Chicago area.

PRESERVING AND PROTECTING  
PROPERTIES ACQUIRED UNDER  
HUD-INSURED MORTGAGE PROGRAMS

The National Housing Act (12 U.S.C. 1701), as amended, allows HUD to insure mortgage loans on various types of housing, including single-family houses. A homebuyer generally makes a downpayment and obtains a mortgage loan for the balance of the purchase price. A bank, a savings and loan association, an insurance company, or other HUD-approved lender (mortgagee) makes the loan, and HUD insures it. Under the insurance contract, HUD charges an insurance premium which the mortgagor pays. HUD insurance guarantees the mortgagee that, if the purchaser defaults, HUD will honor the mortgagee's claim. If a mortgagor defaults and the mortgage is foreclosed, the property is conveyed to HUD and becomes part of its inventory.

By virtue of ownership, HUD is charged with preserving and protecting the Government's interest in all property conveyed to it. HUD's basic objective is to dispose of the property as promptly as possible, while insuring a maximum dollar return on its investment.

To provide necessary onsite management services for its properties, HUD contracts with brokers, community groups, or individuals to act as area managers for its properties within specified geographic areas. Area managers are contractually required to perform a number of duties, including those relating to the preservation and protection of all properties within their jurisdiction. They are required to initially inspect each newly acquired property within 5 working days after being notified of the acquisition. To maintain continuing control over the property, the manager is additionally required to inspect each property at least twice a month.

For vacant properties HUD acquires, area managers are responsible for arranging for and/or supervising such services as:

- Securing the properties against unauthorized entry and damage from the elements.
- Removing all trash and debris from the interior and exterior of the premises.
- Winterizing all water systems and equipment in vacant properties to prevent damage from freezing.

--Mowing the grass and trimming the shrubbery.

--Eliminating conditions hazardous to the public.

Either the area manager or HUD generally subcontract for these services. HUD pays for the services in addition to the monthly fees it pays the area manager.

For occupied properties, certain area managers are responsible for such things as signing leases, collecting rents, and evicting tenants for nonpayment of rent. For these services, the managers receive 5 percent of the gross rents in addition to the monthly fee discussed above.

Area manager contracts, usually covering 3 years, are awarded through competitive bids. HUD's Chicago area office had 19 area managers under contract to manage its properties at fees ranging from \$8 to \$26.50 a month for each property. Differences in fees between areas results from variations in services required under each contract, property locations, and complexities of the management and repair programs. Area managers must have all required local licenses in order to perform under a contract.

HUD's acquired property program is sales oriented, and properties are normally held vacant to allow them to be rehabilitated in the shortest practicable time and to effect a prompt sale and occupancy by purchasers. A rental program may be authorized, however, when a sales program would involve long delays or when occupancy is essential to prevent vandalism or rapid deterioration.

#### SINGLE-FAMILY PROPERTIES IN HUD'S INVENTORY

HUD's nationwide inventory of single-family properties grew dramatically from 26,831 in December 1970 to as many as 78,324 in May 1974. As of June 30, 1976, however, the inventory had declined to 45,151 properties. On the average, single-family properties remain in HUD's inventory 11.6 months before HUD disposes of them.

Although the national inventory has declined, HUD's inventory of single-family properties in the Chicago area continued to increase to a high of 4,297 as of April 30, 1976. By June 30, the inventory had declined to 3,997, as shown in the following table.

<u>As of</u> <u>December 31</u>	<u>Total</u> <u>inventory</u>	<u>Single-family properties</u> <u>held 12 months or more</u>	
		<u>Number</u>	<u>Percent</u>
1970	272	0	0
1971	601	30	5
1972	1,378	179	13
1973	2,479	795	32
1974	3,224	1,256	39
1975	3,690	1,542	42
1976 (June 30)	3,997	1,776	44

The Chicago area office, while serving 19 counties in northern Illinois, has about two-thirds of its acquired properties in Chicago.

#### DISPOSITION OF SINGLE-FAMILY PROPERTIES

HUD's major sales approaches for its acquired properties are:

- Fully repaired. Under this approach, properties are repaired as necessary to comply with local codes and to be structurally sound. They are to have fully operational heating, electrical, and plumbing systems; be free of all health hazards; and be decent habitable dwellings. To stimulate sales and be competitive, HUD may include decorative and cosmetic effects, as well as some upgrading and modernizing. These properties are sold with normal HUD warranty provisions and are eligible for HUD insurance.
- As is. This approach involves selling properties as is, for cash, and without warranty. The properties are not repaired, are not eligible for insurance, nor do they carry a HUD warranty.
- Limited repairs. This approach is used where as-is sales are determined to be inappropriate because of the possibility of undesirable effects on the preservation and maintenance of urban residential areas. Repairs of a limited nature or scope are made which eliminate undesirable elements of the as-is sale. In addition, limited repair sales shall, in all respects other than repairs, be identical to as-is sales; i.e., no warranty, all cash without mortgage insurance.

In recent years HUD has placed increased emphasis on as-is sales to expedite the turnover of and reduce its holding and repair costs on acquired properties while at the same time

ensuring the maximum return to the mortgage insurance funds. HUD's Assistant Secretary for Housing-Federal Housing Commissioner also advised that as-is sales have been used consistent with a recognition of the need to preserve and maintain urban residential areas and neighborhoods. Nationally, such sales have increased from 10 percent in 1972 to 55 percent in the first 5 months of 1976.

As the following table depicts, the Chicago area office's shift to as-is sales has been even more pronounced.

<u>Type of sale</u>	<u>Number of sales closed (calendar year)</u>					<u>Total</u>
	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u> (note a)	
As is, all cash without warranty (note b)	12	402	942	1,875	383	3,614
Other types	<u>480</u>	<u>398</u>	<u>770</u>	<u>87</u>	<u>76</u>	<u>1,811</u>
Total	<u>492</u>	<u>800</u>	<u>1,712</u>	<u>1,962</u>	<u>459</u>	<u>5,425</u>
As-is percent of total sales	2	50	55	96	83	67

a Includes data for January through May 1976.

b Includes properties sold for demolition.

#### HUD LOSSES ON SALES OF ACQUIRED PROPERTIES

Although HUD's policy is to achieve the maximum dollar return on its investment in its acquired properties, HUD is experiencing considerable losses on the properties it sells. Losses are incurred when the cost to acquire and hold properties in inventory, including the cost of maintenance and repairs, exceeds the price obtained when the property is sold. For example, for the 12-month period ended April 30, 1976, HUD nationally lost \$610.4 million on about 65,000 single-family properties sold, for an average loss per property of \$9,341.

During the same period, the Chicago area office lost \$27 million on about 1,900 single-family properties sold. The average loss per property was \$14,025. The following table shows that Chicago ranked fifth among the 10 HUD area offices with the largest average losses per property sold.

<u>HUD area office</u>	<u>Average loss</u>
New York	\$19,874
Newark	18,033
Detroit	15,547
Boston	15,168
Chicago	14,025
Hartford	13,071
Los Angeles	12,608
Minneapolis	10,879
Cincinnati	10,502
Indianapolis	10,057

These losses have contributed to the approximately \$2.1 billion combined deficit (as of June 30, 1975) of the General Insurance Fund and the Special Risk Insurance Fund--two of HUD's four insurance funds. HUD has financed the deficit in large part by borrowing from the Treasury. Outstanding borrowings have resulted in increasing interest costs to the funds, which have further drained available funds. In fiscal year 1975, the two funds paid a total interest of about \$203 million. Interest costs through fiscal year 1975 totaled about \$424 million.

The 1976 Supplemental Appropriations Act provided \$142.5 million to HUD to reimburse the funds for partial losses incurred. HUD has requested \$825.7 million additional for fiscal year 1977 to cover losses in the Special Risk Insurance Fund.

#### SCOPE OF REVIEW

We made our review at HUD headquarters, Washington, D.C., and at HUD's Chicago area office. We visited four area managers under contract to HUD and several departments of the city of Chicago. We inspected properties held in HUD's inventory of acquired properties to determine whether they were being adequately preserved and protected. We also examined selected properties sold as is by HUD and interviewed purchasers of such homes.

At the Chicago area office we reviewed policies and procedures for managing and disposing of acquired single-family properties and the supervision HUD exercised over its area managers. We did our fieldwork from August through November 1975.



## CHAPTER 2

### HUD AND AREA MANAGERS NEED TO BETTER PRESERVE AND PROTECT HUD-ACQUIRED SINGLE-FAMILY PROPERTIES

The Government's interest has not been protected for many single-family properties HUD acquired in the Chicago area. Generally, these properties have not been adequately preserved and protected and, as a result, contribute to the physical deterioration of the neighborhood and/or present health and safety hazards to the community. This deterioration also contributes to the losses HUD has experienced on its single-family property sales. The principal causes of these problems involve:

- Factors beyond HUD or the area manager's control.
- Area managers either not performing, or not expeditiously performing, required management.
- HUD's failure to provide the supervision and review needed to insure area manager performance.

HUD's policy of discouraging occupancy of its acquired properties also may be contributing to the damage and deterioration.

### PROBLEMS IN PRESERVING AND PROTECTING PROPERTIES IN CHICAGO

Problem conditions existed at 77, or 86 percent, of the 90 vacant properties we inspected in 10 Chicago area neighborhoods, indicating they were not being adequately preserved and protected. Types of conditions and the frequency in which they were found are shown below.

<u>Problem condition</u>	<u>Number of properties</u>
Not adequately secured against unauthorized entry	23
Interior debris not removed	16
Destructive vandalism	18
Equipment removed	51
Fire damage	7
Conditions hazardous to the public	45
Water systems not adequately winterized	17
Yard not tended	35

The occurrence of these eight types of problem conditions varied from property to property. Only 13 of the 90 properties had no problem conditions. As the following table shows, 62 of the 90 properties had 2 or more problem conditions.

<u>Number of problem conditions</u>	<u>Number of properties</u>
0	13
1	15
2	24
3	19
4	8
5	8
6	2
7	0
8	<u>1</u>
	<u>90</u>

In some cases, the problem conditions, such as vandalism or theft, were caused by factors beyond the control of either HUD or the area manager. In other cases, the conditions resulted from the failure of HUD or an area manager to properly perform an assigned duty.

To determine how well HUD and its area managers preserve and protect HUD-owned, single-family properties, we selected 109 properties in 6 Chicago neighborhoods and 4 suburbs, as follows.

<u>Location</u>	<u>Number of properties selected</u>
Chicago neighborhood:	
Austin	14
Roseland	28
West Englewood	32
East Garfield Park	5
Morgan Park	5
Pullman	6
Chicago suburb:	
Hazelcrest	5
Maywood	5
Midlothian	3
Robbins	<u>6</u>
	<u>109</u>

We chose the Austin, Roseland, and West Englewood neighborhoods because they had large concentrations of HUD-acquired properties and were mentioned as problem areas by the press and in Senate hearings. For these neighborhoods, we randomly selected about 10 percent of the properties in the HUD inventory. The other three Chicago neighborhoods and the four Chicago suburbs were randomly selected. In each, we inspected three or more randomly selected properties.

Of the 109 selected properties, 90 were vacant and 19 were occupied. Our inspections to determine how well properties were being preserved and protected were limited to the 90 vacant properties. For seven of the vacant properties we made exterior inspections only because we were unable to enter the properties. Our observations on exterior inspections of the 19 occupied properties are discussed on page 33.

#### Properties not adequately secured

HUD instructions require area managers to secure HUD properties against unauthorized entry by boarding up all door and window openings except for one locked door to provide authorized personnel entry. Of the 90 vacant properties in our sample, 23 were not secured against unauthorized entry. Doors were missing or unlocked, and windows were not fully boarded. Representatives of community groups and neighbors said some houses had been vacant and unsecured for long periods, in some cases for more than a year. Persons living near these properties said they were detrimental to the neighborhood because children play in them, teenagers use them for partying, and vagrants hang out in them.

Some of the properties included in our review, although boarded up a number of times by area managers, had been repeatedly broken into while they were in HUD's inventory. We reviewed the records of 4 area managers who were responsible for 74 of the 90 properties included in our sample and found that 60 had been boarded up 149 times and padlocks had been replaced 45 times. Area manager records for the remaining 14 properties showed no evidence that they had been boarded up; however, our inspection disclosed that 8 had been (if not by the area manager, perhaps by the mortgagee of the property before HUD's acquisition) and 6 had not.

Area managers said it was impossible to keep some buildings secured, even with bimonthly inspections. For example, one of the properties in our sample had been boarded up 11 times in a 10-month period at a cost to HUD of \$631.

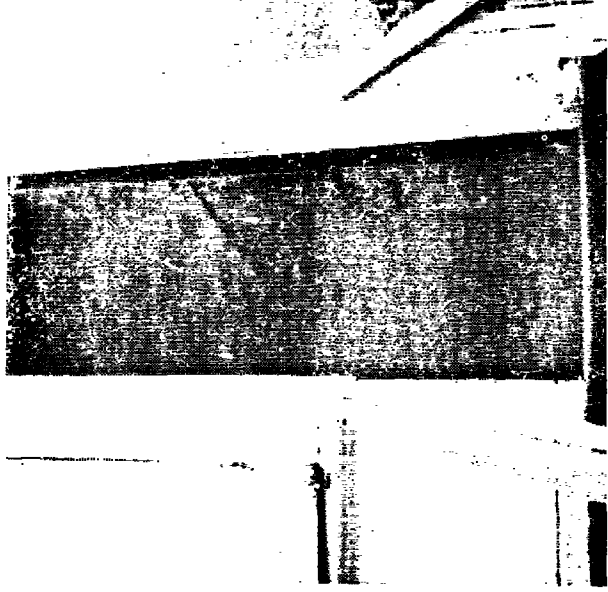
In other instances, area managers had been lax in securing properties. During our initial inspections in one

neighborhood, for example, we found five properties unsecured. Although we brought this to HUD's attention within a few days of our inspections, when we revisited the properties 4 weeks later, two of them were still unsecured and open to entry.

Photographs of two unsecured properties are shown on the following page.



DOOR MISSING ON PROPERTY IN WEST ENGLEWOOD



BACK DOOR NOT BOARDED UP OR LOCKED IN AUSTIN

In September 1975 HUD issued revised instructions to its area managers concerning the securing and boarding up of its acquired properties. These instructions, because of their greater specificity on methods and materials, should help to improve property security.

### Interior debris

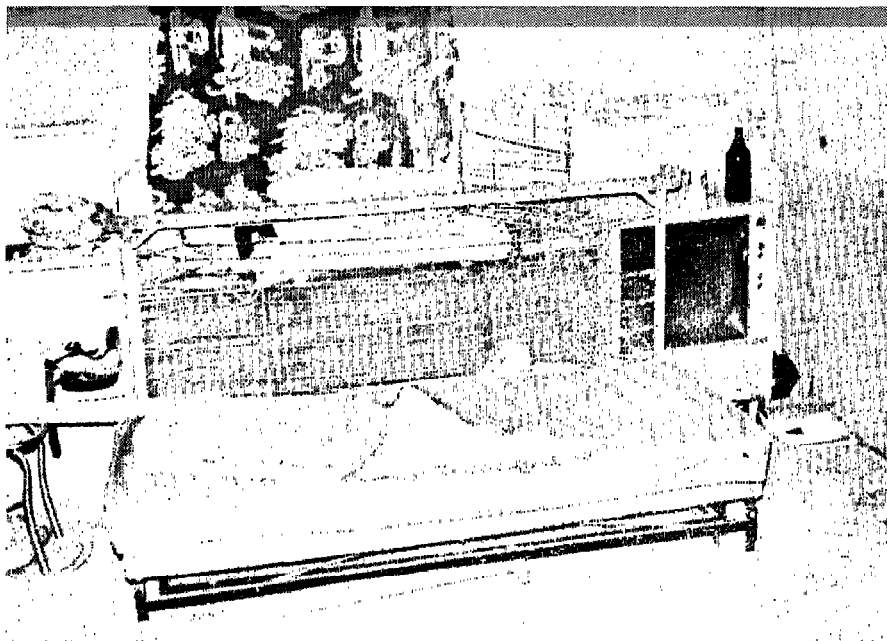
HUD instructions require area managers to arrange for and supervise the removal of all trash and debris from HUD-acquired properties. This is a continuing problem for the area manager, and the initial cleanup of a property is seldom the last.

Debris, such as clothes, garbage, furniture, and dead dogs, were found in 16 of the 83 interiors we inspected. According to area managers, HUD properties are often used as dumping grounds or for parties. In this regard, many properties we inspected contained such things as mattresses, liquor bottles, and beer cans.

Photographs of the interior of some properties are shown on pages 13 and 14.



**TRASH SCATTERED IN WEST ENGLEWOOD PROPERTY**



**FURNITURE IN BASEMENT OF PROPERTY IN AUSTIN**



**OLD CLOTHES IN PROPERTY IN AUSTIN**



**DEAD DOG IN BEDROOM OF PROPERTY IN ROBBINS**

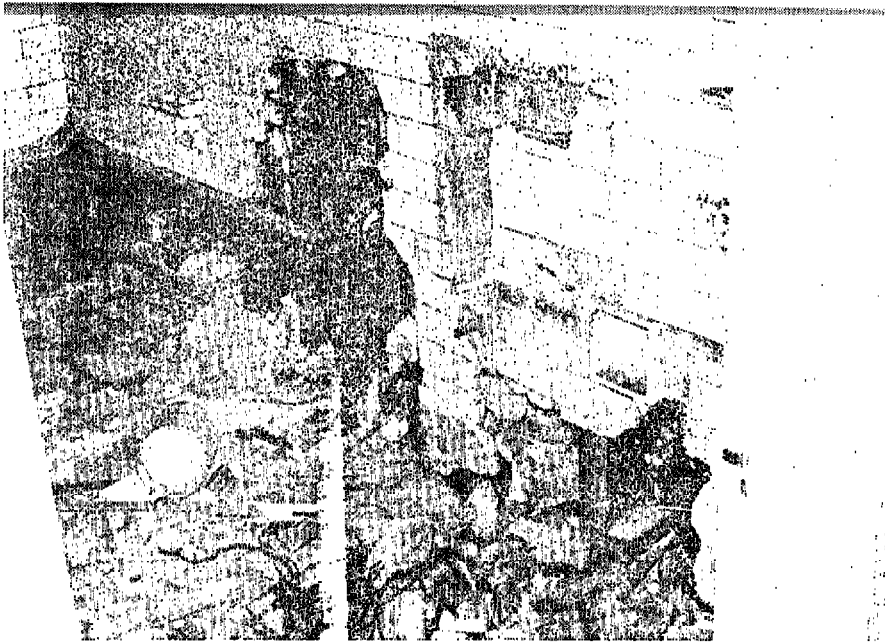


Our review of area manager records for 74 properties showed that debris had been removed from 51 of the properties a total of 134 times. Debris was removed from one property seven times during a 5-month period at a cost to HUD of \$955. For the remaining 23 properties, area managers had no record of debris removal; however, our inspections showed 12 of them to be free of trash and debris.

Some removal of debris was delayed. In one neighborhood, for example, we found debris in six properties during our initial inspections. When we reinspected one of the properties about 6 weeks later, the debris was still there.

#### Destructive vandalism and equipment removal

A large number of properties included in our sample had been vandalized and/or had equipment removed from the premises. For example, 18 properties contained evidence of destructive vandalism, such as smashed toilets and sinks, walls either partially or totally destroyed, and ceilings and roofs with large holes or with the insulation torn down. Photographs of this type of destruction are shown on pages 16 and 17.



**VANDALIZED BATHROOM IN EAST GARFIELD**



**VANDALIZED KITCHEN IN ROBBINS**



WALL TORN DOWN IN PROPERTY IN ROBBINS

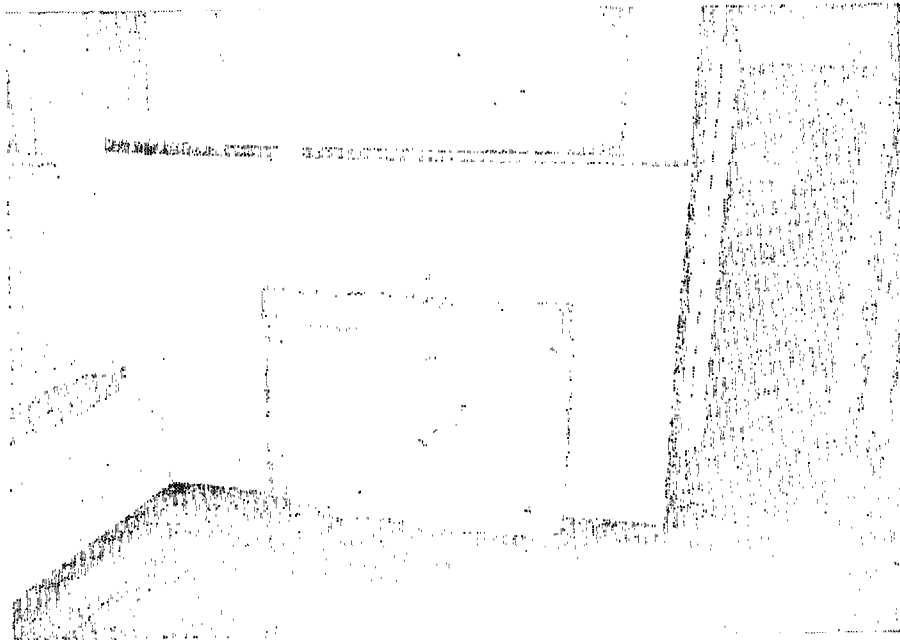


INSULATION REMOVED FROM CEILING IN PROPERTY IN ROBBINS

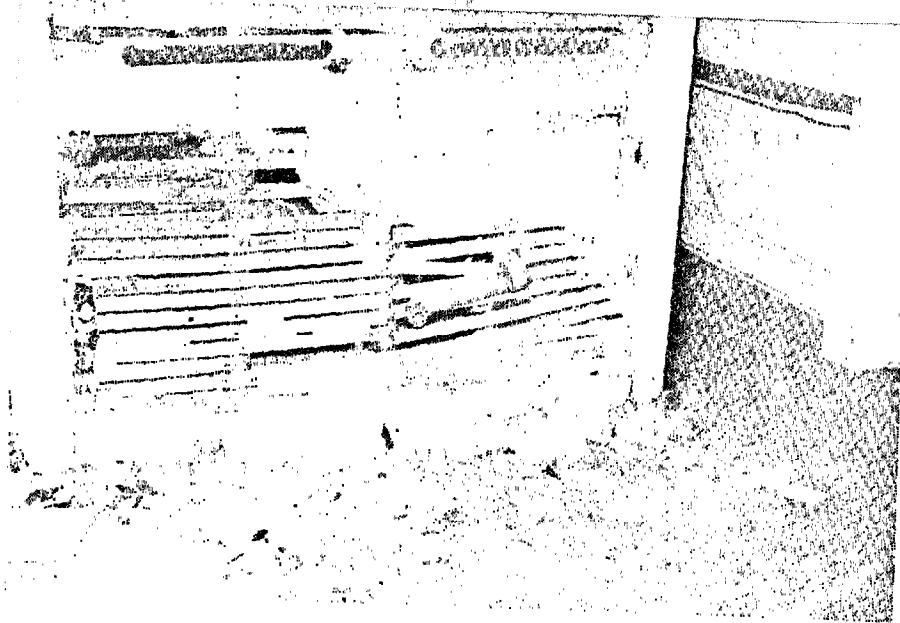
In 51 properties, such equipment as kitchen sinks and cabinets, bathroom sinks, tubs, toilets, furnaces, radiators, and water heater tanks had been removed. Photographs of properties with missing equipment are shown on pages 19 and 20.



**FURNACE REMOVED FROM PROPERTY IN ROBBINS**



**KITCHEN SINK AND CABINETS REMOVED  
FROM PROPERTY IN WEST ENGLEWOOD**



**KITCHEN SINK REMOVED FROM PROPERTY IN AUSTIN**



**BATHROOM FIXTURES REMOVED FROM PROPERTY IN AUSTIN**

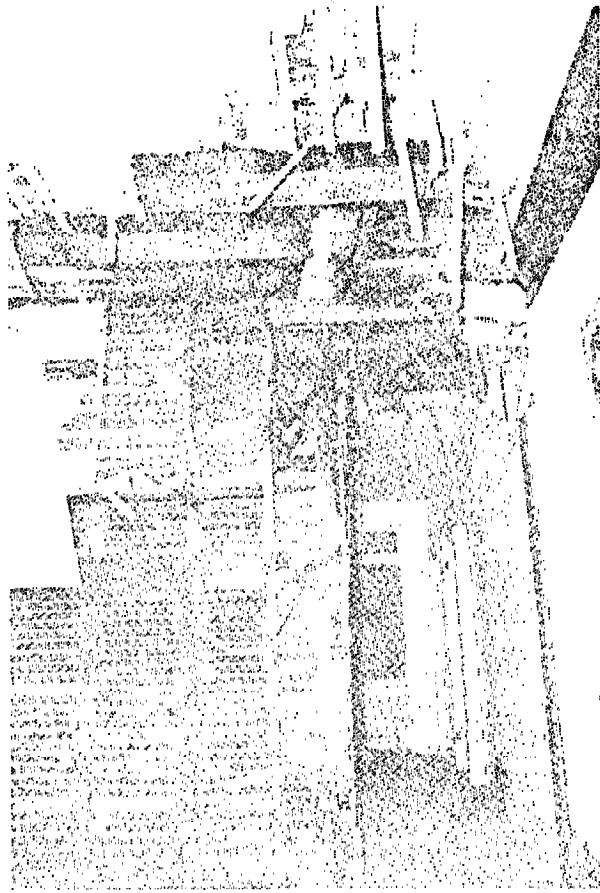
According to area managers, very few vandals are apprehended and convicted for their destruction of or thefts from HUD properties. The neighbors often do not want to become officially involved, so they call the area manager rather than the police when they see vandals at work. By the time the area manager relays the information to the police and the police respond, the vandals are usually gone. Managers said even if vandals are caught with stolen equipment, such as sinks, water heaters, or bathtubs, they will not likely be convicted. For example, one area manager said that once when he had appeared in court, the case against the defendant was dismissed because there was no serial number or other evidence to prove that the equipment had been stolen from HUD property.

One area manager advertised a \$100 reward for information leading to the arrest and conviction of vandals, but no one had collected the reward during the approximately 9 months it had been offered.

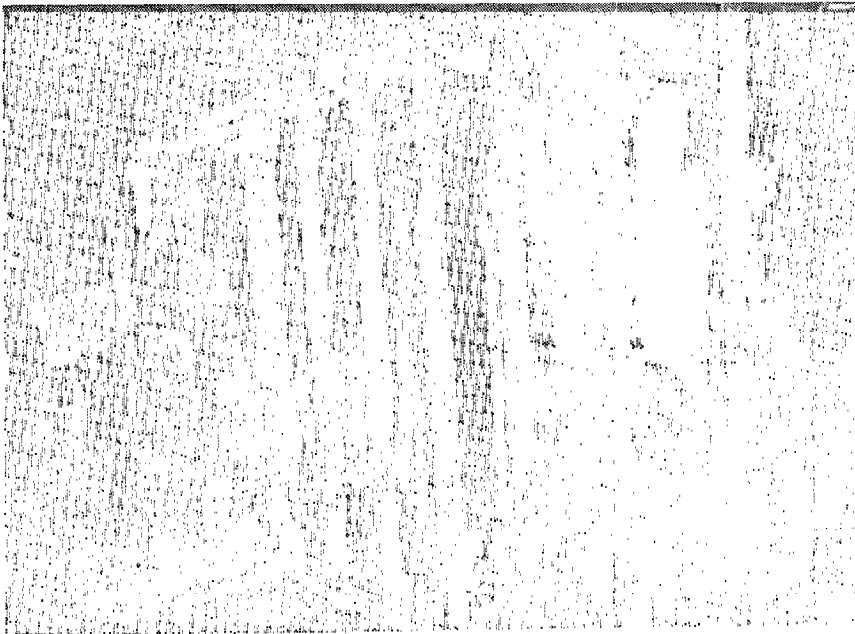
Vandalism and theft are national problems, and as evidenced above, HUD's acquired properties are not exempt from their effects. They are often found where properties are vacant, since such vacancies provide the opportunity for the vandals or thieves to go undetected. The possibility of a given property being vandalized and/or having equipment removed from it illustrates the urgent need for area managers to secure HUD-acquired properties as promptly and effectively as possible.

#### Fire damage

Seven properties we inspected had sustained fire damage ranging from relatively minor damage to a completely gutted interior. Chicago Fire Department records indicated that one of the properties had sustained fire damage before HUD's acquisition. The mortgagee had properly disclosed the damage when he conveyed the property to HUD. The other six properties were damaged by fire following HUD's acquisition. Photographs of two of the properties damaged by fire are shown on page 22.



**FIRE DAMAGE TO PROPERTY IN WEST ENGELWOOD**

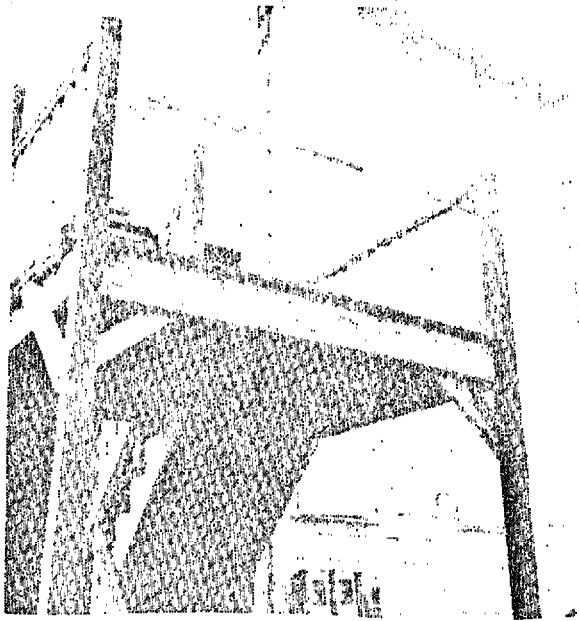


**FIRE DAMAGE TO PROPERTY IN ROSELAND**

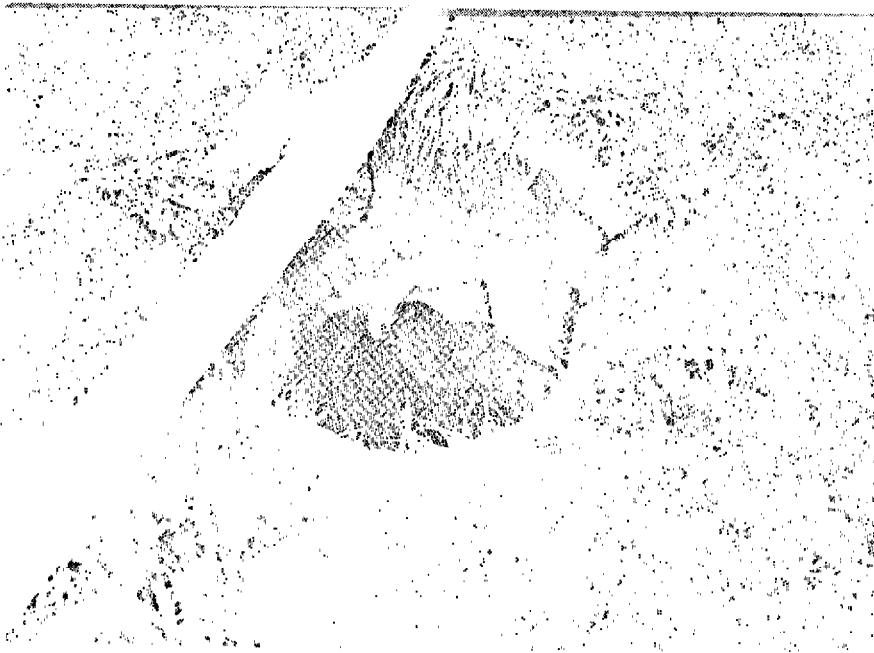


### Conditions hazardous to the public

HUD instructions require area managers to immediately see that repairs are undertaken to eliminate any hazardous conditions at a property. Although such a requirement exists, 45 of the properties we inspected had conditions which we considered to be hazardous, including open catch basins in the yards, porches with weak landings or missing railings, and windows with broken panes. Some examples are shown on page 24.



**MISSING SECOND FLOOR RAILING AT PROPERTY IN AUSTIN**



**OPEN CATCH BASIN AT PROPERTY IN WEST ENGELWOOD**

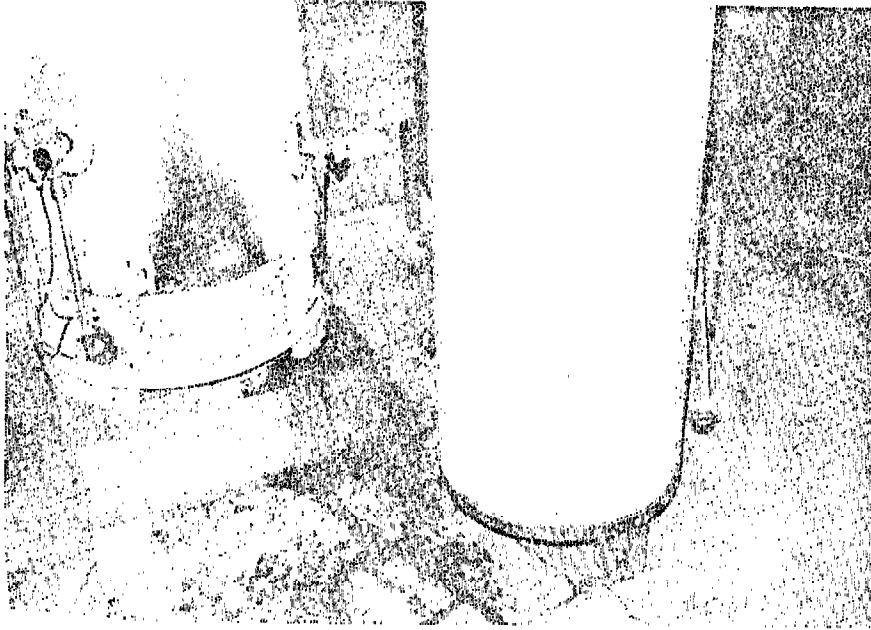
Area managers were somewhat confused as to HUD's requirements for eliminating hazardous conditions. Two area managers stated that they did not know what HUD considered to be a hazardous condition since the instructions do not provide such a definition. Although area managers are authorized to spend up to \$200 to eliminate hazardous conditions without prior HUD approval and to request approval for larger repairs, the following statements show that not all area managers understood clearly what costs could be incurred to correct hazardous conditions.

--One area manager stated he did not replace missing porch railings or cover open catch basins because he did not know if HUD would allow the cost. He also said, however, that he demolished hazardous garages and removed dead trees without prior HUD approval, regardless of the cost.

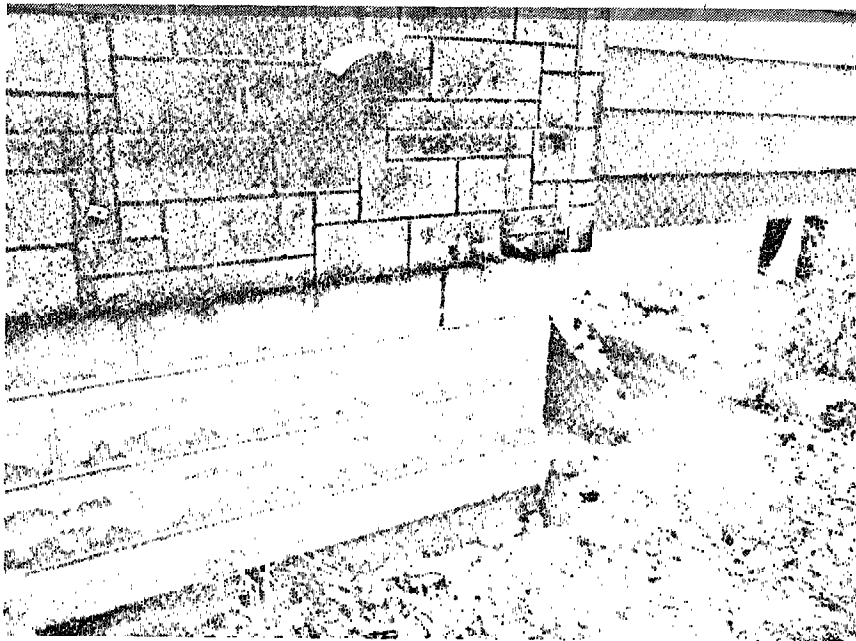
--Another area manager said he removed hazardous one-story exterior stairways but did not request approval to remove hazardous two-story stairways because he did not think HUD would approve the cost.

#### Properties not adequately winterized

HUD instructions require area managers to winterize all vacant properties--incoming water pipes are to be disconnected, plumbing and heating systems are to be drained, and antifreeze is to be poured into toilets and sink traps. This had not been done for 17 of the properties we inspected. Photographs of conditions noted at some properties are shown on page 26.



**HOT WATER TANK NOT DRAINED AT PROPERTY IN AUSTIN  
(TURNED ON BY GAO FOR DEMONSTRATION)**



**RUNNING WATER AT PROPERTY IN ROSELAND  
(TURNED ON BY GAO FOR DEMONSTRATION)**

--more difficulty in selling because many purchasers want immediate occupancy;

--the liabilities and costs of a landlord, the total of which might exceed income; and

--image problems when HUD is forced to evict tenants.

Because acquired properties are generally required to be vacant at the time they are conveyed to HUD, the Chicago task force concluded that:

"Current procedures do not allow sufficient flexibility to Field Office Directors and Regional Administrators to respond to situations which require variation from the vacancy requirement. The current procedure assumes that properties can and will be marketed expeditiously after acquisition. The standard procedures are not designed for areas in which properties are not marketable and will remain in the HUD inventory for long periods of time. The stringent limitations on the Field Office Director's ability to establish a rental program precludes the use of the program in some areas where it may be warranted."

#### Rental experience in Chicago

Only 1 of the 19 managers in the Chicago area was authorized to rent HUD-acquired properties. Because of high vandalism in its area, the manager (a community group) was allowed to rent recently acquired properties requiring minimal repairs for protecting the properties and stabilizing the neighborhoods.

The area manager had met with some success. Because of its close contacts with the community, it seemed better able to place more capable tenants in properties than was the case with those properties that were conveyed to HUD occupied; consequently the area manager's record of collecting rents from those tenants it had placed was also better.

The Chicago area office's inventory of single-family properties as of July 31, 1975, included 159 rented properties. These properties had been either occupied at the time they were conveyed to HUD or had become occupied through later rental. As previously noted, our sample of properties in the Chicago area included 19 which were occupied. The exteriors of the 19 properties we inspected were generally in much better condition than many of the vacant properties. Signs of vandalism and deterioration, so prevalent at the vacant properties, were not apparent at the occupied properties.

## Proposed regulation change

In March 1976 HUD released for public comment proposed regulation changes that could, in some cases, permit tenants and former owners to continue living in HUD-insured housing foreclosed and turned over to HUD. The proposed changes were brought about by court decisions which called for the Secretary of HUD to set forth criteria which could be used in determining whether HUD would insist on vacant delivery or would accept properties occupied. The proposed criteria provides that HUD shall accept conveyance of property with a tenant other than the former owner if it is found after inspection that

- there are no defects to the property affecting use and livability,
- there is no reasonable prospect for sale by HUD within 6 months, and
- the tenant is willing to make a deposit equivalent to 1 month's rent and sign a lease.

For conveyance of property with a former owner in occupancy, HUD shall accept such a conveyance if the former owner

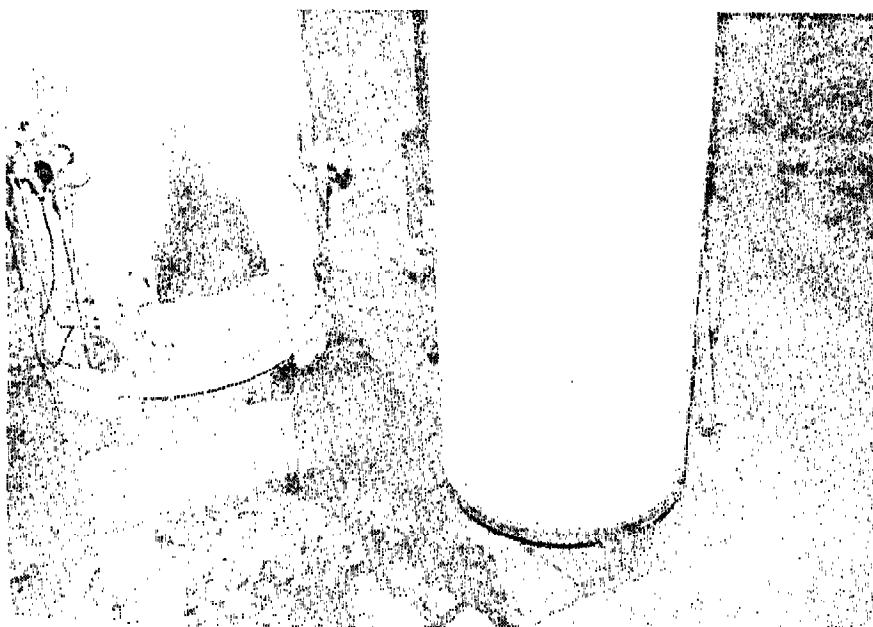
- has the financial ability to immediately repurchase the property,
- signs a contract for repurchase and makes a deposit, and
- signs a month-to-month lease to run until sales closing.

The deposit would be forfeited to HUD if the former owner fails to conclude the sale.

## CONCLUSIONS

Many of HUD's single-family properties in the Chicago area have not been adequately preserved and protected and, as a result, are badly deteriorated. Many of them are eyesores and present health and safety hazards to their respective communities. This deterioration also contributes to the \$14,025-average loss HUD experiences on every Chicago property sold.

Area managers, under contract to preserve and protect HUD's inventory of single-family properties, in many cases were not performing their prescribed duties or were not



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Area managers attributed the unwinterized properties to either oversight on their part or factors beyond their control. For example, the water had not been turned off in one house that had been vacant for about 2 months. The area manager was aware of the running water but said he neglected to request his plumbing contractor to winterize the property. In another area, we found five vacant properties with undrained water heaters. The area manager said he must have overlooked the water heaters when he made his inspections.

Three area managers with properties in Chicago stated that some winterizing problems were beyond their control. Plumbing contractors were sometimes unable to turn the water off because either they could not locate the buried turn-off valve or the valve was inoperable. In these cases, they had to request help from the city water department which they had found not always to be responsive. As an example, one plumbing contractor said he had given the water department a list of properties where the buried turn-off valves could not be located or were inoperable. After about 6 weeks without a response, he called the water department and found that nothing had been done. The water department asked him to resubmit the request because the original list could not be located.

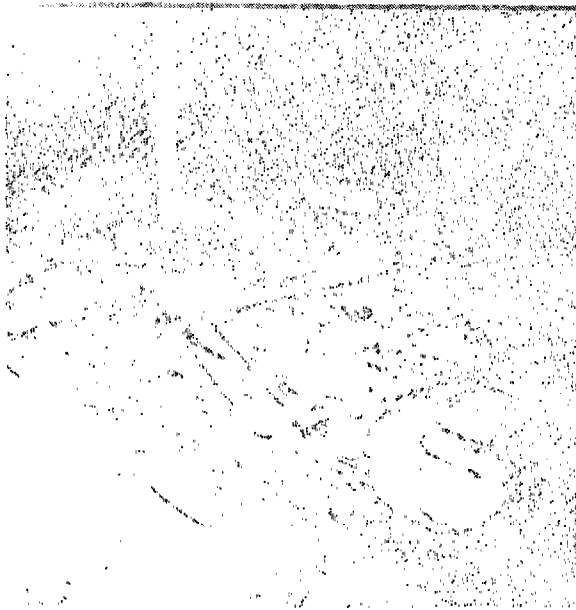
#### Properties with yards not properly tended

HUD contracts with yard-maintenance contractors to take care of the yards of its properties in the Chicago area. The contractors are to mow and edge the grass at each property about every 2 weeks from June through October 15, clip hedges and shrubbery once each month, and remove debris from the yards. HUD's area managers are to inspect the work. At the time of our review, two yard-maintenance contracts covered approximately 2,600 HUD-acquired properties in the Chicago area.

Of the 90 properties we inspected, 35 had yards which had not been properly tended. Lawns were overgrown, debris was scattered, or bushes were growing wild. Photographs of some properties are shown on page 28.



**LAWN AT PROPERTY IN WEST ENGLEWOOD**



**DEBRIS IN BACKYARD OF PROPERTY IN AUSTIN**

A neighbor of one property said that the yard-maintenance contractor cut the lawn in the front but not in the back of the property. The neighbor said that he had talked to people at the HUD area office about this but that they had done nothing. A neighbor of another HUD property said that he cut the lawn and weeds at the HUD property whenever they grew high.

The four area managers we talked to during our review were dissatisfied with the two contractors' performance, particularly with respect to the trimming of bushes and shrubbery. Three of the area managers said they did not approve the contractors' payment vouchers if all work, including trimming of bushes and shrubbery had not been performed satisfactorily. The other area manager said that they approve vouchers if the lawn has been cut and will not withhold payment vouchers because of untrimmed hedges.

The HUD contracting officer thought that, despite some problems, the yard-maintenance contractors had performed reasonably well. The HUD contracting officer said he would analyze the performance under the two contracts and that if he found poor performance, he would bar any guilty contractor from bidding next year.

#### AREA MANAGER INSPECTIONS

HUD instructions require that sign-in sheets be posted inside each property and that they be signed and dated when area manager inspections are made. Twelve properties did not have the required sheets posted, although in some cases there was evidence they had been posted at one time. For the 71 properties where sign-in sheets were posted, only 29 showed evidence of 2 visits a month by the area manager over the preceding 6 months. As stated previously, we were unable to gain entry into the remaining seven properties.

All four area managers said they are now making the required inspections. They attributed their poor inspection performance in the past to workload and labor problems and to their lack of familiarity with the areas for which they are responsible.

#### HUD SUPERVISION OF AREA MANAGERS

HUD's supervision of area managers has been inadequate to insure that its acquired properties are being properly managed. The realty specialists responsible for such supervision have not been making their required inspections of properties and area manager records because their time has been devoted to

other aspects of management. Supervision of area managers has also been hampered by staffing problems.

HUD's Property Disposition Handbook requires each area office to establish a system which will insure continuing, regular reviews of all areas of activity concerning the management of acquired properties. To insure that the quality of performance of area managers is at a high level, each area office, among other things, is required to inspect monthly at least 10 percent of the properties assigned to each manager and to review each manager's records at least every other month. To make these inspections and to otherwise supervise its 19 area managers, the Chicago area office had, at the time of our review, 9 realty specialists.

#### Inspection and review activities

The four realty specialists responsible for the geographical areas included in our review acknowledged that they had not inspected HUD-owned properties nor had they reviewed area manager records as often as required. A lack of documentation made it impossible for us to determine the actual extent of their work. Two specialists stated, however, that they had each made about 10 inspection visits during a 12-month period and another said that he had spent 3 or 4 days on inspection visits some months but that he had made no visits in others. The fourth said that he had made only one visit in the preceding 7 months. None were filling out the inspection form which a HUD instruction requires.

HUD specialists stated that they had been unable to make the required inspections and reviews because most of their time was devoted to various other property disposition functions, principally:

- Preparing property disposition actions.
- Preparing and reviewing data for the computerized property inventory system.
- Reviewing various forms and vouchers submitted by the area managers and repair specification writers.

A Chicago area office study completed in March 1975 similarly found that the specialists were spending the bulk of their time on various in-office functions with little or no time for monthly inspections of properties or reviews of area manager records. The study recommended assigning the computer input preparation and data review functions to clerical staff which would, thus, enable the specialists to spend at least 1 day each week inspecting properties and

supervising the area managers' performances. The recommendation was never implemented, however, because of a lack of clerical staff and the apparent feeling that the accuracy of the computer data would suffer.

In October 1975 the Chicago area office's Chief of Single Family Property Disposition was instituting a policy whereby each realty specialist would be required to spend at least 4 days a month inspecting properties and visiting area managers' offices. The specialist would further be required to document each inspection on an approved inspection form.

#### Staffing problems

Staffing problems have also contributed to the poor supervision of area managers. One such problem has to do with lack of staff continuity. For example, for the 12 months ended September 30, 1975, 7 different realty specialists had been assigned to supervise 3 of the 4 area managers included in our review.

An area office official claimed that a shortage of personnel was also contributing to the inadequate supervision of area managers. He estimated that, for fiscal year 1976, he has only 35 authorized positions available to perform 48 staff-years of work in the property disposition area.

#### RENTAL OF HUD-ACQUIRED PROPERTIES COULD HELP ALLEVIATE PRESERVATION AND PROTECTION PROBLEMS

Because many of the preservation and protection problems noted during our review were beyond the control of HUD or its area managers, HUD needs to explore the desirability of alternative approaches to protecting the Government's interest in its acquired properties. One such approach could be through a broadened rental program which we believe could help reduce the deterioration which is now occurring. HUD's concern that a rental program causes delays in the repair and sale of the properties does not seem too important considering that the average single-family property acquired by HUD remains in the inventory about 12 months.

#### HUD policies

HUD generally discourages occupancy of its single-family properties because it feels that such occupancy would interfere with its sales program and a large-scale rental program would impose major management responsibilities on the Department. HUD's policy requires that, unless otherwise approved,

a property must be vacant at the time it is conveyed to the Secretary by the mortgagee in exchange for the insurance claim. HUD will approve conveyance of an occupied property only under such exceptional circumstances as when

- eviction would cause undue hardship on the occupying mortgagors,
- the mortgagor is unable to vacate the property,
- eviction of the occupants might engender public unrest and tension, or
- sale to a financially qualified tenant is approved before conveyance.

Similarly, HUD's policy generally discourages occupancy of a property after conveyance. HUD handbooks do allow the rental of properties in habitable condition when necessary to prevent vandalism or when there is insufficient sales demand to dispose of the properties available for sale; however, there is little encouragement for a rental program.

#### Advantages and disadvantages of increased rentals

Advantages and disadvantages of renting HUD's single-family properties were discussed in a HUD staff study issued in April 1974 and in the Chicago task force's report to the Secretary of HUD responding to the allegations made in the Chicago Tribune. Among the advantages cited for an increased rental program were

- reduced vandalism in properties which are difficult to sell because of market conditions or location,
- increased number of single-family homes available in the moderate price rental market,
- income from properties in inventory, and
- families would have time to adjust to the financial responsibility of homeownership and build equity before possible purchase.

#### Disadvantages cited included

- more costly and time-consuming repairs because contractors would have to "work around" occupants;

- more difficulty in selling because many purchasers want immediate occupancy;
- the liabilities and costs of a landlord, the total of which might exceed income; and
- image problems when HUD is forced to evict tenants.

Because acquired properties are generally required to be vacant at the time they are conveyed to HUD, the Chicago task force concluded that:

"Current procedures do not allow sufficient flexibility to Field Office Directors and Regional Administrators to respond to situations which require variation from the vacancy requirement. The current procedure assumes that properties can and will be marketed expeditiously after acquisition. The standard procedures are not designed for areas in which properties are not marketable and will remain in the HUD inventory for long periods of time. The stringent limitations on the Field Office Director's ability to establish a rental program precludes the use of the program in some areas where it may be warranted."

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## CONCLUSIONS

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Area managers, under contract to preserve and protect HUD's inventory of single-family properties, in many cases were not performing their prescribed duties or were not



performing them quickly. HUD's Chicago area office has also been neglectful in performing required inspections of properties and in reviewing area manager records. When the managers had not done their jobs, regular HUD inspections could have helped disclose the situations and corrective actions could have been initiated.

Although better area managers' performance and better supervision by HUD would mitigate some of the problems, many of those observed during the review were beyond the control, and took place despite the efforts, of either the area manager or HUD. Given the magnitude of the losses HUD is incurring on its properties, the impact of such losses on the status of the reserve funds, and the immeasurable losses in terms of neighborhood deterioration, something must be done. One possible and partial solution to the problem might be through a broadened rental program, since occupancy appears to be a good defense against the vandalism and deterioration now occurring.

We believe the proposed regulation change, which would allow for conveyance to HUD of occupied properties, is a step in the right direction. However, HUD should also consider renting those properties in HUD's inventory which are vacant and in areas where the turnover of properties is slow and the properties are subject to acts of vandalism and equipment removal.

#### RECOMMENDATIONS

We recommend that, to help insure that HUD-acquired, single-family properties are better preserved and protected, the Secretary of HUD:

- Stress to area managers the important role they play in preserving and protecting properties and the need for them to perform quickly all preservation and protection duties assigned to them.
- Insist on field offices' strict adherence to the requirements regarding property inspections, reviews of area manager records, and replacement of managers who fail to comply with the terms of their contracts.
- Clarify instructions regarding hazardous conditions giving a clearer definition of such conditions and what the area manager is authorized to do to eliminate them.

--Examine the possibility of broadening the rental program to include properties in HUD's inventory which are vacant and in areas where the turnover of properties is slow and the properties are subject to deterioration and abuse.

#### AGENCY COMMENTS AND OUR EVALUATION

In a June 23, 1976, letter, HUD's Assistant Secretary for Housing-Federal Housing Commissioner agreed with our recommendations. The Assistant Secretary stated that the improved performance and supervision of HUD area managers has become a high-priority item in HUD's property disposition programs nationwide and that it is attempting to maximize available staff resources to improve these areas.

In response to our recommendations, the Assistant Secretary said he plans to prepare a memorandum which will be given to all area managers and which will explain the need for timely and accurate performance on their part. He also indicated that a requirement was recently initiated in which area managers will inspect a property within 5 days after acquisition and complete a report detailing the mortgagee's performance in preserving and protecting the property. It is felt that this activity will emphasize to area managers what management services are required on their part.

The Assistant Secretary stated that he is developing two issuances which will assist in meeting our recommendation that field offices strictly adhere to requirements regarding property inspections and reviews of area managers' records and that managers who fail to comply with the terms of their contracts be replaced. The first is a guide which outlines the responsibilities and duties of the area managers. The second is a notice which requires the chief property officer (within the area or insuring office) to establish local procedures documenting the monitoring and review of the performance of the HUD realty specialist and other staff personnel in directing and supervising area manager activities. This will require a log be kept showing area managers' activities and that the chief property officer review it at least once a month and also visit each area manager at least once each quarter. This documentation is expected to assist in compiling evidence against area managers which are not performing their duties properly.

The Assistant Secretary also stated that:

"The Chicago Area Office's current schedule for field visits requires each Realty Specialist to inspect the AMBs' [area management brokers] property records and

the acquired properties in his area, at least once each week. With the pending addition of new staff, the office will be able to inspect 10 percent or more of the acquired property inventory each month as required by Handbook procedures. Also, each Realty Specialist is currently responsible for the supervision of three management areas, having a total inventory of approximately 450 properties. The office feels that in order for the specialists to be more efficient in their supervision of the AMBs, management areas should be reduced from three to two, thereby giving the specialists an adequate amount of time to perform a very necessary and sensitive task."

The Assistant Secretary said that the Chicago area office has taken actions to clarify with its area managers the statement "conditions hazardous to the public." The area managers have been instructed to call the appropriate HUD realty specialist for guidance when they have difficulty identifying (1) conditions that may be considered hazardous and (2) whether the cost to correct the conditions is an allowable expenditure.

While these actions seem appropriate and may well clarify for the Chicago area office and its area managers what is a hazardous condition, we believe a need exists nationwide for the same clarification. HUD's instructions to area managers require the area managers to undertake repairs necessary to eliminate any conditions hazardous to the public; however, the instructions do not provide a definition of such a condition. As noted on pages 23 and 25, our inspections found hazardous conditions in many of the properties included in our review and discussions with area managers in Chicago indicated that there is some confusion regarding HUD's requirements for eliminating such conditions. Because HUD's instructions apply to area managers nationwide, we believe that HUD's efforts in clarifying the current instructions should not be limited to the Chicago area.

Regarding our recommendation to examine the possibility of broadening the rental program, the Assistant Secretary said that he was encouraging the Chicago regional office to give more serious consideration to the use of a rental program as a device to protect and preserve its properties in the types of neighborhoods discussed in this report.

As shown on page 6 of our report, HUD is experiencing considerable losses on the sale of its single-family properties in areas in addition to the Chicago area. Therefore, we believe that a broadened rental program in the Chicago area should be monitored closely with full consideration being given to its possible application in other areas.

The Assistant Secretary mentioned the following additional actions already taken by the Chicago area office.

1. In February 1976 the office reduced the number of properties in a management area from as many as 400 to 150 or less and increased the number of its area managers from 19 to 26. This action is expected to help reduce many of the problems associated with an area manager being responsible for a large number of properties in a large geographical area. It should enable the manager to make required initial and subsequent inspections and perform other duties.
2. The supervision of lawn maintenance contractors (two formal contracts) by area managers was mostly a problem of coordination between the contractors and the area manager. The managers were often not aware of when and where the contractors were working, thereby limiting their ability to supervise and inspect the performance of the contractors. To resolve this problem, the Chicago area office discontinued the use of formal contracting procedures to cover the entire city. Instead, each area manager is now required to solicit, award, and supervise lawn-mowing contractors in his area.

In commenting on our report the Assistant Secretary noted that the vast majority of houses in our sample were from three Chicago neighborhoods, Austin, Roseland, and West Englewood, which were selected because they were mentioned as problem areas in the press and in Senate hearings. The Assistant Secretary stated that no further mention is made of the possibility that this particular sample of properties is not representative of the conditions of other HUD properties in the rest of Chicago and in the Chicago suburbs and that the omission of such a statement can easily lead an uninformed reader to assume that the sample is representative of all HUD properties in the area office jurisdiction. While the majority of properties included in our sample were from the 3 neighborhoods which had been identified as problem areas, our sample also included 29 properties in 7 other randomly selected Chicago neighborhoods and suburbs. The problem conditions noted in our report were not limited to the 3 problem areas but were also found in 23 of the 29 properties in the randomly selected neighborhoods and suburbs. Each of the neighborhoods and suburbs contained at least two properties where problem conditions were noted.

The Assistant Secretary also commented that although the condition of HUD properties in the target neighborhoods may be accurately portrayed, no mention is made of the possible

existence of other poorly maintained vacant properties not owned by HUD or of the fact that only a certain percentage of vacant and poorly maintained properties in a given area may be owned by HUD. The Assistant Secretary recognized that the existence of vacant and poorly maintained HUD-owned properties in the sample neighborhoods is one of many factors that are contributing to physical deterioration and decline in those areas. However, he stated that the chapter invites unwarranted conclusions by not discussing the possible impact of the vacant HUD properties in relation to many other factors which may have a detrimental impact on these areas.

Our report does not invite unwarranted conclusions. As the Assistant Secretary noted, our report does not attempt to attribute any specific portion of the neighborhoods overall problem to the impact of vacant HUD properties. Our report states that the review was directed at determining the adequacy of HUD's preservation and protection of the properties it owns in the Chicago area. We concluded that HUD's inadequate preservation and protection of properties, coupled with factors beyond HUD's control, contributes to neighborhood deterioration. We made no attempt to assess nor did we reach any conclusions regarding the extent of the contribution in relation to other factors which affect neighborhood decline.

The Assistant Secretary also stated that the poor condition of the properties in the sample was attributed to vandalism, inadequate performance by area managers, and to the inadequate supervision and monitoring of the area managers by the local HUD office. The validity of the three causes is carefully documented, as are the remedial steps HUD has taken in the latter two areas. The Assistant Secretary questioned whether the negative impacts of poorly maintained HUD-owned vacant properties could be reduced or eliminated by more careful supervision of the area managers or whether the impact of admittedly uncontrolled vandalism is so great that no amount of supervision and monitoring of area managers could help. He charged that these are important questions that were not addressed. We disagree with the comment that these questions are not addressed in this report. The relationship of the three causes as well as a generalized answer to the above questions may be found on pages iv and 35.

## CHAPTER 3

### IMPACT OF AS-IS SALES ON THE COMMUNITY

Nationally, and particularly in Chicago, HUD has adopted as-is sales as the primary method of selling the single-family properties it owns. From HUD's point of view, the as-is sales method is at times the best way to return the most moneys to its insurance funds, some of which (as noted previously) are experiencing serious financial difficulties.

Community groups in Chicago, however, had mixed views on the merits of the as-is sales method. The city of Chicago has expressed considerable opposition to this sales method because, in its opinion, it shifts the problem of abandoned properties and the cost to demolish them to the community.

Our review disclosed some generally favorable results from the as-is sales method in Chicago. Of the properties we reviewed which were sold as is, most were occupied, had been repaired to some extent, and in general appearance equaled or exceeded others in the neighborhood. Also, the owners we interviewed generally were satisfied with their purchases, although many had experienced some problems with leaky roofs, flooding, vandalism, or difficulty in obtaining funds for repairs. Ten percent of the properties we reviewed were vacant and, in our opinion, detrimental to the neighborhood.

HUD regional office studies of the as-is sales method have found that the method has met with some degree of success; however, the studies have also identified certain conditions which we consider limitations or drawbacks to the program. These limitations include the situation where properties may be disposed of as is in downward-trending areas where the threshold for tipping the neighborhood into a blighted condition may be very low or the situation where properties which contain serious health and safety problems are sold as is.

HUD has taken steps recently to insure that as-is sales do not adversely affect communities. In conjunction with the city of Chicago, HUD developed a disposition plan which does not include as-is sales for HUD properties in that city. Nationwide, HUD has redefined the primary objective of property disposition to recognize the need in selling properties to preserve and maintain urban residential areas and communities. Also, HUD has implemented an urban homesteading demonstration program for some properties which it owns in 22 cities, including Chicago.

RESULTS OF REVIEW OF PROPERTIES  
SOLD AS IS IN CHICAGO

Property sold as is affects neighborhoods primarily in three ways. First, the property can be repaired and occupied, which benefits the neighborhood and increases the available housing stock. Secondly, it can remain vacant and continue to deteriorate, thus becoming a detriment to the neighborhood. Finally, it can be demolished, leaving a vacant lot.

We examined 60 single-family properties HUD sold through the as-is sales method in 5 Chicago neighborhoods and 1 suburban neighborhood during calendar year 1974. Our examinations were made from 9 to 18 months after the properties were sold. The following statistics were developed.

- 51 of the properties, or 85 percent, were occupied; had been repaired to some extent; and, in our opinion, equaled or exceeded in general appearance other homes in the neighborhood;
- 6 of the properties, or 10 percent, were vacant, and, in our opinion, detrimental to the neighborhood;
- 3 of the properties, or 5 percent, had been demolished leaving vacant lots;
- 79 percent of the owners we interviewed, 33 of 42, told us they were satisfied with their purchase, although most had problems, such as vandalism, flooding, leaking roofs, and difficulty in obtaining funds for repairs; and
- 7 properties had been resold, 6 at prices higher than were paid by the as-is purchasers. We could not determine the resale price on the seventh. Three of the 7 properties were reinsured by HUD.

HUD lost about \$1.1 million on the sale of the 60 properties or an average loss of about \$17,700 on each sale. HUD had recommended that 34 of the 51 occupied properties be demolished because they were not economically repairable; i.e., the estimated repair cost exceeded the estimated sales price when repaired. Of the 51 homes occupied, 25 were occupied by owners and 22 by renters. We were unable to contact the persons residing in the remaining four homes.

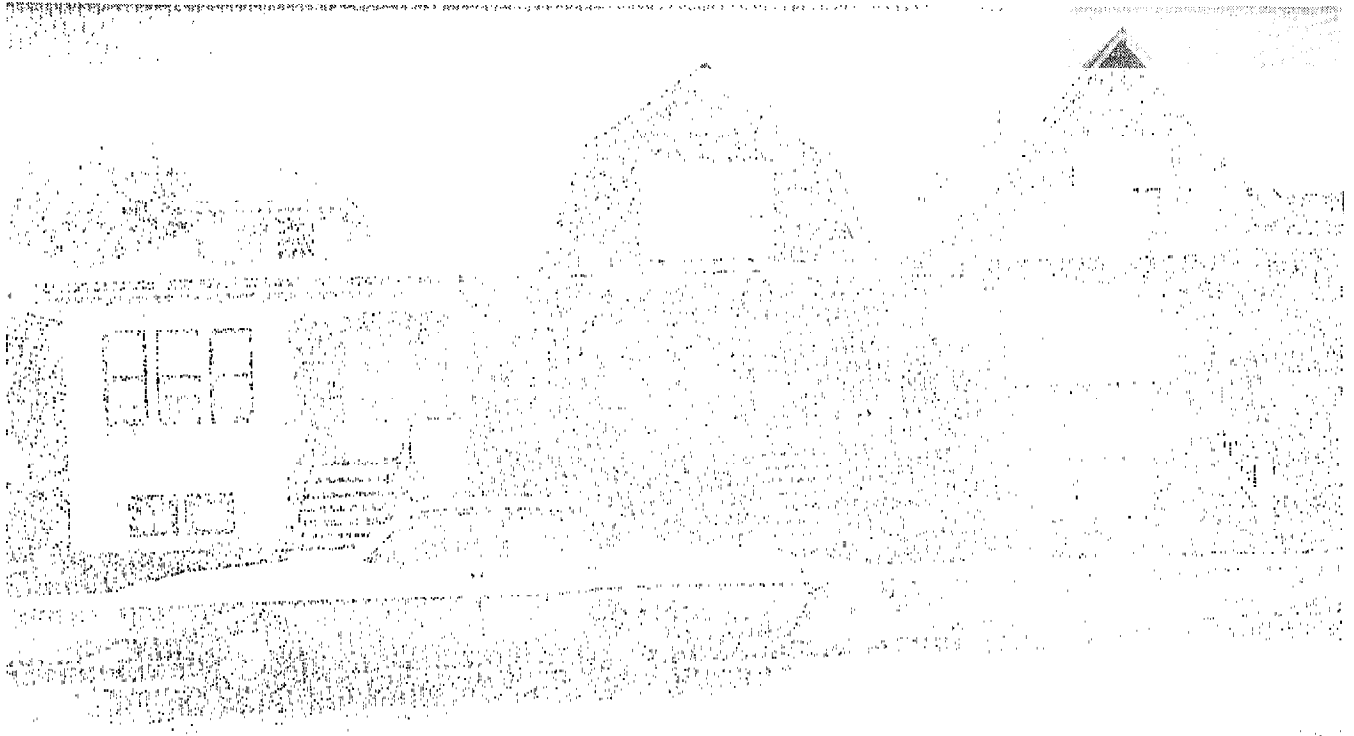
To determine the impact of as-is sales on neighborhoods, we selected all repairable single-family properties HUD sold as is during calendar year 1974 in six Chicago neighborhoods and four suburban neighborhoods. Of 324 properties sold

during this period, 137 were sold as is. However, 77 were sold for demolition and were therefore not included in our sample. Local governments had placed demolition decrees on these properties. The remaining 60 were in the following 6 neighborhoods.

	<u>Number of properties sold</u>
Austin	15
Roseland	16
West Englewood	16
East Garfield Park	9
Morgan Park	3
Hazelcrest	<u>1</u>
Total	<u>60</u>

Eighty-five percent, or 51 of the 60 properties we examined, were occupied. Inspection of the properties indicated that some repairs had been made on each and that these houses equaled or exceeded in general appearance other properties in the neighborhood. Thirty-seven owners we contacted said the cost of repairs they made on their properties totaled about \$199,000 or an average of \$5,380 for each property. The following photographs illustrate the general appearance of some of the 51 properties as compared with others in the neighborhoods.

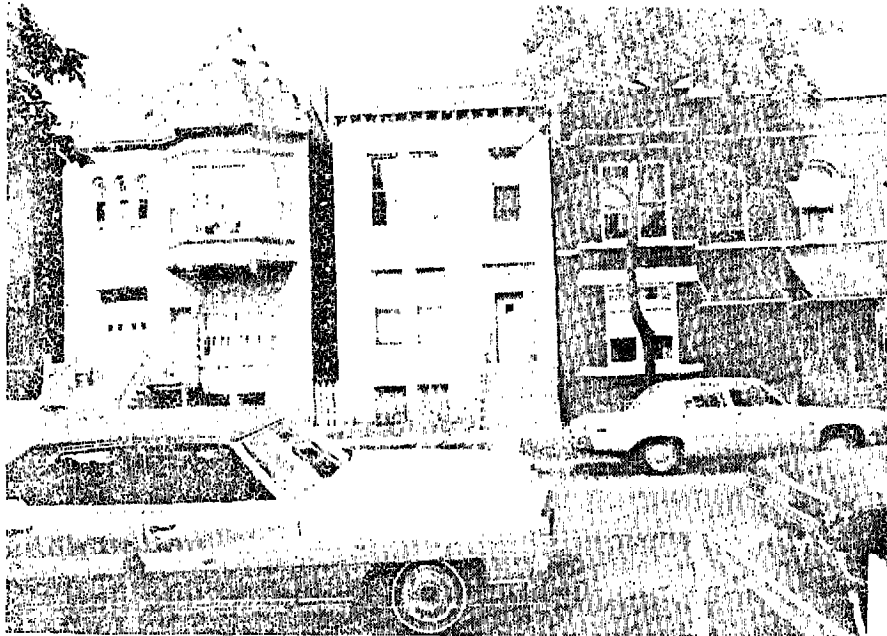




**THE CENTER HOUSE WAS SOLD AS IS FOR \$2,250 AFTER HUD HAD RECOMMENDED DEMOLITION. THE OWNER HAS SPENT \$10,250 FOR REPAIRS.**



THE CENTER HOUSE WAS SOLD AS IS FOR \$7,250. THE OWNER HAS SPENT \$7,000 FOR REPAIRS.



THE HOUSE ON THE LEFT WAS SOLD AS IS FOR \$500. THE OWNER HAS INVESTED ABOUT \$3,500 FOR REPAIRS AND PLANS TO INVEST ABOUT \$2,000 MORE.



**THE HOUSE ON THE RIGHT WAS RECOMMENDED FOR DEMOLITION BY HUD BUT SOLD AS IS FOR \$2,500. THE OWNER HAS SPENT ABOUT \$7,500 FOR REPAIRS AND PLANS TO SPEND ABOUT \$1,000 MORE.**

Ten percent, or 6, of the 60 properties were vacant and no repairs had been made. These properties showed evidence of fire damage, vandalism, structural damage, and/or unkempt yards, which contributed to neighborhood deterioration. The remaining three properties had been demolished leaving vacant lots. Five of the nine owners of the vacant properties and lots which we were able to contact told us that

--financing for repairs was not available,

--the property was in much worse condition than they had originally thought, and/or

--they planned to make repairs in the future.

The photographs on page 47 illustrate the detrimental conditions which the six vacant properties impose on neighborhoods.



**HUD RECOMMENDED THAT THE BUILDING ON THE LEFT BE DEMOLISHED. IT WAS SUBSEQUENTLY SOLD AS IS FOR \$1,000. THE OWNER IS UNDECIDED ABOUT MAKING REPAIRS.**



**HUD RECOMMENDED THAT THE BUILDING ON THE LEFT BE DEMOLISHED. IT WAS SUBSEQUENTLY SOLD AS IS FOR \$450. THE OWNER DOES NOT PLAN TO MAKE ANY REPAIRS BECAUSE OF THE BUILDING'S POOR CONDITION.**

## Purchasers' and HUD's views

An important aspect of the success or failure of any program is the opinion of those who participate in the program. Thirty-three, or 79 percent, of the 42 purchasers we were able to contact told us they were satisfied with their as-is purchase even though most had experienced some problems.

The following comments illustrate those made to us by some purchasers.

--As-is sales give poor people a chance to own a home at minimal cost. When a person puts his sweat into a house he is apt to preserve it and the neighborhood.

--I am really proud of my home. The as-is program gives poor people a chance to purchase property, fix it up, and feel secure and able to own something. It really took hard work to get my home in the present condition, but I now feel it was all worth it.

--Satisfied but think a HUD loan program would be beneficial.

--Not satisfied but would be if I could get a loan.

--Don't think HUD should have been allowed to sell a house in that condition. Unable to get financing needed for repairs.

--Did not know what I was in for. Would buy a new home if I had it to do all over again. Would have been satisfied if I could get a loan to speed up repairs. Cannot get a loan from any bank.

Other problems noted by some purchasers included vandalism, flooding, and leaking roofs.

The Chicago area office recognizes the impact of as-is sales on the local community with mixed views and sees the unsophisticated buyer as a major problem to the overall success of the program. HUD pointed out that many of the less knowledgeable buyers frequently make serious mistakes pertaining to the physical condition of properties and their ability to obtain financing for necessary repairs. The Chicago area office was said to be studying other alternatives to this problem. HUD also mentioned that properties are sold on an as-is basis because of the expense involved in making the repairs and that buyers should expect to experience repair difficulties. HUD does not consider the fact that buyers of

as-is houses have to make repairs to their houses as a negative aspect of the as-is sales program.

Property resales

Seven of the 60 properties had been resold at the time of our review, 6 of them at prices higher than the as-is purchasers had paid. HUD had reinsured three of the seven properties. Details on the resale of two of the houses follow.

--One house was purchased as is for \$1,500 and resold less than 1 month later for \$4,500. The current owner was satisfied with his purchase and had spent \$6 to \$7 thousand on repairs plus labor.

--Another house was purchased as is in March 1974 for \$2,750 and resold in October 1974 for \$14,000 with HUD insurance. The new owners informed us that they had encountered major problems with the property's major systems and structures, including electrical, heating, and a flooded basement. The new owners were 3 months delinquent on their mortgage payments as of November 30, 1975, which could mean that the property may once again revert to HUD.

Losses sustained in disposing of properties as is in Chicago

Although HUD has sustained losses in selling as is the single-family properties included in our review in Chicago, the losses would have been greater if the properties had been repaired before sale, according to HUD estimates.

HUD's Chicago area office lost about \$27 million on its sales of single-family properties during the 12-month period ended April 1976. During the first 5 months of calendar year 1976, about 83 percent of the HUD Chicago area office's single-family property sales were through the as-is sales method.

HUD lost about \$1.1 million on the 60 properties we reviewed, or an average loss of about \$17,700 on each property, as shown below.

	<u>Average per property</u>	<u>Total properties</u>
Cost to acquire and hold properties	\$19,778	\$1,186,669
As-is sales price	<u>2,039</u>	<u>122,315</u>
Loss to HUD	<u>\$17,739</u>	<u>\$1,064,354</u>

Cost to acquire and hold the properties includes the unpaid balance of the mortgage principal, interest, foreclosure costs, taxes, maintenance and operating costs, and selling expenses.

As noted previously, one of HUD's objectives when disposing of properties is to maximize the return of moneys to the insurance funds. HUD compares the anticipated net recovery from the sale of the property as if it were an as-is sale, a repaired sale, or razed for vacant lot sale. HUD's policy was to select the method of disposition that provided the maximum return to the Federal Government.

HUD therefore estimated that the loss to the Federal Government on the 60 properties included in our review would have been about \$2,300 greater for each property--a total increase of about \$138,000--if the properties were repaired before the sale.

#### CITY AND COMMUNITY VIEWS

HUD's use of the as-is sales method for disposing of acquired single-family properties in Chicago has increased dramatically in recent years--from 2 percent of all sales made in 1972 to 83 percent of all sales made during the first 5 months of 1976. As noted previously, HUD sold 3,614 single-family properties as is in Chicago from January 1, 1972, through May 31, 1976.

The as-is sales method has received criticism from city of Chicago officials, who have charged that HUD sold properties to purchasers with inadequate financial resources to rehabilitate them. According to city officials, such properties are usually abandoned, leaving the responsibility and cost of demolishing them to the city.

Chicago community groups have expressed mixed views on the as-is program. One community group leader told us that:

"As-is sales are destroying the neighborhoods. Houses are purchased by low-income minority people, who don't have the money to rehabilitate them. The program sucks people in, and represents an easy way for HUD to rid itself of responsibility."

Officers of another community group, while not objecting to the concept of as-is sales, dislike the way HUD has handled it. They said that they thought this sales method could work but not as the total property disposition program. They said they knew of people who had purchased properties as is, made the necessary repairs, and were satisfied. However, when all properties were offered for sale as is, many were not purchased,



thereby adding to neighborhood deterioration. They said that the ideal situation would be for HUD to sell some houses as is and others under a warranty program.

In responding to our report (see app. I), HUD stated that the fact that a property does not sell on an as-is basis does not affect its physical condition and consequently does not change its effect on the neighborhood. The condition that existed before the sales offering will continue to exist.

#### HUD OBSERVATIONS AND STUDIES OF AS-IS SALES AT OTHER LOCATIONS

A HUD staff study in April 1974, before HUD emphasized as-is sales, identified a number of advantages to that method, including (1) minimizing the inventory, (2) reducing HUD's exposure and adverse publicity from prolonged ownership of acquired properties, (3) insuring maximum return to the insurance fund, and (4) allowing buyers, rather than HUD, to determine the appropriate extent of repairs.

The April 1974 study also identified what we consider to be the following possible drawbacks to this sales method:

- Surrounding property values could fall.
- Some buyers could make large profits (windfall) upon resale and HUD could be accused of aiding speculators.
- HUD could be accused of selling substandard housing units or of undermining neighborhoods.
- Potential buyers may not be able to find financing for purchase or repairs.

HUD also noted that as-is sales are particularly dangerous in transitional neighborhoods because the failure to repair properties before sale could cause loss of confidence in the neighborhood, thus hastening its deterioration.

As of July 20, 1976, HUD had completed four studies of the as-is sales method at various locations within the jurisdiction of four of its regional offices--New York, Philadelphia, San Francisco, and Seattle. The Chicago regional office had in process studies in Detroit and Chicago.

Some of the benefits to communities described by the completed studies follow.

- About 97 percent of the properties included in the Seattle study were occupied (60 percent by owners and

37 percent by renters). About 55 percent of the properties included in the San Francisco study were occupied, and repairs visible from outside the house appeared to have been made on about 72 percent of the vacant properties.

--Most as-is purchasers were satisfied with their homes. In the San Francisco study, 80 percent of the families who stated a comparison liked their as-is house better than their previous unit.

--Properties included in the New York and Seattle studies showed signs of significant improvement or renovation.

Some of the conditions identified by HUD's studies which we consider drawbacks to the as-is sales method follow.

--Of the properties included in the Philadelphia study, 55 percent were in downward-trending areas. HUD instructions caution against using as-is sales in downward transitional neighborhoods where the possibility of encouraging a blighted condition is great.

--The San Francisco study pointed out that 21 percent of the properties internally inspected (12 of 57 properties) had serious health and safety deficiencies. Of the 12 properties, 10 were sold as is to owner investors. Only 1 of the 10 properties was owner occupied.

--About 30 percent of the renter occupants (10 of 33 renters) interviewed for the San Francisco study said owner investors had made no repairs.

--Of the properties included in the Philadelphia study, 38 percent appeared vacant.

--Many properties offered for sale as is in the Camden area could not be sold because prospective purchasers could not obtain conventional financing.

--One of 30 properties included in the New York study was sold to a speculator who resold the property before making any repairs.

While HUD's New York regional office study pointed out that the as-is sales evaluated were largely for homeownership, about 75 percent of the properties in the San Francisco study were sold to owner investors. At the time of the San Francisco study, about 25 percent of owner investor sales had resulted in resales. About 39 percent of the properties in the Seattle study had been resold. HUD or the Veterans Administration

financed 38 percent of the resales. One property was in the process of foreclosure at the completion of the study in March 1976.

A HUD official informed us on March 4, 1976, that HUD is seriously considering making a nationwide study comparing the as-is and repaired sales methods which would address the financial and social impact of these sales techniques.

RECENT HUD ACTIONS AFFECTING THE IMPACT OF AS-IS SALES ON COMMUNITIES

HUD has taken a number of steps recently which may lessen any adverse impact of single-family as-is property sales in Chicago as well as other cities. HUD has developed a property disposition plan in conjunction with the city of Chicago; implemented an urban homesteading program for some properties which it owns in 22 cities, including Chicago; and issued revised instructions to its field offices redefining its primary property disposition objective by recognizing the need to preserve and maintain urban communities.

Because of Chicago's opposition to as-is sales, HUD agreed in August 1975 to cancel such sales in Chicago. Further, HUD and the city agreed to have a joint review team inspect and make disposition decisions on all single-family properties in HUD's Chicago inventory.

The review team inspected and categorized all 2,168 properties in HUD's Chicago inventory as of September 11, 1975, as follows.

<u>Category</u>	<u>Number of properties</u>
Requiring demolition	289
Structurally sound--need minor repair	341
Need major repair to meet city code	1,028
Occupied	341
Vacant lots	<u>169</u>
Total	<u><u>2,168</u></u>

The review team's property disposition plan contained in its October 20, 1975, report was to:

- Demolish the 289 properties requiring demolition.
- Sell the 341 structurally sound properties with a limited 30-day warranty on the structure and major mechanical systems to buyers who would be told about the minor defects and told to correct them.
- Sell the 1,028 properties requiring major repairs in groups of 300 to contractors.
- Offer for sale the 341 occupied properties to eligible current occupants of the properties.
- Sell the 169 vacant lots at HUD's market value, giving the city of Chicago preference in the sales.

In conjunction with the disposition plan, agreement was reached for a demonstration rehabilitation program under which 50 properties would be assigned to the city under a court-appointed receiver that would supervise the rehabilitation. Sales would be financed by local mortgagees, and HUD would receive all proceeds exceeding rehabilitation costs. This program, if successful, will be considered as a method for disposing of other HUD properties in Chicago. The Chicago area office also entered into an agreement with a Chicago community organization in which HUD agreed to rehabilitate and sell properties in the six neighborhoods represented by the organization, including Roseland and Austin--two of the neighborhoods included in our review.

In addition, under section 810 of the Housing and Community Development Act of 1974 (12 U.S.C. 1706e (Supp. IV, 1974)), HUD is implementing an urban homesteading demonstration program in 22 cities, including Chicago, to encourage preservation of existing housing in certain neighborhoods. Section 810 of the act authorized the Secretary of HUD to transfer without payment, to a requesting unit of general local government or a State or a designated public agency, unoccupied one- to four-family residences to which the Secretary holds title and determines is suitable for use in an urban homestead program.

Under the program, HUD will transfer the homes to selected cities. The cities will transfer the housing conditionally to an individual or family without any substantial consideration. The homesteader must agree to occupy the property for not less than 3 years; make the needed repairs for health and safety before occupancy; and meet local

standards for decent, safe, and sanitary housing within 18 months, permitting inspections at reasonable times. If all these conditions are met, the homesteader is given title to the property.

The program is being implemented in cities that have specified the neighborhoods in which they will coordinate conservation efforts and provide the public services and amenities needed to arrest decline and encourage private investment.

The program involves some 1,000 properties of varying values, totaling \$5 million. The 22 participating cities are expected to use about \$50 million of their own funds to launch the experiment. In Chicago, HUD-held houses valued at \$250,000 and rehabilitation loans of \$350,000 will be provided under the program.

The Secretary is required to make a continuing evaluation of urban homesteading programs and, beginning with the third year after enactment of the legislation, to transmit to the Congress an annual evaluation of the programs and recommendations for their future conduct.

On February 23, 1976, HUD issued instructions to its field offices which redefined the primary objective of its property disposition program and provided guidelines relating to tools available for achieving that objective. The redefined primary objective of the property disposition program was stated to be:

"To reduce the inventory of acquired properties in such a manner as to ensure the maximum return to the mortgage insurance funds consistent with the need to preserve and maintain urban residential areas and communities."

The revised instructions point out that it is essential that the acquired properties be disposed of consistently with the primary objective, so that it will not adversely affect the areas or communities in which HUD acquired properties are located. To accomplish this, a carefully developed and fully coordinated plan must be devised for those areas where acquired properties may significantly affect their surroundings. Accordingly, a formal planned program approach is required to be developed and implemented for each urban area where, among other things, the inventory of acquired properties or the projected acquisition of properties, is sufficient to significantly affect the preservation and maintenance of such urban residential areas and communities.

## CONCLUSIONS

HUD's use of the as-is sales method for disposing of acquired single-family properties in Chicago and nationwide has increased dramatically in recent years. While city officials and community groups in Chicago have voiced considerable opposition to this sales method, our review disclosed generally favorable results from its use in Chicago.

HUD studies of the method in other locations have likewise shown that it has met with some success; however, these studies have also identified conditions we consider to be limitations or drawbacks to the method.

HUD recently has taken a number of actions aimed at insuring that as-is sales do not adversely affect communities. If properly implemented, these actions should lessen the adverse impact of single-family as-is property sales in Chicago as well as other cities.

## CHAPTER 4

### MONITORING OF

#### MORTGAGEE LOAN ORIGINATION ACTIVITIES

HUD-approved mortgagees function as a focal point for the origination of HUD-insured mortgage loans--dealing directly with the prospective mortgagor and obtaining the data necessary to determine risk acceptability. The failure of the mortgagee to adequately assess the prospective mortgagor's ability to repay the proposed loan can result in a loan which is subsequently defaulted and foreclosed and through which the Government often incurs a substantial loss. HUD has a responsibility to monitor mortgagee activities to insure itself that such activities comply with its loan origination procedures. These procedures are designed to give HUD a reasonable degree of protection in view of its limited contact with the mortgagor.

HUD has not always monitored mortgagee loan origination activities as closely as it should have; as a result, loans to unqualified buyers have been made which have subsequently gone bad. To help it identify mortgagees who are responsible for an excessive number of bad loans and to improve its mortgagee monitoring efforts, HUD has recently initiated a number of corrective actions, including

- implementing an automated system known as the Mortgagee Performance Monitoring System,
- establishing a monitoring staff,
- adopting a requirement that field offices verify 10 percent of the employment and cash asset data received from mortgagees, and
- increasing the number of audits of mortgagees performed by HUD's OIG.

#### RESPONSIBILITY OF MORTGAGEES

HUD requires that the mortgagee's analysis of the prospective home buyer's ability to make future payments on a mortgage should include a reasonably accurate estimate of the amount and stability of his income. This estimate cannot be made without reliable information on the buyer's (1) basic salary, (2) overtime earnings, and (3) prospects for continued employment. The mortgagee obtains this information directly from the buyer's employer. HUD also requires the mortgagee to obtain a confirmation of the amount and source of the buyer's cash assets which is used to determine if the homebuyer has

sufficient cash to undertake the mortgage loan without the use of secondary financing which is prohibited under HUD procedures. In addition, the mortgagee provides credit information on each prospective homebuyer which shows the amount of his debts and his past payment record.

The mortgagee submits evidence of the verifications of employment and cash assets, as well as the credit information, to HUD along with the application for mortgage insurance. HUD usually has no personal contact with the buyer and generally must rely on the data furnished by the mortgagee in passing judgment on the buyer's ability to finance and maintain the loan.

#### NEED FOR HUD TO MONITOR MORTGAGEES

In September 1973 HUD's OIG reported on the need for HUD to monitor mortgagee operations. OIG reported that many mortgagees were not fulfilling their loan-processing responsibilities and were not complying with HUD requirements. The audit of mortgagees and verification of documents concerning mortgagors' employment and bank deposits revealed many instances in which mortgagees submitted false or misleading documentation and/or certification to HUD. The report stated that the problem of deficiencies and irregularities in loan-processing activities by approved mortgagees, which had contributed to the increase in the volume of acquired properties, was caused, in part, by a decline in HUD's supervision of mortgage lenders. The report recommended that onsite reviews of originating and servicing mortgagees be required on a scheduled basis.

On November 8, 1973, we issued a report on "Processes for Approving and Monitoring Nonsupervised Mortgagees" (B-114860) which stated that HUD field offices (both the area and insuring offices) were not testing nor were they required to test the reliability of the employment and cash asset data received from the mortgagees on prospective buyers. We reported that the risk of reimbursing the mortgagee, if the homebuyer defaulted and the mortgage was foreclosed, was increased because HUD approved buyers for mortgage insurance without assurance that the employment and cash asset data received on the buyer was accurate. We recommended that HUD establish requirements for field offices to verify the reliability of employment and cash asset data concerning a buyer submitted by the mortgagee.

Our report also concluded that, because of its liability in case of foreclosure, HUD had a vested interest in the quality of mortgagees' lending operations and effective monitoring of such operation was essential to protect its interest. We concluded that HUD should use all means available in monitoring mortgagees' activities, including self-initiated audits of mortgages.



## HUD ACTIONS TO IMPROVE ITS MONITORING EFFORTS

HUD has recognized the need to strengthen its monitoring and supervision of mortgagees. In response to our and the OIG reports, HUD initiated several actions which should help to improve its monitoring activities.

### Employment and cash deposits verification

Responding to our report, HUD stated it would emphasize to its field offices the need to carefully examine the financial information pertaining to a homebuyer submitted as a part of the mortgage insurance application. To help carry this out, HUD on July 30, 1975, instructed its field offices to spot check the accuracy of 10 percent of the employment and cash deposit verifications received from each mortgagee. HUD additionally instructed its field offices to notify headquarters of any mortgagees which abuse HUD's underwriting system.

### Establishment of Mortgagee Performance Monitoring System

In April 1975 HUD implemented the Mortgagee Performance Monitoring System which provides automated capability to monitor mortgagee performances and permits special analysis and attention to mortgagees with abnormal foreclosure rates. The system provides mortgagee performance data--number of loans originated, number of claims, claim rate, and loan life--by State for each HUD program in which the mortgagee participates. It also provides comprehensive data on a mortgagee's total operations, including both home and branch offices. Before establishing the system, HUD had no systematic method to identify mortgagees whose claim rate exceeded the rate of other mortgagees.

### Establishment of a monitoring staff to make onsite reviews

HUD has established a staff, based at HUD headquarters, to make onsite spot reviews of mortgagee production operations. These reviews, initiated in June 1975, include looking at mortgagee origination activities at both home and branch offices. Mortgagees are selected for review on the basis of (1) notification from field offices of mortgagees which appear not to be in compliance with HUD regulations and procedures in the loan origination process and (2) statistical data obtained from the Mortgagee Performance Monitoring System for each mortgagee's portfolio size and past performance. While field offices do not make onsite reviews of mortgagee origination

practices, HUD depends on its field offices to have a working knowledge of mortgagees which may not be operating within HUD regulations.

HUD's reviews have concentrated on mortgagees with higher-than-normal claim rates. As of December 18, 1975, reviews have been conducted at the home and/or branch offices of 52 mortgagees. Of the 52 mortgagees, about 50 percent had an above-average claim rate in at least one HUD program in which the mortgagee had originated a high number of loans.

The onsite reviews consist of examining the mortgagee's case files for a number of recently originated loans to determine compliance with HUD regulations and administrative requirements. As a part of the review, a (1) comparison of liabilities shown on the application for mortgage insurance is made with the credit report, (2) certifications made by the applicant as to accuracy and completeness are reviewed, (3) verifications of employment and deposits are checked, and (4) an examination is made of mortgagee records of the amounts and types of fees collected from the mortgagors.

The reviews have disclosed several types of deficiencies in mortgagee loan origination activities, including the processing of insurance applications through mortgagee branch offices which HUD has not approved, the practice of the applicant-mortgagor signing loan applications before their completion, and the collection of unallowed fees by the mortgagees.

After each review is completed, the mortgagee is advised by letter of the review team's findings and directed to correct the deficiencies. The mortgagee is to notify HUD when corrective action has been taken, and when appropriate, field offices are requested to follow up to insure that deficiencies have been eliminated. If major irregularities are found during the review, the matter is forwarded to OIG for a thorough audit. If the irregularities are confirmed during the OIG audit, the entire matter is turned over to the Mortgagee Review Board, which was established on September 12, 1975, to determine whether or not to withdraw approval of a mortgagee under HUD programs.

#### Increase in number of OIG-conducted mortgage audits

The onsite reviews discussed above supplement OIG's comprehensive audits of mortgagee activities. The OIG audits cover not only loan origination aspects of a mortgagee's operations but also loan servicing aspects. In a further

attempt to improve HUD's mortgagee monitoring, OIG was directed about the first of August 1975 to increase the number of its mortgagee audits from 50 to 100 annually.

CHICAGO TASK FORCE'S OBSERVATIONS ON  
MORTGAGEE MONITORING

The Chicago task force, established by the Secretary to review and recommend solutions to the problems of single-family housing programs, examined HUD headquarters' and field offices' monitoring of mortgagees. The task force, looking at both origination and servicing activities of a mortgagee, concluded that HUD's fragmented system of mortgagee monitoring is ineffective because overall responsibility and direction is not focused in any one organizational unit. For example, Housing Production and Mortgage Credit (an organizational unit within HUD) is responsible for loan origination activities while Housing Management (another organizational unit) is responsible for loan servicing. HUD's dealings with mortgagees are further divided between and within headquarters and the field offices. The task force further concluded that the lack of an effective HUD program for dealing with mortgagees has contributed to the large inventory of acquired single-family properties and a rapidly declining balance in the insurance reserves.

While recognizing the actions HUD has taken in the area of mortgagee monitoring, the task force recommended in an undated report that HUD strengthen its capacity for monitoring mortgagees by coordinating Housing Production and Mortgage Credit and Housing Management work. The task force also recommended that HUD establish in either its regional or field offices a staff of mortgagee representatives to be responsible for making annual onsite monitoring reviews of selected mortgagees which would encompass origination, servicing, and property preservation practices of mortgagees. This staff could take the place of the monitoring staff referred to earlier which is located at HUD headquarters under Housing Production and Mortgage Credit and which looks at loan originations.

On June 14, 1976, the functions of the Assistant Secretary for Housing Production and Mortgage Credit and the Assistant Secretary for Housing Management were combined under a single Assistant Secretary for Housing. On July 8, 1976, a HUD official said that, while reorganization plans have not yet been finalized, current plans include a consolidation of existing mortgagee monitoring to allow more effective review of mortgagee operations.

## OIG AUDITS OF MORTGAGEES

At the request of the Secretary of HUD, OIG audited six mortgagees operating in the Chicago area to determine, among other things, the validity of charges that the mortgagees had failed to process applications for mortgage insurance in accordance with HUD's regulations. The mortgagees selected for review either had been the subject of media criticism or had a relatively high rate of default. Audit work at one of the mortgagees also included an investigation of four of its branches in Detroit, Seattle, Miami, and Los Angeles.

The OIG reviews included confirmation of employment, income, and cash asset data on 50 recently insured loans originated by each of the six mortgagees. The examinations also included an analysis of mortgagee files and mortgage insurance applications to determine if credit information and employment and cash asset verifications had been accurately reported to HUD.

OIG informed the Secretary in an August 29, 1975, letter that their reviews had disclosed in some instances that mortgagees had not given HUD complete and accurate information concerning prospective mortgagors. As a result, HUD had approved mortgagors for mortgage insurance on the basis of erroneous data.

The reports for two of the mortgagees disclosed weaknesses in the mortgagees' loan origination practices and procedures which caused incorrect and misleading information to be submitted to HUD to obtain mortgagor approval. For example, at one of the mortgagees, three instances were found where mortgagor liabilities were not shown on the insurance application and three cases were found where verifications of deposit or employment were completed by other than authorized officials of the banks or employers. At the other mortgagee, the review of origination cases disclosed nine instances where information shown on the insurance applications was incorrect or had not been properly verified. The reports concluded that loan origination activities need to be improved to insure that complete and accurate information concerning prospective mortgagors is submitted to HUD. The reports did not conclude as to whether the subject loans should have been made. In both reports, OIG recommended that, to insure accuracy, the responsible field offices should independently verify, on a limited basis, information contained in mortgage applications submitted to HUD by the mortgagees. A requirement for field offices to test the accuracy of income, employment, and deposit verifications from all mortgagees has now been established nationwide.

The report on the third mortgagee described serious deficiencies in all major activities of the mortgagee's operations which were examined, including loan origination. The report stated that the mortgagee did not exercise adequate control to insure that loans were originated in accordance with HUD's requirements. The report noted numerous instances where the mortgagee apparently either had submitted false credit information or had omitted pertinent information when submitting mortgage applications to HUD. OIG recommended that HUD withdraw its approval for the mortgagee to participate in HUD mortgage insurance programs.

After the recommendation for withdrawal, HUD and the mortgagee entered into an agreement whereby the mortgagee agreed to implement a number of reforms aimed at improving its operations. In addition, the mortgagee agreed to reimburse HUD for \$145,000 in improper charges and assume liability for mortgages which go into foreclosure as a result of improper origination. The agreement also placed the mortgagee on probationary status for 180 days and suspended the authority of one of its branch offices to originate loans for 30 days.

In its report on the fourth mortgagee, OIG found that because of the mortgagee's lack of adequate management control over branch office practices and activities, inaccurate and incomplete insurance applications were submitted to HUD causing approval of mortgagors that otherwise would not or may not have been approved. The report stated that the mortgagee had knowingly made misrepresentations in 83 of the 105 cases reviewed, 34 of which were considered to be material misrepresentations. OIG estimated that HUD may sustain as much as \$440,000 additional losses on properties to be foreclosed or foreclosed by the mortgagee and recommended that the mortgagee strengthen its supervisory review of mortgagor applications for insurance. As of July 9, 1976, the report findings were under consideration by the Mortgage Review Board.

Reports on the last two mortgagees described some weaknesses in loan origination activities in that mortgagors were overcharged or incorrectly charged for loan settlement fees or did not make the required minimum investment. The audit reports did not, however, identify any instances in which inaccurate information was given to HUD on the mortgage insurance applications.

#### CONCLUSIONS

HUD's monitoring of mortgagee loan origination activities has not always been as effective as it should have been. Weaknesses in HUD's monitoring efforts have been disclosed in

reports by our office, HUD's OIG, and a Chicago task force. In response to these reports and in recognition of the need for improving the monitoring of loan originations, HUD has recently taken a number of corrective actions. These actions should help HUD in identifying mortgagees which are making a disproportionate number of bad loans and in providing the means by which these mortgagees can receive closer HUD supervision.

The Chicago task force identified problems in terms of both loan origination and loan servicing. It made several recommendations calling for better coordination between those at HUD responsible for the two activities. The recent consolidation of the functions of the Assistant Secretaries for Housing Production and Mortgage Credit and Housing Management, including the mortgagee monitoring functions, should resolve the monitoring problems identified by the task force.



DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, D.C. 20410

OFFICE OF THE ASSISTANT SECRETARY FOR  
HOUSING-FEDERAL HOUSING COMMISSIONER

JUN 23 1976

IN REPLY REFER TO:

Mr. Henry Eschwege  
Director, Resources and  
Economic Development Division  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. Eschwege:

The Secretary has asked me to respond to your letter of April 22, 1976, requesting the Department's views on your draft report to the Chairman, Senate Committee on Banking, Housing and Urban Affairs, and Senator Adlai E. Stevenson, III on the impact of acquired single-family properties on urban blight in Chicago.

The enclosed statement contains our comments on the material submitted in the proposed draft report.

We appreciate the opportunity to review the proposed draft report before it is presented to the Congress.

Sincerely,

A handwritten signature in black ink, appearing to read "James L. Young".

James L. Young  
Assistant Secretary for Housing-  
Federal Housing Commissioner

Enclosure

STATEMENT BY THE  
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
GAO DRAFT REPORT  
"THE IMPACT OF ACQUIRED SINGLE-FAMILY  
PROPERTIES ON URBAN BLIGHT IN CHICAGO"

The GAO, in attempting to accomplish their mission, does present a fairly balanced analysis of the as-is sales and management programs. However, many of their statements are based on weak and/or inconclusive premises.

The comments will be on a chapter by chapter basis.

Chapter 1

The reports state that HUD contracts with brokers, community groups or individuals to act as Area Management Brokers (AMBs), and their fees range from \$8.00 to \$26.50 per property per month. However, no mention is made that these contractors must have all required local licenses to perform management services, nor is there any mention as to the services required under each contract, to property location, or to complexities of the management and repair programs, which have a significant impact on the amount paid for management services.

[See GAO note 1, p. 72.]



[See GAO note 1, p. 72.]

## Chapter 2

There are a number of large issues that are not addressed in this chapter.

[See GAO note 1, p. 72.]

The vast majority of the houses in the sample are from three Chicago neighborhoods, Austin, Roseland and West Englewood. Although it was stated that the neighborhoods were chosen partly because they "were mentioned as problem areas in the press and in Senate held hearings," no further mention is made of the possibility that this particular sample of properties is not representative of the condition of other HUD properties in the rest of Chicago and in the Chicago suburbs. This omission can easily lead an uninformed reader to assume that the sample is representative of all HUD properties in the area office jurisdiction.

Although the condition of HUD properties in the target neighborhoods may be accurately portrayed, no mention is made of the possible existence of other poorly maintained vacant properties not owned by HUD, or of the fact that only a certain percentage of the vacant and poorly maintained properties in a given area may be owned by HUD. The existence of vacant and poorly maintained HUD owned properties in the sample neighborhoods is obviously one factor among the many factors that are contributing to physical deterioration and decline in those areas. Although the chapter does not attempt to attribute any specific portion of the neighborhoods overall problems to the impact of vacant HUD properties, it nevertheless invites unwarranted conclusions by not discussing the possible impact of the vacant HUD properties in relation to the multiplicity of other factors which may be detrimentally impacting on those areas.

The following comments refer to some of the more specific elements of the chapter. The poor condition of the properties in the sample was attributed to vandalism, inadequate performance by HUD's AMBs, and to the inadequate

supervision and monitoring of the AMBs by the local HUD office. The validity of these three causes is carefully documented, as is the remedial steps that HUD was taking in the latter two areas. There was no discussion, however, of the relative importance of the three causal factors. Could the negative impacts of poorly maintained HUD owned vacant properties be significantly reduced or entirely eliminated by more careful supervision of the HUD AMBs? Or is the impact of admittedly uncontrolled vandalism so great that no amount of supervision and monitoring of AMBs could significantly improve the condition of vacant HUD properties? These are important questions that were not addressed. Although the data were not really adequate to provide definitive answers to these questions, a brief discussion of them would have increased the likelihood of a more informed judgment on the part of the reader.

The chapter mentioned some specific corrective steps being taken by HUD in response to the inadequate performance and supervision of the AMBs. Improvements in these areas have gone beyond the specific responses mentioned in the report. The improved performance and supervision of HUD AMBs have become a high priority item in HUD's property disposition programs nationwide. We are attempting to maximize available staff resources in order to effect improvements in these areas.

The GAO recommends that to help insure that HUD-acquired single-family properties are better preserved and protected, the Secretary of HUD should:

1. Stress to AMBs the important role they play in preserving and protecting properties and the need for them to perform in a timely manner all preservation and protection duties assigned to them.

Reply: We have recently initiated a requirement that the AMBs inspect a property within five days after acquisition, and complete a report (9516A) which details the mortgagee's performance in connection with the preservation and protection of properties. This activity also serves to emphasize to the AMBs what management services are required on their part.

We will prepare a memorandum for the area and insuring offices to give to all AMBs, which will explain the need for the timely and accurate performance on their part.

2. Insist on strict adherence by field offices to requirements regarding property inspection and reviews of AMB records, and on replacement of managers who fail to comply with the terms of their contract.

Reply: We have developed two issuances which should be released to the area and insuring offices within the near future that will assist in meeting this recommendation. The first is an AMB Guide which outlines the responsibility and duties of the AMB. The second is a Notice which requires the Chief Property Officer (CPO) to establish local procedures documenting the monitoring and review of the performance of the HUD Realty Specialist, and other staff personnel, in directing and supervising AMB activities. This will require that a log concerning the AMBs' activities be maintained and the CPO review it at least once a month. Also, the CPO shall visit each AMB at least once each quarter. This documentation shall assist in compiling evidence against AMBs that are not performing their duties properly.

The Chicago Area Office's current schedule for field visits requires each Realty Specialist to inspect the AMBs' property records and the acquired properties in his area, at least once each week. With the pending addition of new staff, the office will be able to inspect 10 percent or more of the acquired property inventory each month as required by Handbook procedures. Also, each Realty Specialist is currently responsible for the supervision of three management areas, having a total inventory of approximately 450 properties. The office feels that in order for the specialists to be more efficient in their supervision of the AMBs, management areas should be reduced from three to two, thereby giving the specialists an adequate amount of time to perform a very necessary and sensitive task.

3. Clarify instructions regarding hazardous conditions, giving a clearer definition of such a condition and what the AMB is authorized to do to eliminate it.

Reply: Actions have been taken by the Chicago Area Office to clarify the statement "conditions hazardous to the public," with all of their AMBs. Also, the AMBs have been instructed by the CPO to call the Supervisory Realty Specialist for guidance when they have difficulty identifying (1) conditions that may be considered hazardous, and (2) whether the cost to correct the conditions is an allowable expenditure.

4. Examine the possibility of broadening the rental program to include those properties in HUD's inventory which are vacant and located in areas where the turnover of properties is slow and the properties are subject to deterioration and abuse.

Reply: The recommendation is partly based on a statement that appeared in the Chicago Task Force Report, and was quoted in this chapter: "The standard procedures are not designed for areas in which properties are not marketable and will remain in the HUD inventory for long periods of time. The stringent limitations on the Field Office Director's ability to establish a rental program preclude the use of the program in some areas where it may be warranted." The policy concerning rentals stated in the Property Disposition Handbook For One to Four Family Properties (4310.5, paragraph 22, page 3) contradicts that assertion: "Normally acquired properties are held vacant to effect prompt sale and occupancy by purchasers. However, when conditions are such that satisfactory sale will involve delay to an extent which warrants seeking rental income, or whenever occupancy is essential to prevent vandalism or rapid deterioration, such properties may be listed for rent." We are currently encouraging our Chicago Regional Office to give more serious consideration to the use of a rental program as a device to protect and preserve our properties in the types of neighborhoods discussed in the GAO report.

For your information, the following are a few of the specific actions already taken by the Chicago Area Office:

1. The Chicago Area Office has recently (February 1, 1976) reduced the number (300 - 400) of properties in the management areas to approximately 150 properties or less per area, and the number of AMBs has been increased from 19 to 26. This action will eliminate many of the AMBs problems associated with covering a geographical area of several square miles, including bi-monthly inspections of properties, the initial preparation of Form HUD-9516, inspections of repaired and secured properties and the various other duties required of the AMB.

2. The supervision of the Lawn Maintenance Contractors (two formal contracts) by the AMBs were mostly problems of coordination between the contractors and the AMBs. The AMBs were not always aware of when and where the contractors were working, thereby limiting their ability to supervise and inspect the performance of the contractors. This condition has been cleared up as the Chicago Area Office has discontinued the use of formal contracting procedures to cover the entire city. Instead, each AMB is required to solicit, award, and supervise lawn mowing contractors in his area.

### Chapter 3

This chapter indicates that some of the properties inspected were vacant and, in the opinion of the reviewer, were detrimental to the neighborhood. Some of the buyers who were interviewed said they experienced difficulties such as leaking roofs, flooding, vandalism and the lack of available financing for repairs. However, most of the purchasers were satisfied with their properties.

The Chicago Area Office recognizes the impact of as-is sales on the local community with mixed views, and the office views the unsophisticated buyer as a major problem to the overall success of the program. Many of the less knowledgeable buyers very frequently make serious mistakes pertaining to the physical condition of properties, and their ability to obtain financing for the necessary repairs. This office is studying other alternatives to this problem.

This office has initiated a repair program in the communities of Roseland and Austin, in support of the Department's Demonstration Programs with the City of Chicago.

[See GAO note 1, p. 72.]

It should also be mentioned that the properties were sold on an as-is basis because of the expense involved in making the repairs, and the buyers should have expected to experience difficulties. Accordingly, these items cannot be considered as negative factors of the as-is sale program. Also, the captions under the picture contained in the report suggest that financing for repairs is available.

[See GAO note 1 below]

The reviewer also states that community group leaders are dissatisfied with the method by which as-is sales are conducted. They state that many properties offered for sale on an as-is basis were not purchased thereby adding to neighborhood deterioration. The fact that a property does not sell on an as-is basis does not affect its physical condition and consequently does not change its effect on the neighborhood. The condition that existed prior to the sales offering will continue to exist.

[See GAO note 1 below]

#### Chapter 4

[See GAO note 2 below]

- GAO notes:
1. Deleted comments relate to suggested changes that have been made, and matters revised or omitted in the final report.
  2. Comments deleted since they pertained to matters not directly related to the chapter.