

UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

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TUESDAY, NOVEMBER 13, 1979

STATEMENT OF  
HENRY ESCHWEGE, DIRECTOR  
COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION

BEFORE THE

SUBCOMMITTEE ON HUD-INDEPENDENT AGENCIES  
COMMITTEE ON APPROPRIATIONS  
UNITED STATES SENATE

ON

[ HUD'S MANAGEMENT AND MONITORING OF THE CLIFTON  
TERRACE APARTMENTS AND GENERAL INFORMATION ON ASSIGNED  
MULTIFAMILY PROJECTS ]

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

WE ARE HERE TODAY AT YOUR REQUEST TO DISCUSS WHAT WE KNOW  
OF HUD'S MANAGEMENT AND MONITORING OF THE CLIFTON TERRACE APART-  
MENTS IN WASHINGTON, D.C., AND CERTAIN PAST AND PRESENT GAO  
REVIEWS OF HUD'S MANAGEMENT OF ITS MULTIFAMILY MORTGAGE PROGRAMS.

CURRENTLY, THE DEPARTMENT OF JUSTICE IS CONDUCTING AN  
INVESTIGATION OF THE CLIFTON TERRACE PROJECT WHICH COULD RESULT  
IN CRIMINAL PROCEEDINGS. THEREFORE, OUR DISCUSSION THIS MORNING  
WILL CONCENTRATE ONLY ON HUD'S ADMINISTRATIVE MANAGEMENT AND  
MONITORING OF THE PROJECT. THE DEPARTMENT OF JUSTICE HAS  
SUBPOENAED THE HUD FILES ON THIS PROJECT AND, AS A RESULT,  
OUR RECENT INQUIRIES HAVE BEEN CONDUCTED WITHOUT THE BENEFIT OF  
COMPLETE PROJECT FILES.

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THE INFORMATION WHICH WE HAVE OBTAINED FROM AVAILABLE FILES INDICATES THAT HUD: (1) SOLD THE CLIFTON TERRACE PROPERTY TO P.I. PROPERTIES, INC., UNDER UNUSUAL CIRCUMSTANCES, *and a price \$405,000 below that which was agreed upon* (2) INADEQUATELY MONITORED THE ACTIVITIES OF THE NEW OWNERS AND, (3) DELAYED FORECLOSURE ON THE PROJECT DESPITE INDICATIONS OF SERIOUS FINANCIAL PROBLEMS.

TO FULLY UNDERSTAND THE CIRCUMSTANCES LEADING TO HUD'S FORECLOSURE IN AUGUST 1978 OF THE CLIFTON TERRACE PROJECT, LET ME PRESENT A BRIEF DESCRIPTION OF EVENTS CONCERNING THE PROJECT.

HUD ACQUIRED THE PROPERTY ON APRIL 2, 1973, BY FORECLOSURE AFTER THE PREVIOUS OWNER HAD DEFAULTED ON THE HUD INSURED MORTGAGE. THE PROJECT WAS PRESENTED TO HUD'S PROPERTY DISPOSITION COMMITTEE ON FEBRUARY 6, 1974, WITH A RECOMMENDATION FOR A PUBLIC OFFERING AT A MINIMUM PRICE OF \$1,202,000, WITH A SECRETARY-HELD MORTGAGE OF 90 PERCENT. ON MAY 16, 1974, HUD ENTERED INTO AN AGREEMENT TO SELL THE PROJECT TO P.I. PROPERTIES, INC., FOR \$1,286,600 ON A NON-COMPETITIVE BASIS WITH A 100-PERCENT SECRETARY-HELD MORTGAGE. THE SALES AGREEMENT PROVIDED THAT P.I. PROPERTIES, INC., WAS TO MANAGE THE PROJECT AS AN AGENT FOR HUD UNTIL DECEMBER 1, 1974. CLOSING ON THE PROPERTY WAS SCHEDULED FOR DECEMBER 2, 1974, CONTINGENT ON SATISFACTORY MANAGEMENT OF THE PROJECT DURING THE INTERIM PERIOD. ACTUALLY, CLOSING DID NOT TAKE PLACE UNTIL JUNE 30, 1975. HUD OFFICIALS TOLD US THAT SELLING THE PROJECT WITHOUT COMPETITIVE BIDDING AND FINANCING IT WITH

A 100-PERCENT SECRETARY-HELD MORTGAGE WAS NOT A COMMON PROCEDURE. A HUD OFFICIAL PREPARED A "WAIVER OF CRITERIA TO NEGOTIATE SALE" TO JUSTIFY THE DEVIATION FROM NORMAL PRACTICES.

HUD'S ANALYSIS INDICATED THAT THERE WERE SOME PROBLEMS WITH THE MANAGEMENT OF THE PROJECT DURING THE PERIOD THAT P.I. INC., WAS THE MANAGEMENT AGENT. FOR EXAMPLE, IN A MARCH 18, 1975, MEMORANDUM TO THE ASSISTANT SECRETARY FOR HOUSING MANAGEMENT, THE AREA OFFICE DIRECTOR DISCUSSED P.I.'S PERFORMANCE AND RECOMMENDED THAT P.I. INC., NOT CONTINUE MANAGING THE PROJECT. ALSO THE TENANT ORGANIZATION AT CLIFTON TERRACE HAD INDICATED ITS DISSATISFACTION WITH P.I.'S MANAGEMENT.

DESPITE THE IDENTIFIED PROBLEMS DURING THE INTERIM MANAGEMENT PERIOD, THE PROJECT SALE WAS CLOSED ON JUNE 30, 1975, AT A SALE PRICE OF \$820,400--SOME \$400,000 LESS THAN THE RECOMMENDED AND THE PREVIOUSLY AGREED TO SALE PRICE--WITH A 100-PERCENT SECRETARY-HELD MORTGAGE. OUR EXAMINATION OF AGENCY DOCUMENTS INDICATES THAT AFTER THE SALE, P.I. INC., FAILED TO PROVIDE HUD WITH THE REQUIRED FINANCIAL STATEMENTS WHICH WOULD HAVE PERMITTED AN ANALYSIS OF THE QUALITY AND EFFECTIVENESS OF PROJECT MANAGEMENT. THIS, COUPLED WITH THE FACT THAT P.I. WAS NOT MAKING MONTHLY MORTGAGE PAYMENTS TO HUD, CAUSED HUD HEAD-QUARTERS OFFICIALS, AS EARLY AS SEPTEMBER 1976, TO QUESTION WHETHER P.I. WOULD MEET ITS OBLIGATION AND WHETHER THE MORTGAGE SHOULD BE FORECLOSED. IN ALL, P.I. INC., MADE ONLY FOUR PAYMENTS ON THE MORTGAGE, AND AS OF MAY 1, 1977, P.I. WAS ABOUT \$193,000 BEHIND IN MORTGAGE PAYMENTS.

ON MAY 27, 1977, THE HUD INSPECTOR GENERAL'S OFFICE ISSUED THE FIRST AUDIT REPORT ON THE PROJECT'S OPERATIONS AND CONCLUDED THAT THE BOOKS AND RECORDS WERE INCOMPLETE; WERE INACCURATE; AND, IN SOME INSTANCES, COULD NOT BE LOCATED. THE REPORT ALSO CONCLUDED THAT A COMPREHENSIVE AUDIT COULD NOT BE PERFORMED UNTIL DEFICIENCIES IN THE FINANCIAL RECORDS WERE CORRECTED.

ON THAT SAME DATE, THE INSPECTOR GENERAL'S OFFICE WROTE THE AREA OFFICE DIRECTOR CONCERNING THE AUDIT. THE LETTER CRITICIZED THE AREA OFFICE'S SERVICING OF THE PROJECT, STATED THAT THE MORTGAGOR HAD NOT BEEN REQUIRED TO SUBMIT ANNUAL FINANCIAL STATEMENTS, AND SAID THAT MONTHLY FINANCIAL REPORTS SUBMITTED TO THE AREA OFFICE BY PROJECT OFFICIALS WERE NOT FULLY UTILIZED.

ON JUNE 20, 1977, THE AREA OFFICE DIRECTOR RECOMMENDED TO THE DIRECTOR, OFFICE OF LOAN MANAGEMENT IN HUD HEADQUARTERS, THAT THE MORTGAGE BE FORECLOSED BASED ON THE LACK OF RESPONSIBLE AND EFFICIENT MANAGEMENT. IN A SEPARATE ACTION ON JUNE 22, 1977, ELECTRIC SERVICE ON THE PROJECT WAS DISCONTINUED BRIEFLY BECAUSE OF DELINQUENT BILLS AMOUNTING TO ABOUT \$91,000.

ON AUGUST 3, 1977, THE AREA OFFICE DIRECTOR REQUESTED THAT HIS EARLIER FORECLOSURE RECOMMENDATION BE HELD IN ABEYANCE. HE STATED THAT HE BELIEVED IMPROVEMENTS COULD BE MADE IN 90 DAYS. ALTHOUGH THE SITUATION AT CLIFTON TERRACE DID NOT IMPROVE, HUD DID NOT FORECLOSE ON THE MORTGAGE FOR ANOTHER YEAR OR UNTIL LATE AUGUST 1978.

I WOULD LIKE TO POINT OUT THAT A NUMBER OF THE PROBLEMS AT THE CLIFTON TERRACE PROJECT ARE NOT UNIQUE. HUD CURRENTLY HOLDS THE MORTGAGES ON ABOUT 2,000 MULTIFAMILY PROJECTS VALUED AT ABOUT \$3 BILLION. ABOUT 75 PERCENT OF THESE PROJECTS ARE DELINQUENT IN THEIR MORTGAGE PAYMENTS. ESTIMATES OF THESE DELINQUENCIES TOTAL AS HIGH AS \$500 MILLION. THERE ARE ABOUT 500 ADDITIONAL PROJECTS WHICH HUD OWNS AS A RESULT OF MORTGAGE FORECLOSURES.

PROBLEMS OF DEFAULTS, INADEQUATE MONITORING, INADEQUATE MORTGAGE SERVICING, AND LENGTHY PERIODS BETWEEN DEFAULT AND FORECLOSURE HAVE BEEN NOTED IN OTHER GAO REPORTS AND TESTIMONY. HUD'S INSPECTOR GENERAL'S FIRST SEMIANNUAL REPORT TO THE CONGRESS ON APRIL 30, 1979, STATED THAT THEIR AUDIT REPORTS HAVE OFTEN DISCLOSED THE LACK OF MONITORING AND ON-SITE REVIEWS OF THE ACTIVITIES OF PROGRAM PARTICIPANTS BY HUD PROGRAM PERSONNEL.

PAST GAO REPORTS AND CONGRESSIONAL TESTIMONY ON THIS SUBJECT HAVE IDENTIFIED SUCH PROBLEMS AS:

- FIELD OFFICES BEING INEFFECTIVE IN EXERCISING CONTROL OVER RECEIPTS AND DISBURSEMENTS.
- FAILURE TO MAINTAIN PROJECT BOOKS AND RECORDS IN REASONABLE CONDITION FOR AUDIT OR FOR SHOWING RESULTS OF OPERATIONS.
- INADEQUATE MANAGEMENT AND MONITORING OF MULTIFAMILY PROJECTS.
- ADMINISTRATIVE ACTIONS TAKEN ON A CASE-BY-CASE BASIS WITHOUT ESTABLISHING AN EXPLICIT POLICY REGARDING WORKOUT AGREEMENTS OR FORECLOSURES.
- INCREASING DELINQUENCIES DURING WORKOUT PERIODS.

CURRENTLY, GAO HAS SEVERAL REVIEWS RELATED TO HUD'S MULTI-FAMILY PROGRAMS. WE ARE REVIEWING THE DEPARTMENTAL DECISION-MAKING PROCESS WHICH RESULTED IN HUD'S "TROUBLED PROJECTS" STRATEGY AND THE POTENTIAL EFFECTIVENESS OF THE STRATEGY IN TREATING THE FINANCIAL PROBLEMS IN SUBSIDIZED PROJECTS. WE ARE ADDRESSING CERTAIN AREAS OF STRATEGY EFFECTIVENESS WHICH MAY BE OF INTEREST TO THE SUBCOMMITTEE, INCLUDING

- REVERSALS OF HUD FIELD JUDGMENTS REGARDING OWNER/ MANAGEMENT EFFECTIVENESS,
- POTENTIAL COSTS OF THE FLEXIBLE SUBSIDY PROGRAM AND HUD/OWNER COST SHARING, AND
- HUD/OWNER EVALUATION OF PROJECT EXPENSES AND MANAGEMENT AND THE ADEQUACY OF RESPONSES TO PROBLEMS.

WE ARE COMPLETING A REVIEW OF HUD'S ACCOUNTING SYSTEM FOR MULTIFAMILY ASSIGNED MORTGAGES. DURING THIS REVIEW, WE HAVE NOTED THAT THE HUD SYSTEM IS UNABLE TO IDENTIFY THE TOTAL AMOUNT OF DELINQUENT MORTGAGE PAYMENTS. WE ESTIMATE THE DELINQUENCIES TO BE ABOUT \$500 MILLION, AND WE ARE IN THE PROCESS OF DETERMINING THE CAUSES FOR THE DELINQUENCIES. HUD IS NOT USING TWO IMPORTANT MANAGEMENT TOOLS ON THESE MORTGAGES: (1) THE MONTHLY FINANCIAL STATEMENTS REQUIRED FROM PROJECT OWNERS; AND (2) THE ANNUAL AUDIT REPORTS REQUIRED FROM INDEPENDENT PUBLIC ACCOUNTANTS. IN MANY CASES, THESE STATEMENTS AND REPORTS ARE NOT RECEIVED BY HUD; AND, WHEN THEY ARE RECEIVED, THEY ARE OFTEN NOT REVIEWED IN ANY DETAIL.

FURTHER, IN A REVIEW OF HUD'S MANAGEMENT OF ITS ACQUIRED FORMERLY SUBSIDIZED PROJECTS WHICH WE ARE CONDUCTING FOR THE SUBCOMMITTEE ON MANPOWER AND HOUSING, HOUSE COMMITTEE ON GOVERNMENT OPERATIONS, WE ARE ADDRESSING THE ISSUES OF WHETHER HUD HAS:

- ADEQUATE CONTROL OF INFORMATION ON PROJECT OPERATING EXPENSES,
- COST STANDARDS TO EVALUATE THE REASONABLENESS OF EXPENSES, AND
- MONITORS PROJECT OPERATIONS ADEQUATELY.

IN SUMMARY, OUR PAST AND ON-GOING REVIEWS HAVE SHOWN THAT HUD HAS GREAT DIFFICULTY MANAGING SOME 2,500 MULTIFAMILY PROJECTS WHICH IT HOLDS IN ITS INVENTORY OR ON ASSIGNMENT. WE HOPE THAT THE RECENT DRAMATIC DISCLOSURES REGARDING CLIFTON TERRACE WILL SERVE TO UNDERLINE THE NEED FOR A BROAD RANGE OF SUBSTANTIVE ACTIONS BY HUD TO DEAL WITH THE PROBLEMS EXEMPLIFIED BY THIS PROJECT.

THIS CONCLUDES MY PREPARED STATEMENT. WE WILL BE GLAD TO RESPOND TO YOUR QUESTIONS.