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Report to the Congress; by Elmer B. Staats, Comptroller General.

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Although the Department of Housing and Urban Development (HUD) has been able to reduce real estate taxes sporadically through local appeal actions, it has been unresponsive generally to real estate tax problems of multifamily housing projects. The lack of a program to verify that taxes assessed on HUD-insured projects are fair and equitable has resulted in payment of excessive taxes and approval of unnecessary rent increases. Findings/Conclusions: A review of the Chicago, Detroit, and Dallas area office operations indicated that HUD has not effectively reviewed and appealed tax assessments on projects it owns, insured proper and timely payment of taxes on these projects, or concerned itself with real estate taxes in its review of financial operations of insured projects. These problems were caused, in part, by a lack of needed tax information at the local offices and the absence of a headquarters policy on servicing insured-project tax problems. In Detroit, HUD was overassessed in several cases, paid taxes on projects it did not own, and paid \$35,000 worth of late charges. In other cases, HUD paid unnecessary taxes by not taking advantage of State relief laws, and did not appeal a known overassessment. Although area offices are required to evaluate the fairness of tax assessments, they do not have the data available to them. HUD believes that tax assessment review for insured projects is the owners' responsibility. Recommendations: Real estate taxes should be included as one of the items to be dealt with in monitoring problems of insured projects. Procedures should be established to assure that real estate taxes assessed on both HUD-owned and -insured multifamily projects are fair and equitable. A multifamily tax payment system should be developed which insures proper and timely payment of real estate taxes. States and other taxing

authorities which have enacted tax relief legislation should be noted, and HUD-insured project owners should be instructed to take advantage of such programs. (Author/SS)

REPORT TO THE CONGRESS

BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

Department Of Housing And Urban Development Unresponsive To Multifamily Housing Real Estate Tax Problems

Although an increasingly large number of multifamily housing projects have been unable to generate sufficient income to pay the rapidly increasing cost of local real property taxes, the Department has not

- effectively reviewed and appealed tax assessments on owned projects,

- insured proper and timely payment of taxes on owned projects, and

- concerned itself with real estate taxes in its monitoring of insured projects' financial operations.

As a result, the Department has paid unnecessary taxes on projects it owns and project owners have paid unnecessary taxes on projects insured by the Department



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

B-114850

To the President of the Senate and the
Speaker of the House of Representatives

This report shows how the Department of Housing and Urban Development's unresponsiveness to real estate tax problems has resulted in the payment of unnecessarily high taxes. The report also identifies problems with the Department's real estate tax payment system.

We reviewed this area because real estate taxes constitute a large portion of the operating costs of multifamily housing projects and the payment of unnecessarily high taxes results in increased rents for project tenants and can adversely affect project viability.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget, and the Secretary of Housing and Urban Development.

A handwritten signature in black ink, appearing to read "Thomas B. Atack".

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

DEPARTMENT OF HOUSING AND URBAN
DEVELOPMENT UNRESPONSIVE TO
MULTIFAMILY HOUSING REAL ESTATE
TAX PROBLEMS

D I G E S T

Although the Department of Housing and Urban Development has been able to reduce real estate taxes sporadically through local appeal actions, it has been unresponsive generally to real estate tax problems of multifamily housing projects, where such taxes are a significant part of the rising cost of operation and maintenance. (See p. 6.)

An effective tax management program could probably reduce significantly taxes on Department-owned and -insured projects. However, it has no program to verify that taxes assessed on Department-insured multifamily housing projects are fair and equitable. This has resulted in payment of excessive taxes and approval of unnecessary rent increases.

In a review of the Chicago, Detroit, and Dallas area offices, GAO found that the Department has not

- effectively reviewed and appealed tax assessments on projects it owns (see p. 6),
- insured proper and timely payment of taxes on these projects (see p. 13), and
- concerned itself with real estate taxes in its reviews of financial operations of insured projects. (See p. 14.)

These problems were caused, in part, by a lack of needed tax information at the local offices of the Department and the absence of a headquarters policy on servicing insured-project tax problems. The large number of Department-insured projects, the short time allowed for appeals of tax assessments by many of the approximately 6,000 taxing authorities nationwide, and the fact that tax assessments are

sent directly to owners of insured projects make it difficult to establish an effective tax management program for insured projects.

However, an effective program can be established if Department field offices become more directly involved with real estate tax issues when monitoring insured projects.

Specifically, its field offices could

- arrange to have local taxing authorities to send copies of tax assessments on insured projects directly to the Department at the time the notices of assessments are sent to financing institutions holding mortgages on property,
- identify methods used to compute tax assessments by the taxing authorities in those areas where Department-insured projects are located,
- compute tax assessments on Department-insured projects before tax assessments are sent by the local taxing authority,
- compare the Department's computed assessment with the taxing authority's to identify unreasonable assessments,
- alert the owners to unreasonable assessments and instruct them on the appeal process, and
- verify that appeals are filed, when warranted.

Since tax increases on insured projects are generally passed on the tenants in rent increases, unreasonably high taxes ultimately have their greatest impact on the low- and moderate-income tenants, those least able to afford them. (See p. 5.)

Here are some examples noted by GAO:

- Six of 14 Department-owned projects in Detroit were overassessed by 9 to 76 percent. (See p. 8.)
- The Department was aware of, but did not appeal, an unreasonable assessment on a Rockford,

Illinois, project which resulted in about \$25,000 annually of unnecessary tax payments. (See p. 8.)

--Of 20 owned projects in Chicago, 4 were vacant, boarded-up properties which had not earned any income since 1975. The Department, however, had not appealed even the assessments on these properties. (See p. 9.)

--Of 71 eligible Department-insured projects in Detroit, 52 did not take full advantage of a tax relief program provided by the State of Michigan for subsidized projects. (See p. 17.)

--In four projects in Detroit, the Department incurred \$35,000 in late charges because it did not pay tax bills on time, paid taxes of \$36,000 on property it did not own, and did not pay two tax bills totaling \$2,100. (See p. 14.)

Although area offices are required to evaluate the fairness of tax assessments on owned projects and seek reductions when warranted, tax information needed to do this is obtained and retained by Department headquarters, which is responsible for paying the taxes due. (See p. 18.) With respect to insured projects, headquarters officials believe that the primary responsibility for review and appeal of tax assessments rests with the owners.

GAO believes that an effective tax management program can be established if the Department field offices become more directly involved with real estate tax issues when monitoring Department-insured projects. GAO is making specific recommendations for improving the Department's tax management of both owned and insured projects. (See p. 23.)

AGENCY COMMENTS

The Department agreed to implement one of four GAO recommendations--to identify States and other taxing authorities which have enacted

tax relief legislation and to instruct insured-project owners to take advantage of such programs.

With respect to the remaining three recommendations, the Department either disagreed or proposed to implement changes in its instructions and training. These changes, in GAO's opinion, will not resolve the problems discussed in this report. (See p. 23.)

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| | <u>ABBREVIATIONS</u> | |
| GAO | General Accounting Office | |
| HUD | Department of Housing and Urban Development | |

CHAPTER 1

INTRODUCTION

The Department of Housing and Urban Development (HUD), pursuant to the provisions of the National Housing Act, as amended (12 U.S.C. 1701 et seq.), insures mortgage loans made by private lending institutions on various types of housing, including multifamily rental housing. In addition to insurance, HUD also provides interest subsidy payments for housing intended for low- and moderate-income families. These payments enable project owners to charge lower rents.

If a project owner defaults on a loan agreement, the lender may collect full insurance benefits by foreclosing the property and conveying the title to HUD. An alternative for the lender is to collect reduced benefits--1 percent of the unpaid principal is forfeited--by assigning the mortgage to HUD.

As assignee of a defaulted mortgage, HUD may

- hold the mortgage and give the project owner an opportunity to work out his problems and bring the mortgage out of default or
- proceed with acquisition of the property title through foreclosure.

In instances when the owner abandons an assigned mortgage project, HUD becomes mortgagee-in-possession and operates the project pending foreclosure.

As of June 30, 1976, HUD had insurance outstanding on 13,841 mortgaged multifamily properties amounting to \$19.4 billion and had 1,709 assigned multifamily mortgages valued at \$2.8 billion. For the purpose of this report, these two categories will be referred to as "insured projects."

HUD's inventory of foreclosed or owned property consisted of 319 projects valued at \$369.6 million. These properties plus those projects where HUD is mortgagee-in-possession will be referred to as "owned." Responsibility for these projects as well as the insured mortgage programs is distributed among 76 area and insuring offices, 10 regional offices, and HUD headquarters.

HUD AND REAL ESTATE TAXES

A provision of the National Housing Act subjects all multifamily housing owned by HUD to real property taxation on the same basis as privately held real estate. HUD-insured projects being privately held are also liable for real estate tax payment.

Importance of taxes to project viability

Real estate tax is one of the largest costs of owning and operating multifamily rental housing. "The Compendium of Multifamily Housing," a publication of the National Association of Home Builders, initiated a survey of the income and expenses experience of HUD-subsidized projects in December 1974. The compendium stated that

" * * * although the survey clearly reflects the high costs of utilities, it also showed another cost that all but rivals electricity and gas in the percentage of total costs - real estate taxes."

In a 1975 study conducted by the Institute of Real Estate Management, a HUD consultant indicated that real estate taxes nationwide averaged 28 percent of all expenses and ranged as high as 48 percent in one city surveyed. Compared to payroll expenses at 18 percent and all utilities (electricity, gas, water, and heating fuel) which totaled 23 percent, real estate taxes accounted for the single largest element of cost. Our analysis of 164 subsidized and nonsubsidized HUD projects in the Chicago area office inventory showed that taxes averaged 31 percent of total operating expenses.

Additionally, a narrow margin between cash outlays and revenues limits the ability of subsidized projects to cope with rising costs. A 1976 HUD task force report explained that certain projects were less able to deal with cost increases. Our analysis of 76 subsidized and 88 nonsubsidized projects showed that the subsidized projects had the least amount of margin between cash outlays and revenues. This lack of margin places HUD multifamily projects in jeopardy of default whenever taxes or any other cost increases.

In 1975 congressional testimony, the Secretary of HUD commented that

" * * * an increasingly large number of HUD-related multifamily projects have been unable to generate income sufficient to keep up with rapidly increasing costs for utility and local real property taxes."

She went on to state that this situation is further complicated by project tenants' inability to absorb rent increases necessitated by these rising costs.

HUD responsibility for tax payment

Under most mortgage loan agreements, the lender/mortgagee arranges for tax payment to protect his interest and insure taxes are paid. The funds used to make payment come from the owner/mortgagor and are kept in an escrow account. HUD assumes this tax payment function when assigned a mortgage.

HUD's tax payment system for multifamily housing is centralized in its headquarters in Washington, D.C., which pays all taxes for assigned mortgages as well as owned multifamily projects. As part of this system, all tax-related information (i.e., tax bills and reassessment notices) is sent to HUD headquarters to facilitate payment.

Unique nature of real estate taxes

Unlike other costs of owning multifamily rental housing, such as payroll and utilities, real estate taxes are subject to both sudden increases at the time of reassessment and to reassessment appeal or protest by the property owner. This right to appeal gives a property owner an opportunity to have an assessment reduced. However, the burden of appeal falls solely on the property owner and an appeal cannot be made at the owner's leisure. Most taxing authorities have appeal deadlines which must be met to successfully reduce an assessment. Time frames for successful appeals are limited as illustrated below.

| <u>State</u> | <u>Appeal deadline (see note a)</u> (days after assessment notice) |
|----------------|-----------------------------------------------------------------------|
| South Carolina | 10 |
| Georgia | 10 |
| Illinois | 20 |
| Maryland | 30 |

a/Deadlines may vary among taxing jurisdictions within each State.

These appeal deadlines are typified by a lack of uniformity and, since about 6,000 taxing authorities exist nationwide, any centralized system for payment or appeal is difficult to operate effectively. If appeals are not filed

within specified time frames, opportunities to appeal are lost, along with any potential for tax savings.

SCOPE OF REVIEW

Our review was primarily conducted in the Chicago, Detroit, and Dallas area offices, as well as HUD headquarters. We interviewed HUD officials, local taxing authorities, and others concerned with real estate taxes. We also examined HUD project and appeal files, local taxing authority records, and data provided by professional associations.

At the time of our review, HUD owned 77 multifamily projects in the Chicago, Detroit, and Dallas area offices. We selected 32 of these projects for review because files for the selected projects had the information, such as tax assessment amounts and project financial statements, needed for evaluating the real estate taxes paid for the projects.

We concentrated our analysis primarily on HUD-owned projects. During the review, however, it became apparent that the real estate tax issue for insured projects should not be ignored; our review was expanded to include a limited review of such projects. Projects reviewed were selected from inventory listings and included projects insured under various HUD programs.

HUD's inventory of insured and assigned multifamily projects in the three area offices totaled 1,514 at the time of our review. We selected 123 of these projects for review. The following schedules identify the extent of audit coverage.

HUD-owned multifamily projects

| <u>Area office</u> | <u>Inventory</u> | <u>Reviewed</u> |
|--------------------|------------------|-----------------|
| Chicago | 20 | 10 |
| Detroit | 16 | 8 |
| Dallas | <u>41</u> | <u>14</u> |
| Total | <u>77</u> | <u>32</u> |

HUD-insured multifamily projects

| <u>Area office</u> | <u>Inventory</u> | <u>Reviewed</u> |
|--------------------|------------------|-----------------|
| Chicago | 516 | 14 |
| Detroit | 743 | 82 |
| Dallas | <u>255</u> | <u>27</u> |
| Total | <u>1,514</u> | <u>123</u> |

CHAPTER 2

HUD UNRESPONSIVE TO REAL ESTATE TAX PROBLEMS

HUD has not been responsive to the real estate tax problems of multifamily properties. Real estate taxes are a significant cost factor and can cause serious problems for tenants, project owners, and the Government. While HUD officials are aware that significant tax reductions are often possible, they have not

- effectively reviewed and appealed tax assessments of HUD-owned projects,
- insured proper and timely tax payment on HUD-owned projects, and
- concerned themselves with real estate taxes when monitoring HUD-insured projects' financial operations.

As a result, HUD has paid unnecessarily high taxes on its owned projects as have project owners on HUD-insured projects. Since tax increases on insured projects are generally passed on to tenants in the form of rent increases, high taxes ultimately have the greatest impact on those least able to afford them--the low- and moderate-income tenants. Also, as discussed on page 2, tax increases may threaten project viability.

Taxes are high. According to HUD financial statements, HUD paid over \$6.9 million in taxes on owned projects in fiscal year 1976. Assuming a similar rate of taxes paid for insured projects, taxes paid in fiscal year 1976 on these properties would have amounted to approximately \$368 million.

HUD RESPONSIBILITY

HUD claims to have different tax management responsibility for owned and insured multifamily projects. On owned projects, area offices are required to evaluate the reasonableness of tax assessments and to seek reductions when warranted.

On insured projects, HUD rules state that:

"Aggressive servicing of insured project mortgages by HUD personnel is of vital importance. Initiative

must be taken to provide continuous knowledge of all aspects of project operation, maintenance, and financial status so that unfavorable conditions may be promptly identified and corrected. Servicing based upon waiting for request(s) from mortgagors or mortgagees is a negative approach that cannot be condoned."

In this regard, HUD requires submission of annual financial statements, approves rent levels established for the projects, and periodically inspects the projects to determine adequacy of maintenance and condition of the project. HUD headquarters officials explained, however, that primary responsibility for review and appeal of tax assessments on insured projects rests with the owners. They stated that no specific guidelines or procedures for HUD area offices exist concerning insured project tax problems. They did say that HUD might get involved, but only on a case-by-case basis.

HUD HAS NOT EFFECTIVELY REVIEWED OR APPEALED TAX ASSESSMENTS ON OWNED PROJECTS

HUD acknowledges its responsibility to insure that real estate taxes on owned projects are reasonable and has had some success in reducing the taxes on these projects. However, HUD's efforts to reduce taxes have been at best sporadic and unreasonable tax assessments on owned projects, including vacant, boarded projects, have not been appealed. Our review of 32 HUD-owned projects identified 12 projects with apparent unreasonable tax assessments. As a result, HUD has paid unnecessary taxes on its owned projects.

HUD efforts to reduce taxes have been sporadic

In the Chicago area office during the January 1974 to February 1976 period, a total of 22 owned property assessments were appealed. Eleven of these appeals were successful, resulting in over \$380,000 of tax savings.

Nineteen of the 22 appeals had been filed by the end of June 1974, but no further appeals were filed until November 1975. The HUD area official responsible for tax appeals in 1974 explained that his supervisor would not let him continue active pursuit of tax reductions. His supervisor agreed tax appeal work was needed, but informed him that other work must take precedence.

Because HUD did not continue its efforts, nine of the project assessments which had been appealed successfully in 1974 were increased \$460,000 the following tax year when they were not appealed. The new assessed values were 19 percent higher than the values successfully appealed in 1974.

During the period June 1973 to 1975, the Dallas area office achieved numerous tax reductions through the efforts of one individual. Although adequate documentation showing tax savings achieved through appeals was not maintained, we nevertheless found 17 cases where tax savings of about \$124,000 were realized. However, the effective Dallas efforts ended when the individual making the appeals was reassigned to a HUD regional office.

During the period June 1972 to 1976, the Detroit area office filed only two tax assessment appeals, which achieved about \$133,000 in tax savings. Despite their success, HUD officials stated that additional appeals were not filed because of a lack of staff.

HUD did not appeal unreasonable assessments

In Detroit, when reliable income and expense data is available, the assessor values multifamily projects using the income approach. This assessment method is based on the amount a potential purchaser would be willing to pay for the right to earn a certain net income from that property over a period of years. The data needed to use this method would normally be provided by the property owner. If the data were not provided, other valuation methods would be used.

At December 31, 1975, HUD owned 14 projects in Detroit. Information in HUD files was adequate to enable us to evaluate the accuracy of the 1976 tax assessment for seven of these projects. Using the assessor's income approach, we concluded that six of these projects were overassessed by rates ranging from 9 to 76 percent.

| <u>Project</u> | <u>Assessed Value</u> | | <u>Over- assessed</u> | <u>Excess tax</u> | <u>Percent overassessed</u> |
|----------------|-----------------------|----------------------------|---------------------------|-----------------------|---------------------------------|
| | <u>Actual</u> | <u>Income approach</u> | | | |
| 1 | \$ 323,120 | \$ 183,330 | \$139,790 | \$ 4,557 | 76 |
| 2 | 1,372,720 | 1,255,680 | 117,040 | 3,816 | 9 |
| 3 | 422,120 | 317,181 | 104,939 | 3,421 | 33 |
| 4 | 147,820 | 94,530 | 53,290 | 1,737 | 56 |
| 5 | 40,580 | 32,019 | 8,561 | 279 | 27 |
| 6 | 40,900 | 35,161 | <u>5,739</u> | <u>187</u> | 16 |
| Total | | | <u>\$429,359</u> | <u>\$13,997</u> | |

As shown above, taxes were almost \$14,000 more than necessary. The local assessor agreed with our analysis subject to verification of the HUD data used and, in fact, explained that our calculations were conservative and the tax reductions could be greater.

In Chicago in 1974, HUD used tests on the basis of taxes as a percentage of income and taxes per dwelling unit to determine whether an assessment should be appealed. As of January 1976, there were 20 owned projects in the Chicago area office's inventory. We chose 10 projects which had sufficient information to apply HUD's appeal criteria. Using this test, five project assessments qualified for appeal. A true estimate of the tax savings is impossible without actually appealing, but previous successful appeals indicate that savings probably could have been realized on the five projects.

The following example illustrates the impact of HUD's inaction in Chicago.

A HUD-owned apartment complex located in Rockford, Illinois, consists of 10 brick walkups ¹/ _{containing 192 dwelling units. The project was built in 1969 with a HUD-insured mortgage of \$2,429,000. The project owner defaulted on the mortgage and HUD acquired the property in 1974.}

¹/_{A building of several stories with no elevator.}

HUD records show high taxes as one of the causes contributing to project default although the owner had been successful in reducing high assessments as shown below.

| <u>Year</u> | <u>Tax authority assessment</u> | <u>Assessed amount after appeal</u> | <u>Reduction in assessed amount</u> |
|-------------|---------------------------------|-------------------------------------|-------------------------------------|
| 1970 | \$1,116,000 | \$612,000 | \$504,000 |
| 1971 | 1,375,000 | 612,000 | 763,000 |
| 1972 | 1,191,000 | 641,000 | 550,000 |

By the time HUD acquired the project, however, the assessment had increased to \$1,191,000 and has remained at that figure.

A HUD official called this situation to the attention of the area director, but no appeal was filed. This same official estimated that, because of HUD's inaction, about \$25,000 in excess taxes was being paid annually.

The most obvious signal of a project's decline is when it is vacated and boarded up. This should also indicate that the assessed value of the property should be reevaluted to determine if it is still equitable. At the time of our review, there were four vacant and boarded-up properties in the Chicago area office inventory of 20 HUD-owned projects. These projects had earned no income since 1975. HUD, however, had not appealed the assessments on even these properties as the following examples illustrate.

A brick three-story walkup containing 37 units in Chicago, Illinois, was originally rehabilitated and insured by HUD for \$190,000 in 1967. After acquisition of title in 1971, HUD sold the property with a HUD mortgage of \$165,000 in 1972.

HUD acquired the title once again in 1974 when, according to the property management firm, the building was in deplorable condition. After acquisition, the building suffered numerous fires and was totally vandalized.

The project has not earned income since 1974 and was vacated and boarded up. Because of its condition, in late 1975 the City of Chicago had the building condemned, ultimately resulting in its demolition in 1976.

Despite the physical and financial decline of the project during HUD's ownership, the assessed market value was increased by the Cook County Assessor to \$264,000 in 1974, resulting in a tax of about \$11,000. This tax actually exceeded the potential sales value of the property estimated by HUD to be only \$1,000. HUD did not appeal this reassessment.

Another HUD project located in Chicago has been cited with numerous building code violations since 1972 and has suffered damage from fire and vandalism. This project is pictured below.



Side view showing missing and partially boarded windows.



Rear view showing missing window and door.

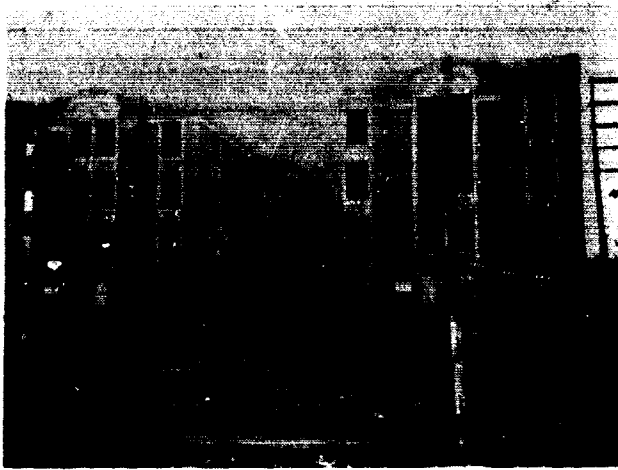
This building's assessed market value was increased to \$179,733 in 1974. Although the building was vacated and boarded up in early 1975, HUD did not appeal the tax assessment when it had the opportunity to do so later that year.

A similar situation in Detroit is illustrated by the following example:

A HUD-owned project located in Detroit, Michigan, consists of three buildings at three separate sites containing a total of 138 units. HUD acquired title to the property in April 1975. At the time of acquisition, the buildings were boarded up, vandalism had been extensive, and city inspectors said the buildings were dangerous and should be demolished. The following photos show the three buildings with broken and partially boarded-up windows. Under these conditions the buildings are susceptible to extensive weather damage and vandalism.

Building Number:

1



Assessment increased \$3,400

2



Assessment increased \$4,160

3



Assessment increased \$62,040

In 1976 an assessor for the city noticed the condition of the third building and initiated an assessment reduction of \$62,000, or 63 percent. The other two buildings however, received assessment increases totaling about \$8,000. HUD did not appeal the reassessments on these two buildings. The local assessor informed us that if HUD had appealed these reassessments, reductions similar to the one granted building three would have been possible.

HUD'S SYSTEM DOES NOT INSURE CORRECT AND TIMELY TAX PAYMENTS

The multifamily housing real estate tax payment system is a manual operation handled centrally in Washington, D.C., by the Servicing and Settlement Section of the Multifamily Mortgage Branch. This section is responsible for (1) obtaining tax bills on all acquired-mortgage and owned multifamily properties, (2) verifying HUD's obligation to pay these taxes, (3) preparing the tax payment vouchers, and (4) dealing with the taxing authorities on any matters requiring resolution.

Our previous report (B-171630, Nov. 26, 1975) noted serious weaknesses in a similar system used to pay the taxes on HUD single-family residences. The weaknesses included:

- Late tax payment resulting in unnecessary penalty and interest charges.
- Tax payment on property it did not own.
- Failure to pay taxes it owed.

We suggested, among other things, computerization and partial decentralization of the single-family residence tax system.

According to a HUD official, improvements planned for the single family residence tax payment system will not include multifamily projects because the current manual multifamily system is considered adequate.

Our limited review, however, disclosed payment problems identical to those found in the single family residence tax system. For example, during our review of only four projects in Detroit, we found that HUD

--incurred \$35,200 in late charges because it did not pay tax bills on time,

--paid taxes of \$36,300 on property it did not own, and

--did not pay two tax bills totaling \$2,100.

Except for \$14,400 of the late charges, all of these errors were the result of incorrect property identification information in the tax files at HUD headquarters.

The problem of timely payment was confirmed by a HUD internal audit report issued in 1976. This report concluded that HUD personnel were not adequately controlling the timely payment of taxes on multifamily projects and that, as a result, \$60,500 in tax penalties were incurred during the last 3 months of 1975.

We are currently following up on the actions taken to correct the deficiencies found in our 1975 report and are including an evaluation of the systems for paying taxes on properties assumed and acquired under other HUD programs. The review is concentrating on identifying the causes of improper tax payments and the results will be included in a separate report.

NO MONITORING OF HUD-INSURED PROJECT'S REAL ESTATE TAXES

HUD is required to know all aspects of project operation, maintenance, and financial status so that unfavorable conditions may be promptly identified and corrected. But HUD officials have explained that HUD does not become involved in evaluating the reasonableness of real estate tax assessments or in reviewing and appealing them as that responsibility rests with the insured-project owners.

However, we believe HUD officials should not ignore real estate taxes when monitoring these projects because to do so can result in the payment of excessive taxes which threaten project viability and contribute to defaults or result in unreasonable rent increases for project tenants. Lack of involvement has left HUD unaware of changes in project assessments, owner tax appeal efforts, or the availability of local tax reduction programs.

Our review of 123 insured projects identified 56 instances of unreasonable tax assessments or payment of

unnecessary taxes. The following example illustrates the effect of HUD's unawareness of a tax assessment increase on a subsidized project. In this case about \$85,000 paid in unnecessary taxes contributed to the projects's temporary default and a large rent increase for the low-income people residing in the project.

A 30-story apartment project in Chicago was completed in 1970 with a HUD-insured mortgage. This was a subsidized project designed to serve low-income families.

In 1971 the local assessor increased the assessed value of this project from \$763,000 to \$2,181,000, or an increase of 186 percent. The owner was unaware of the increase until the tax bill was received the following year, according to the management agent, who said the notice of reassessment had not been received. By the time the tax bill was received, it was too late to file an appeal.

The bill received showed a tax increase of \$177,000 over the previous year's taxes. According to the management agent, the project, unable to cope with the large tax increase and other rising costs, was forced to default on the mortgage payments.

To offset increased costs, the owner requested a rent hike and HUD approved a 31-percent increase. This increase averaged \$44 per month on the projects' average rent of \$143. HUD records show that 75 percent of the increased rent was directly attributable to the tax increase.

The project owner ultimately did appeal the assessment and won a reduction of \$85,000 in taxes for the following year.

The next example also shows that, because HUD did not keep abreast of insured-project tax matters, an unreasonably high rent increase resulted for another project's tenants.

A HUD-insured project consisting of two 10-story elevator buildings containing 540 dwelling units was completed in the early 1960s. In September 1975 the owner requested that HUD approve a rental increase of about \$287,000 because of increased operating costs. HUD approved an increase of \$272,000--slightly less than requested.

HUD, in approving the rent increase, used a real estate tax of \$258,941, the amount shown on the project financial statement of December 31, 1974.

Unknown to HUD, the project owner had won a reduction in property taxes in 1975. Instead of \$258,941, taxes were only \$158,877. Thus, the rent increase approved by HUD was based on taxes that were more than \$100,000 overstated. Had HUD used the correct figures, the rental increase could have been 40 percent less.

The following example illustrates the need for HUD personnel to know local tax rules. In this case, an erroneous claim of high taxes made by the project owner went undetected, resulting in another unnecessary burden being placed on project tenants.

The owner of a Chicago project submitted a request in 1974 for a rent increase of \$125,000. As support for the request, the owner claimed real estate taxes of \$173,000. The actual tax paid, however, was only \$92,000. The owner's figure was computed by multiplying two times the second tax installment but, in Chicago, the second installment is not always one-half of the total tax.

HUD approved a rent increase of \$97,000 partly on the basis of the larger tax amount submitted by the owner. The actual tax bills were submitted by the owner with his request for the rent increase. If HUD had added these bills, rather than relying on the owner's erroneous total, it would have come to the correct total.

The following example is another illustration of HUD's overall unconcern about insured-project real estate tax matters. Many States provide some form of property tax relief for low-income families. In some States, this relief is provided by tax abatements or reduced payments in lieu of taxes for subsidized housing. We believe it is important that HUD-subsidized projects take full advantage of any available tax relief.

We found, however, at least one program--in Detroit--where eligible HUD-subsidized projects did not take full advantage of available tax relief.

The State of Michigan Public Act of 1966, No. 346, as amended, provides that municipalities can grant tax relief to projects having Federal- or State-subsidized mortgages.

Although most municipalities decided not to provide relief, the City of Detroit implemented the law. Beginning in 1969, the city began allowing projects to make a payment in lieu of taxes on the basis of the formula specified in the law.

Our analysis of all HUD-subsidized projects in Detroit showed that 52 of the 71 projects eligible for the program did not take full advantage of the available tax relief. Although we believe the owners' ignorance contributed to their failure to take advantage of the program, HUD did not provide any guidance to owners of insured projects nor did HUD instruct owners of eligible projects to either initially apply for relief or to annually submit required data to the city. In addition, we found that HUD officials had only a limited knowledge of how the program worked and did not know who should be receiving tax relief and how much.

HUD AREA OFFICE COMMENTS

We discussed the examples of unreasonable assessments identified during our review which were still outstanding with HUD area office officials. The Detroit office said it would appeal the assessments on the HUD-owned projects but would not take any action on the insured projects unless it received directions to do so from HUD headquarters. The Chicago office said it would appeal assessments on the HUD-owned projects if sufficient staff was made available for the work. With respect to the insured projects, the examples of unreasonable assessments noted were no longer outstanding, either because the owner had successfully appealed or HUD had subsequently acquired the properties. Chicago officials stated that they would not take any action on future assessments of insured projects unless HUD headquarters instructed Chicago to do so.

ACTION NEEDED TO MORE EFFECTIVELY MANAGE REAL ESTATE TAX PROBLEMS

The significance of real estate taxes was recognized by the Secretary of HUD in 1975 when she testified before the Congress that an increasingly large number of multi-family projects have been unable to cope with rapidly increasing real estate taxes. The Assistant Secretary for Housing Management testified at the same time that preventing foreclosures of HUD-insured properties was a major goal. Both of these HUD officials testified that the low- and moderate-income families in these projects frequently cannot absorb the rent increases necessitated by rising costs.

HUD area officials advised us the program for managing real estate taxes was not more effective because of a lack of personnel, a lack of expertise in the tax area, and higher priority work.

We believe these problems are compounded by the fact that

--responsibility for tax problems of HUD-owned projects is divided between the field and headquarters and

--no policy exists for tax management of insured projects.

Divided responsibility

A barrier to reducing taxes on HUD-owned multifamily projects is the division of responsibility between area offices and headquarters. Area offices are responsible for reviewing and, where necessary, filing appeals on owned-project tax assessments. Despite this decentralized approach, responsibility for the multifamily project tax payment system is centralized in Washington, D.C. Tax information needed by the area offices to determine the reasonableness of the tax assessment is sent to and retained by headquarters. This division has contributed to the missing of appeal deadlines, problems in paying tax bills, and the overall inability to develop an effective tax management program. For example, the tax assessment on a Detroit project was increased in 1975. HUD headquarters, upon receiving the tax bill, wrote to the area office and asked if the increase was reasonable. Area office officials didn't know; therefore, they asked the project's managing agent who informed HUD that the deadline for appeal of the assessment increase had passed and, as a result, no action was taken.

Numerous HUD local officials have questioned this division of responsibility. For example, a HUD Region V lawyer who had worked on tax problems for the Chicago area office stated that the main problem is the centralized payment system which separates those responsible for reviewing taxes from information needed to review taxes. Another Region V official mentioned constant complaints from area and insuring office officials about tax information going to headquarters. He explained that it was difficult for these officials to carry out their responsibilities when necessary information is not readily available.

No policy on insured projects

HUD has no stated policy toward real estate taxes on insured projects. Although HUD guidelines require that initiative must be taken to deal with all project problems, headquarters officials disclaim responsibility for taking positive action relative to taxes saying they are the owner's problem. These officials also state that there are no HUD guidelines or procedures for the review of tax assessments on insured projects.

Some local officials, however, think it is important that HUD get involved in insured-project tax problems. For example, HUD Region VII has prepared, on its own initiative, a real estate tax handbook to aid local officials. A Region VII official explained that HUD directives were not clear on insured projects but that HUD could and should assist mortgagors with their tax problems. The handbook states that a systematic plan must be developed that will identify and track insured projects which require possible tax abatement action. The view of these local officials appears more consistent with HUD's guidelines which, in requiring aggressive servicing of all project problems, would seem to include tax management. However, as long as HUD headquarters lacks a clear policy, the situations described in our report will continue.

This lack of a clear policy has also contributed to the absence of tax information on insured projects at the area offices. As a result, HUD does not know what insured-project owners are doing or not doing to appeal their taxes.

HUD requires the insured mortgagor to submit annual financial statements but does not require submission of tax information, such as copies of reassessment notices or tax bills. As a result, the agency does not know of a tax increase until the financial statement is received, which could be well after appeal deadlines have lapsed.

In addition, HUD does not require the insured mortgagor to inform it of tax appeal action being taken. Thus, when a mortgagor requests agency approval of a rent increase on the basis of increases in taxes or other costs, HUD does not know what, if anything, the owner has done to reduce these taxes. If the owner has filed appeals, HUD does not know the results. Inadequate information has been a major factor in the approval of unreasonable rent increases.

CONCLUSIONS

Real estate taxes are a significant part of the rising cost of operating and maintaining HUD multifamily housing. An effective tax management program could more than likely obtain significant tax reductions on HUD-owned and -insured projects. HUD, however, has not established a program to insure that the taxes assessed on HUD-insured multifamily housing projects are fair and equitable, and its program on owned projects has not been effective. This has resulted in excessive tax payments and unnecessary rent-increase approvals.

These problems were caused, in part, by a lack of needed tax information at the local HUD offices and the absence of headquarters policy on servicing insured-project tax problems. We recognized that the large number of HUD-insured projects, the short time frames allowed for appeals of tax assessments by many of the approximately 6,000 taxing authorities nationwide, and the fact that tax assessments are sent directly to owners of insured projects makes it difficult to establish an effective tax management program for insured projects. We believe, however, that an effective program can be established if the HUD field offices become more directly involved with real estate tax issues when monitoring HUD-insured projects.

Specifically, we believe HUD field offices could

- arrange to have local taxing authorities to send copies of tax assessments on HUD-insured projects directly to HUD at the time the notices of assessments are sent to financing institutions holding mortgages on property,
- identify methods used by the taxing authorities to compute tax assessments in those areas where HUD-insured projects are located,
- compute the tax assessments on HUD-insured projects before the tax assessments are sent by the local taxing authority by using the latest data available concerning project status,
- compare the HUD-computed assessment with the assessment actually made by the taxing authority to identify assessments which appear unreasonable,

--alert the owners to unreasonable assessments and instruct them on the appeal process, and

--follow up to insure that appeals are filed, when warranted.

AGENCY COMMENTS AND OUR EVALUATION

On March 9, 1977, we solicited HUD's views on the matters discussed in this report. HUD responded on July 19, about 4 months later, with the following comments. (See app. I.)

HUD agreed with our proposal that it should identify States and other taxing authorities which have enacted tax relief legislation and instruct HUD-insured project owners to take advantage of such programs. HUD plans to implement this recommendation through the regional administrators.

HUD also agreed with our proposal that real estate taxes should be included as one of the items to be dealt with when monitoring problems of insured projects. HUD stated that (1) field offices would be instructed to encourage owners to seek redress where tax assessment is excessive and the statutory limitation for protest and appeal have not lapsed and (2) changes will be incorporated into ongoing training programs to insure that loan management personnel receive instructions in this area.

However, a close reading of HUD's entire response indicates the above comments are made in the context that HUD's first knowledge of an increase in taxes would normally occur when an owner applied to HUD for a rent increase. The changes proposed by HUD will only deal with the situation "after the fact," whereas our proposal envisioned monitoring the projects before the tax assessments are finalized, which is before HUD is now made aware of tax increases. We believe HUD's monitoring should include the specific items we have identified on pages 20 and 21 of our report.

Regarding our proposal that HUD establish procedures to insure that real estate taxes assessed on both HUD-owned and -insured multifamily projects are fair and equitable, HUD stated that, with respect to HUD-owned properties, paragraph 151 of the "Multifamily Property Handbook" instructs the regions and area-insuring offices how to proceed with an appeal and the factors that are needed to make an appeal of tax assessments.

We recognize that the HUD handbook provides the methodology for making tax appeals. HUD's implementation of these procedures, however, has been ineffective as evidenced by the examples cited in our report because it has been an area that HUD field offices have not actively pursued and staffed. We believe that if HUD conscientiously evaluated new tax assessments and appealed those that appear to be unreasonable, HUD could achieve substantial savings in real estate tax payments on owned properties.

With respect to HUD-insured properties, HUD feels that project owners and managers must bear the responsibility for assuring that their tax assessments are fair, but that HUD personnel, to the extent feasible, upon reviewing an application for a rent increase, an annual financial statement, or data in support of mortgage relief, should assist owners to seek relief for inequitable assessments. HUD plans to issue additional written guidance to its field offices on this subject.

As indicated earlier (see p. 21), HUD's proposed changes deal primarily with the tax issue after the fact, that is, in connection with a request for a rent increase or mortgage relief. Our report examples demonstrate the shortcomings of this approach. Although primary responsibility to appeal tax assessments rests with project owners, we believe HUD officials must aggressively monitor such assessments to insure that taxes paid by project owners are not excessive; otherwise, excessive taxes may threaten project viability and contribute to defaults or result in unreasonable rent increases for project tenants.

HUD disagreed that there was a need to develop a multi-family tax payment system which insured prompt and timely payment of real estate taxes. It stated that the present system meets those objectives and indicated that the percentage of penalties paid because of late tax payments amounted to only 0.0025 percent of total taxes paid.

Penalties due to late payments account for a small percentage of total taxes paid--about 0.25 percent for the October 1975 to March 1977 period rather than the 0.0025 percent indicated. HUD's response, however, ignores the other problems discussed on page 13--HUD's payment of taxes on property it does not own and its failure to pay taxes on projects it does own. Furthermore, in May 1976 HUD's Inspector General reported on the lack of control in HUD's tax payment system. In our opinion, the

lack of control resulted from a centralized system attempting to deal with a highly decentralized problem. We, therefore, believe that HUD should implement the following recommendations.

RECOMMENDATIONS

We recommend that the Secretary of HUD:

- Require, as a matter of policy, that HUD officials include real estate taxes as one of the items to be dealt with in monitoring problems of insured projects.
- Establish procedures to assure that real estate taxes assessed on both HUD-owned and -insured multifamily projects are fair and equitable.
- Develop a multifamily tax payment system which insures proper and timely payment of real estate taxes.
- Identify States and other taxing authorities which have enacted tax relief legislation and instruct HUD-insured project owners to take advantage of such programs.



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

OFFICE OF THE ASSISTANT SECRETARY FOR
HOUSING—FEDERAL HOUSING COMMISSIONER

July 18, 1977

IN REPLY REFER TO:

Mr. Henry Eschwege
Director
Community and Economic Development
Division
United States General Accounting
Office
Washington, D.C. 20548

Dear Mr. Eschwege:

Your letter of March 9, 1977 addressed to the Secretary of Housing and Urban Development transmitting a proposed report to the Congress entitled: "HUD Unresponsive to Multifamily Projects Real Estate Tax Problems," has been referred to me for reply. I will answer the recommendations in the order that they were presented.

Recommendation No. 1: The Secretary of HUD should require, as a matter of policy, that HUD officials include real estate taxes as one of the items to be dealt with in monitoring problems of insured projects.

Reply: We concur that real estate taxes should be included as one of the items to be dealt with in monitoring problems of insured projects.

Normally, HUD is first informed of an increase in taxes at the time an owner files for a rent increase. Currently, HUD's rental processing procedures for insured projects, require that field offices make every effort to ascertain that operating expenses, including real estate taxes, are reasonable and necessary to the project's operations. Field offices will be instructed to encourage owners to seek redress where it appears the tax assessment is excessive and the statutory limitation for protest and appeal have not lapsed. Appropriate instructions will be forthcoming in 4350.1, Insured Project Servicing Handbook.

In our ongoing training programs for loan management personnel at HUD East, changes will be incorporated into the curricula to ensure

that field personnel receive instructions in this area.

Recommendation No. 2: The Secretary of HUD should establish procedures to assure that real estate taxes assessed on both HUD owned and HUD insured multifamily projects are fair and equitable.

While HUD must rely on project owners and managers to bear the major responsibility for assuring that their tax assessments are fair, HUD personnel, to the extent feasible, upon reviewing an application for a rent increase, an annual financial statement or data in support of mortgage relief, will be instructed to assist owners to seek relief for inequitable assessments. Additional written guidance to field offices on this subject will be forthcoming.

Recommendation No. 3: The Secretary of HUD should develop a multifamily tax payment system which ensures proper and timely payment of real estate taxes.

Reply: We believe that the present system meets the objectives of proper and timely payment of real estate taxes. While the problem can not be entirely eliminated, the percentage of penalties paid amount to only about .0025 percent of the total taxes paid.

The procedure for the procurement and payment of tax bills on Secretary-held project mortgages and properties is outlined below:

On or about 60 days prior to the tax penalty date, form letters are sent to each tax collector.

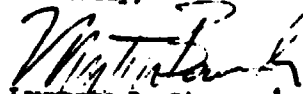
At the same time, a master list of properties and mortgages are printed from the addressograph plates which are prepared at time of property acquisition. The master list is retained for recording the receipt of tax bills, making payments and sending follow-up letters for tax bills not received. After the tax bills received have been checked off the master list, and approximately 15 days after the first mailing, a follow-up letter is mailed to each tax collector for bills not yet received. If the requested bills have not been received from the tax collector within 30 days from the initial request, we address a letter to mortgagor or the Area/Insuring Office Director, as appropriate, advising that we have been unsuccessful in obtaining the tax bill and requesting that he secure and forward the bill in order that payment may be effected prior to the penalty date.

Recommendation No. 4: The Secretary of HUD should identify states and other taxing authorities which have enacted tax relief legislation

and instruct HUD insured project owners to take advantage of such programs.

Reply: After identification of states and other taxing authorities which have enacted tax relief legislation, we will take the necessary steps to implement this recommendation.

Sincerely,


Lawrence B. Simons
Assistant Secretary

Enclosure

PROPLRTY DISPOSITION HANDBOOK
MULTIFAMILY PROPERTIES

4315.1

CHAPTER 6

- * 151. REAL ESTATE TAX APPEALS. Directors shall make continuing efforts to achieve reductions in real estate tax assessments when the facts warrant, particularly when a reassessment is being made. Formal protest or appeal of an assessment shall not be made without prior consultation with the Area/Regional Counsel. Private counsel shall not be retained to perform legal services in connection with tax appeals without the prior written consent of the OGC. When a formal protest or appeal is planned, the Director shall gather information and evaluate the assessment in the light of local conditions and make appropriate recommendations to the Area/Regional Counsel. Tax appeals taken above the level of a local tax assessor shall be handled through the Area/Regional Counsel. On all tax appeals handled through the Area/Regional Counsel, a continuous follow up with the Area/Regional Counsel shall be conducted by the CPO until such time that the final tax appeal authority has adjudicated the matter. Where a tax appeal will be taken, the CPO shall notify OFA to pay the taxes under protest, if allowable under local law.
- a. Real estate tax assessment appeals shall be made when:
1. The project's value has been adversely affected by local economic conditions.
 2. The project has experienced accelerated obsolescence due to nearby modern construction and/or changing neighborhood characteristics.
 3. Gross rental income has been adversely affected by reduced rental rates in competitive projects, or other similar factors.
 4. Actual and/or estimated annual operating expenses are disproportionate to the estimated annual income.
 5. Taxes represent a disproportionate percentage of the expenses.
 6. The project has been programmed for razing or removal; the site is or will be a vacant lot.
 7. The project has been conveyed to HUD in a vandalized or structurally incompleated condition.
 8. The tax assessment is based on a value in excess of the current market value of the property.
 9. The project's gross rental income/or value have been adversely affected by the loss of a rental subsidy.

PROPERTY DISPOSITION HANDBOOK
MULTIFAMILY PROPERTIES

4315.1

CHAPTER 6

- * b. During the period HUD manages a multifamily project as a mortgagee-in-possession, the CPO shall gather information and evaluate the tax assessment in light of local conditions, and submit this information with recommendations to the Director. All data and information concerning the tax appeal, together with required forms and documents, shall be developed and prepared so that the appeal may be made upon acquisition. A determination shall be made as to the calendar dates the Appeals Board will honor the assessment appeal. *
152. SALE BEFORE REAL ESTATE TAX SETTLEMENT. In the event the local office does not have the time, prior to sale of a property, to follow through to the final tax settlement, it shall keep the case alive by protesting the assessment in question, so that the ultimate purchaser could take over and settle the case. Upon settlement:

PRINCIPAL HUD OFFICIALS RESPONSIBLE FOR ADMINISTERING
ACTIVITIES DISCUSSED IN THIS REPORT

| | <u>Tenure of office</u> | |
|------------------------------------------------------------------------------------------------------------|-------------------------|-----------|
| | <u>From</u> | <u>To</u> |
| SECRETARY OF HOUSING AND URBAN DEVELOPMENT: | | |
| Patricia R. Harris | Jan. 1977 | Present |
| Carla A. Hills | Mar. 1975 | Jan. 1977 |
| James T. Lynn | Feb. 1973 | Feb. 1975 |
| ASSISTANT SECRETARY FOR HOUSING-- FHA COMMISSIONER: | | |
| Lawrence B. Simons | Mar. 1977 | Present |
| Morton A. Baruch (acting) | Mar. 1977 | Mar. 1977 |
| Joseph Burstein (acting) | Jan. 1977 | Feb. 1977 |
| John T. Howley (acting) | Dec. 1976 | Jan. 1977 |
| James L. Young | June 1976 | Dec. 1976 |
| ASSISTANT SECRETARY FOR HOUSING PRODUCTION AND MORTGAGE CREDIT-- FHA COMMISSIONER (note a): | | |
| David S. Cook | Aug. 1975 | June 1976 |
| David M. DeWilde (acting) | Nov. 1974 | Aug. 1975 |
| Sheldon B. Lubar | July 1973 | Nov. 1974 |
| ASSISTANT SECRETARY FOR HOUSING MANAGEMENT (note a): | | |
| James L. Young | Mar. 1976 | June 1976 |
| Robert C. Odle, Jr. (acting) | Jan. 1976 | Mar. 1976 |
| H. R. Crawford | Apr. 1973 | Jan. 1976 |

a/ On June 14, 1976, HUD combined the functions of these two Assistant Secretaries under a single Office of Assistant Secretary for Housing--FHA Commissioner.

(38702)