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

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B-197141

JANUARY 16, 1980

The Honorable William Proxmire, Chairman
Subcommittee on HUD-Independent Agencies
Committee on Appropriations - SEN00306
United States Senate

Dear Mr. Chairman:

Subject: Analysis of Multifamily Assigned Mortgages (CED-80-43)

During hearings on the Clifton Terrace Project before your subcommittee on November 13, 1979, you asked the General Accounting Office to analyze the Department of Housing and Urban Development's (HUD's) inventory of multifamily mortgages to identify other mortgages which could be in severe financial difficulty. In response to this request, and based on subsequent discussions with your office, we have obtained information on

--the amount of money involved in delinquencies on mortgages held by HUD and how long the mortgages had been delinquent;

--mortgages which are currently under workout arrangements designed to bring the mortgages current; and

--mortgages which are currently in the foreclosure process, the difficulties in bringing a mortgage to foreclosure, and the length of time involved in foreclosing.

The information presented in this report was gathered from several different offices within HUD. Some of the data in the records and reports we examined was inconsistent. We had difficulty reconciling the various HUD statistics and categories of the multifamily-assigned inventory. Although we were unable to reconcile completely the number of mortgages in each category, we are confident that the discrepancies represent a small percentage of the total inventory and thus should not significantly alter our overall findings and conclusions.

HUD's management and servicing of assigned multifamily mortgages is a difficult and formidable task because, when assigned, the projects already have a history of financial and/or management problems. While we recognize these difficulties, our analysis of the current inventory indicates that

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improvements can be made in HUD's management of its multifamily inventory. Seriously delinquent mortgages were neither in foreclosure nor under current workout arrangements. When a project does go to foreclosure, it takes about 2-1/2 years to complete. HUD's slow actions (workout arrangements and/or foreclosures) affect both the mortgage insurance funds and tenants living in these projects because the projects often deteriorate after the owners realize that foreclosure will likely occur. In addition, certain Federal income tax benefits are available to project owners even when they are delinquent in their mortgage payments or while foreclosure is in process. Because these tax benefits are based on expenses which in many instances are not actually paid, more effective monitoring is needed to recapture these benefits after HUD acquires the projects.

Past experience has shown that at the time of mortgage assignment, action to either expeditiously foreclose on the mortgage or vigorously monitor its reinstatement could save millions of dollars for the Federal Government as well as protect the interests of the tenants these projects were built to serve.

DELINQUENCY OF MORTGAGES

Many mortgages are so delinquent that the possibility of reinstatement is highly unlikely. As of September 30, 1979, HUD held 2,032 mortgages with a balance of approximately $3.7 billion. About 71 percent, or 1,442, of these projects were delinquent in their mortgage payments. The total amount of those delinquencies, according to records in HUD's Office of Finance and Accounting, was about $500 million. The records showed the current status of the mortgages assigned to HUD as of September 30, 1979, as follows:

Category	Number of mortgages	Percent
Current	a/ 590	29
Delinquent	1,442	71
Total	2,032	100

a/HUD's Office of Multifamily Financing and Preservation records indicated that 732 projects were current. This difference is due to the fact that the finance office considers a project delinquent if payment is not received when due; however, the financing and preservation office does not consider the project in default until the second month's payment is delinquent.

Following is a breakout of the 1,442 delinquent mortgages.

Category	Number of mortgages	Percent
In foreclosure process	364	25
With current workout arrangement	382	27
Not in foreclosure process, without current workout arrangement	a/ 696	48
Total	1,442	100

a/HUD officials told us that about 150 of these mortgages are less than 2 months delinquent and thus do not yet require a workout arrangement.

Of the 1,442 delinquent mortgages, 514, or 36 percent, are more than 2 years behind in their mortgage payments and, of these, 126 are more than 4 years late in their payments. Twelve of the mortgages that are over 4 years delinquent are neither under a current workout arrangement nor in foreclosure. These 12 mortgages have a total delinquency of $17 million. (See enc. I.)

According to HUD officials, one historical method of estimating whether a delinquent mortgage can be brought current involves determining the degree of delinquency in accrued interest as a percentage of principal balance. According to these officials, if accrued interest delinquency on a mortgage exceeds more than 10 percent of its current outstanding principal balance, the probability of the mortgage becoming current is questionable. HUD officials stated that there are other factors which should be considered in evaluating whether or not a mortgage can be brought current, such as compliance with regulatory agreements and/or workout arrangements, the quality of project management, and the physical condition of the project. While the 10 percent criteria should not be the sole determinant in foreclosure decisions, mortgages exceeding this criteria should be closely monitored.

Using this criteria, we calculated the degree of delinquency in accrued interest as a percentage of outstanding principal balance as of September 30, 1979, for the 1,442 delinquent mortgages. We found that 538 mortgages, or about 37 percent, exceeded the 10 percent criteria; 188 of these projects were delinquent by 20 percent or more. Several of these mortgages exceeding the 10 percent criteria were not in foreclosure nor under current workout arrangement. (See enc. I.)

USE OF WORKOUT ARRANGEMENTS

A workout arrangement is one tool available to HUD to attempt to reinstate delinquent mortgages to current status. It is a written agreement with the mortgagors which permits them to temporarily make partial payments and work toward a permanent solution to the projects' financial problems.

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Officials in the Office of Multifamily Finance and Preservation told us they attempt to have all delinquent mortgages under terms of a workout arrangement within 6 months of assignment.

Our analysis showed that numerous delinquent mortgages are not under workout arrangements. For example, of the delinquent mortgages not in foreclosure, only 382 had current workout arrangements, and about one-fourth of these were delinquent in terms of their workout. Of the mortgages which did not have current workout arrangements and were not in foreclosure, we identified 283 mortgages that were over 1 year delinquent. We could not find evidence of any workout arrangements for about one-third of these mortgages. Many others had workout arrangements which had expired several years ago.

If an acceptable or financially feasible workout cannot be arranged between HUD and the owner, the mortgage will probably never become financially stable. Thus, HUD loan servicers need to expeditiously recognize the point at which a mortgage cannot be reinstated and initiate foreclosure proceedings promptly.

Currently, HUD is negotiating with a contractor on a plan to design improved methods and systems for use in developing workout arrangements. The proposal calls for establishing a uniform, systematic approach to developing effective workout arrangements. An interim report is expected later this year.

FORECLOSURES OF MULTIFAMILY MORTGAGES

Foreclosures of HUD multifamily mortgages take an average of over 2-1/2 years to accomplish and have been applied inconsistently, based on the financial status of the mortgages. Extended proceedings in initiating foreclosure and obtaining control of projects results in increased losses to the Federal Government and may result in hardships on tenants because projects often deteriorate after mortgagors become aware of a potential foreclosure action.

During fiscal year 1979 HUD acquired 99 multifamily mortgages. Based on readily available data, we were able to analyze 54 of these mortgages and found the average time from the date the Office of Multifamily Financing and Preservation requested foreclosure until the foreclosure was actually accomplished was 31 months. The range was from 4 to 59 months.

We also reviewed information on 178 foreclosure actions that are currently in the process of judicial foreclosure. Records maintained by HUD's Office of General Counsel indicated that, on the average, it took about 7 months from the time the financing and preservation office requested foreclosure until HUD's Office of General Counsel forwarded the case to the Department of Justice. The records also indicate that these 178 foreclosure actions have been with the Department of Justice and U.S. Attorneys for an average of 26 months without final resolution.

Of the mortgages currently in foreclosure, 100 were delinquent for less than 2 years and totaled about $22 million. Yet 139 mortgages, totaling $82 million, were more than 2 years delinquent and were not in foreclosure or under current workout. Thus, the amount of delinquency for the mortgages not in foreclosure or under workout is about four times greater than those already in foreclosure. This raises a question of consistency of HUD's foreclosure actions based on the financial status of the mortgages. HUD officials acknowledged that a firm foreclosure policy does not exist but stated that such a policy is being developed. As mentioned earlier, other factors in addition to financial considerations influence HUD's decision on foreclosure.

After mortgagors become aware of a potential foreclosure action but before actual control is removed from the mortgagor, projects are susceptible to deterioration and diversion of funds. This results in increased losses to HUD's mortgage insurance funds (HUD has estimated that upon acquisition, the average project needs about $600,000 in repairs) and hardships for the tenants who live in these projects. In a recent Area Office Managers' workshop participants expressed concern about the time involved in foreclosures. A HUD memo on the workshop indicated that:

> "The most critical problem period is from the time the mortgagor becomes aware of the potential foreclosure action and the transfer of possession and control to HUD as mortgagee-in-possession or to a judicially appointed receiver. It is that time period that presents the greatest opportunity for diversions by owners or managers, lack of maintenance and firm management of the project with consequent physical deterioration, all with adverse impact on the tenants."

In spite of the above, HUD's General Counsel's records indicate that many projects in the foreclosure process are still controlled by the mortgagors. HUD officials told us that when foreclosure is initiated, control of the projects is requested, but is not always granted by the courts.

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HUD's Office of Inspector General recently issued a report on a nationwide audit of HUD's timeliness in foreclosing multifamily project mortgages. The report identified significant delays in recommending, approving, referring, and completing foreclosures. The Inspector General noted that delays occurred because field offices were not prompt in initiating action to bring mortgages current and did not obtain workout arrangements in a timely manner. Additionally, the report stated that unrealistic workout proposals were accepted, inadequate determinations were made as to the prospects for reinstatement, and foreclosure was not recommended when the terms of the workout were not met. Other delays occurred, according to this report, in the referral and completion of foreclosures by HUD's General Counsel and the Department of Justice.

TAX BENEFITS OF PROJECT OWNERSHIP
NEED TO BE MONITORED

During the period owners are delinquent in their mortgage payments and while foreclosure on mortgages is in process, 4 Internal Revenue Service (IRS) officials said the project owners can claim income tax deductions for accrual of unpaid interest and depreciation expenses. Justice, HUD, and IRS officials acknowledged that owners often contest foreclosure actions to extend the period of time in which they can benefit from accrued interest and depreciation deductions on their Federal income tax returns.

However, at a January 10, 1980, meeting, IRS officials told us that under the tax benefit rule (26 CFR 1.111-1(a)), unpaid expenses--including accrued interest expense--which had previously been claimed as deductions should be recaptured in the year the liability for such expenses ends. IRS could not estimate the amount of money which has been recaptured from owners for accrued interest or depreciation deductions on mortgages which have been foreclosed. This information is not available, according to IRS, because examinations or audit results are not maintained by type of issue or adjustment.

IRS officials have stated in congressional testimony that IRS is concerned that taxpayers fail to report depreciation recapture and other deferred adverse tax consequences. In a May 18, 1979, letter to GAO on a related issue, IRS stated that it had recently developed a draft prospectus for a study regarding recapture provisions on low-income housing projects. The study is to measure taxpayer compliance levels in recapturing additional depreciation expenses and to determine the feasibility, costs, and benefits of using HUD information on real property defaults, foreclosures, and ownership changes to monitor compliance with the tax code.

In our January 10, 1980, meeting with IRS officials, we were told that the above-mentioned study plan has not been approved by IRS and therefore we could not obtain a copy. These officials did state that the study would be completed by the end of 1981 if HUD provides IRS certain needed data on schedule. They did acknowledge, however, that the subject of accrued interest expense was not included as part of the study plan, but, based on our concerns, agreed to add it to the study.

As of September 30, 1979, the total accrued interest delinquency on HUD-held multifamily mortgages was about $325 million. Since about three-fourths of these projects are owned by profit-motivated mortgagors, substantial income tax revenues could be lost to the Federal Government, if not recaptured, because deductions are allowed for expenses which are not actually paid. That part of the accrued interest delinquencies which may eventually be paid by project owners, as well as those subsequently recaptured, will not result in lost tax revenues. However, for many mortgages which are seriously delinquent and those in foreclosure, the likelihood of accrued interest ever being paid to HUD is small.

Thus, the already lengthy process of foreclosure which results in project deterioration, mortgage insurance losses to HUD, and hardship for tenants, is exacerbated by monetary incentives to delay foreclosures based on income tax considerations.

Because IRS does not know the amount of recapture of accrued interest and depreciation deductions from foreclosed multifamily mortgages and because IRS, HUD, and Justice officials acknowledge that the income tax advantages are an important consideration for project ownership, the tax consequences should be closely monitored.

CONCLUSIONS AND RECOMMENDATIONS

HUD has a difficult task in managing its multifamily-assigned inventory, which admittedly are troubled mortgages; however, improvements can be made to minimize mortgage insurance losses and to protect the safety and welfare of the tenants living in these projects. When mortgages are assigned to HUD, it must expeditiously decide whether mortgage payments on the project can be brought current. If reinstatement is possible, a workout arrangement should be initiated promptly; if reinstatement is not possible, HUD should initiate foreclosure.

However, many seriously delinquent mortgages are neither in foreclosure nor under current workout arrangements. Carrying out these decisions promptly could prevent project deterioration and the possibility of diversion of project funds, save millions of Federal dollars, and protect tenants from hardships.

HUD officials told us that the Department had recently increased field office staffing levels by 357 positions, from 793 in 1977 to 1,150 for 1979, and is now planning to (1) require annual operating budgets for projects, (2) perform annual management reviews, and (3) train field personnel in both the loan management and property disposition functions. HUD officials told us they are also exploring ways to reduce the tax benefits of delinquent, uncooperative project owners.

We believe HUD can do more to improve the management of its assigned multifamily inventory. Specifically, we recommend that the Secretary, HUD:

--Achieve consistency in data used by various HUD offices by developing a single, comprehensive management information system capable of disclosing accurate and timely data on the status of assigned mortgages.

--Make expeditious determinations, after assignment, as to whether a mortgage can realistically be brought current, and thereafter either place the mortgage under a closely monitored workout arrangement or proceed promptly with foreclosure.

--Work with the Department of Justice and the Internal Revenue Service to identify causes of delays and alternatives, including legislative remedies if appropriate, for reducing the time periods and Federal losses (including those through the income tax process) resulting from lengthy foreclosure proceedings.

--Pursue more effective and timely efforts in obtaining control of project operations once a decision to foreclose is made.

HUD officials generally agreed with our conclusions and recommendations and stated that they had already begun to take, or plan to take, action to correct identified deficiencies or problems noted in our report.

HUD officials acknowledged that the foreclosure process is cumbersome and lengthy. These officials stated that HUD has begun exploring means of reducing the length of time necessary to process foreclosures, but indicated that, in their opinion, the situation is not likely to improve significantly unless several legislative remedies are developed and enacted by the Congress. These remedies include elimination of certain favorable tax advantages for mortgagors; the exemption of HUD from Federal bankruptcy laws; and enactment of a uniform Federal foreclosure law applicable to HUD projects.

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As your office requested, we did not obtain written agency comments on our review. We met, however, with HUD, Justice, and Internal Revenue Service officials and have incorporated their comments where appropriate.

As discussed in our November 13, 1979, testimony before your subcommittee, we currently have several ongoing reviews related to HUD's multifamily programs. We will provide the subcommittee with copies of the resulting reports when they are issued or released by the requesting parties.

Your office requested that we make no further distribution of the report prior to committee hearings, now scheduled to be held on January 23, 1980.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

Enclosure

ASSIGNED MORTGAGES MORE THAN FOUR YEARS DELINQUENT NOT UNDER WORKOUT NOR IN FORECLOSURE AS OF SEPTEMBER 30, 1979

Project name and location	Amount of delinquency	Months delinquent	Percent of interest delinquency to outstanding principal balance	Expiration date of latest workout
Acorn Redevelopment Project, Oakland, Cal.	$ 1,935,233	51	12	12-31-77
Brightmoor Terrace (Parcel 34), Boston, Mass.	1,260,879	49	19	4-30-76
Camfield Gardens, Boston, Mass.	879,381	51	13	4-30-78
Chicago's Best Landlord, Chicago, Ill.	44,686	54	19	(a)
Edgewater Village, Edgewood, Md.	445,177	136	14	(a)
Geneva Apartments, San Francisco, Cal.	3,345,071	70	15	11-30-78
Methunion Homes, Boston, Mass.	1,486,463	63	19	(a)
Mulberry Square Apts., Syracuse, N.Y.	1,491,207	54	16	7-31-79
Predow Apartments, Wilmington, Del.	276,555	53	19	7-31-78
Roxse Homes, Inc., Boston, Mass.	2,498,083	51	13	8-31-79
United Housing Development #2, Middletown, Ohio	250,002	49	14	(a)
Woodlawn Gardens, Chicago, Ill.	3,321,100	61	18	12-31-76
Total	$17,233,837			

a/We could not find any evidence of HUD ever executing a workout arrangement for this mortgage.