~~13765~~

BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of Housing And Urban Development

112330

HUD Should Make Immediate Changes In Accounting For Secretary-Held Multifamily Mortgages

Over $500 million in delinquent mortgage payments is owed to HUD partially because of the Department's poor loan servicing and lack of incentive for prompt payments. Also, loan servicing is hampered by an accounting system which does not provide sufficient and timely information.

UNITED STATES GENERAL ACCOUNTING OFFICE

010401

FGMSD-80-43
MAY 16, 1980

Single copies of GAO reports are available free of charge. Requests (except by Members of Congress) for additional quantities should be accompanied by payment of $1.00 per copy. (Do not send cash).

Requests for free single copies should be sent to:

U.S. General Accounting Office
Distribution Section, Room 1518
441 G Street, NW
Washington, DC 20548

Requests for multiple copies should be sent with checks or money orders to

U.S. General Accounting Office
Distribution Section
P.O. Box 1020
Washington, DC 20013

Checks or money orders should be made payable to the U.S. General Accounting Office.

To expedite placing your order, call (202) 275-6241. When ordering by phone or mail, use the report number and date in the lower right corner of the front cover.

GAO reports are now available on microfiche. If such copies will meet your needs, be sure to specify that you want microfiche copies.

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

DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

B-198676

The Honorable Moon Landrieu
The Secretary of Housing and
Urban Development

Dear Mr. Secretary:

The Department of Housing and Urban Development holds over 2,000 multifamily mortgages valued at about $3.7 billion. These Secretary-held mortgages were either returned from commercial lenders after mortgagors defaulted on their insured mortgages or resulted from the Department selling property it had previously acquired. As of September 30, 1979, the Department reported that about $500 million in payments on these mortgages was delinquent.

In a recent review, we found numerous problems contributing to the high amount of delinquency. These included several accounting system weaknesses that prevented adequate information from being available to properly service individual mortgages and to promptly and accurately pay property taxes. Also, incentives were lacking to encourage mortgagors to make payments under revised payment plans (workout agreements) to prevent foreclosure. Specifics on these conditions are in enclosure I and are discussed briefly below.

After defaulted mortgages are returned to the Department by the original mortgagees, the responsible field office should determine if the mortgages can be reinstated (brought current) or if they should be foreclosed. If reinstatements are possible, workout agreements should be negotiated and the Department's Office of Finance and Accounting should provide monthly payment and billing data to the mortgagors and the field offices. The current accounting system, however, does not provide the data needed for aggressive loan servicing. For example, the monthly bills did not reflect the payment status of the mortgages under the terms of workout agreements, first bills on new mortgages were often prepared months late, and some monthly bills were sent to the wrong field offices. In addition, late payment penalties were charged only to mortgagors who had a current mortgage and were over 15 days late in making a payment. Defaulted mortgagors were not assessed late charges, regardless of whether they were being serviced under workout agreements.

Accounting problems also were noted in the Department's system for paying property taxes on the multifamily mortgages. For example, according to taxing authorities' records in the cities of New York and Yonkers, overpayments of approximately $128,000 had been made by the Department or by the mortgagors for real estate taxes and/or water and sewer charges for 18 of the 26 projects we reviewed. On the other hand, about $80,000 in delinquent real estate taxes and/or water and sewer charges were owed for 17 of the 26 projects. Ineffective procedures to obtain tax bills and periodically reconcile taxing authority records with the Department's tax records contribute to these problems.

Mortgage servicing in the Department's New York field office contributed greatly to the high delinquency total. In that office, some mortgagors were placed under agreements which called for them to remit only the cash remaining after the payment of project operating expenses. This type of work-out agreement provides little incentive for mortgagors to meet their payment responsibilities.

The New York office's loan servicing also was hampered by frequent failure to receive and/or review required financial data. Each month, defaulted mortgagors should submit accounting reports which show cash receipts and disbursements plus cash on hand at the end of the reported month. Annually, mortgagors should submit financial statements certified as accurate by an independent public accountant.

In reviewing monthly accounting reports submitted to the New York office, we noted instances where the field office failed to receive reports, failed to review reports received, received reports late, accepted unsigned reports, and failed to obtain explanations for questionable uses of project funds. Also, in a detailed analysis of financial statements accepted from mortgagors, we found that all the statements were missing one or more of the schedules or the supporting data required by the Department's guidelines. Only in two cases were the mortgagors requested to submit revised statements which complied with the guide.

Many of these problems are not new; they have been previously reported by us and the Department's Inspector General. To correct the problems noted, we recommend the Secretary of Housing and Urban Development direct that the Department's accounting and servicing functions be changed so that

--servicing personnel receive information on mortgagors' payment status under the terms of workout agreements,

--an interim billing system is established for newly assigned mortgages,

--late charges are assessed on payments overdue under the mortgages or the workout agreements,

--inventories of the responsible headquarters' offices and the field offices are reconciled periodically,

--the responsibility to obtain tax bills on multifamily projects is transferred to the field offices,

--records of the taxing authorities and the Department are reconciled periodically,

--workout agreements that provide for a specific payment amount be established within 90 days after receiving a defaulted mortgage,

--field offices are required to obtain adequate financial statements when they are not submitted promptly or fail to meet Department regulations,

--servicing personnel be further trained in financial statement analysis, and

--aggressive action will be taken to obtain repayment of project funds that have been diverted.

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. You must send the statement to the House Committee on Government Operations and the Senate Committee on Governmental Affairs within 60 days of the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made over 60 days after the date of the report.

We are sending copies of this report to the Director of the Office of Management and Budget and to the committees mentioned above.

We appreciate the courtesies extended to our representatives during the review. We also would appreciate receiving your comments on any actions you take or plan to take on the matters discussed in the report.

Sincerely yours,

D. L. Scantlebury
Director

Enclosure

HUD'S ACCOUNTING SYSTEM FOR SECRETARY-HELD MULTIFAMILY MORTGAGES

This enclosure contains findings and recommendations that we presented in testimony to the Senate Subcommittee on HUD and Independent Agencies, Committee on Appropriations, January 23, 1980. Our statement on that date was based on our review of Department accounting and servicing policies and procedures related to Secretary-held multifamily mortgages. The review was performed at Department headquarters in Washington, D.C., and in the New York and San Francisco field offices. The enclosure is essentially our statement of January 23, 1980, with minor changes.

Over the years, we have reported and testified on many deficiencies in HUD's accounting systems. We first reported on accounting weaknesses in 1975 after examining HUD's system for the payment of taxes under another housing program. At that time, HUD informed us it planned to institute a highly automated system, HUDMAP (Housing and Urban Development Mortgage Accounting Project), which was to solve most of its system problems. Since then, HUD has continued to cite the still forthcoming HUDMAP system as the answer to many problems identified in our reviews and currently plans to have the multifamily phase of HUDMAP operational by October 1981. The new system should address itself to many of the current system problems. We believe, however, that since the planned implementation of the multifamily HUDMAP phase is about 18 months away, interim changes must be made in the current system.

MORTGAGE DELINQUENCIES

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

As of September 30, 1979, HUD held 2,034 project mortgages valued at approximately $3.7 billion. About 71 percent, or 1,442, of these projects were delinquent in their mortgage payments. According to records in HUD's Office of Finance and Accounting, these delinquencies totaled about $500 million, of which about $325 million represented accrued interest delinquencies. The 1,442 delinquent mortgages were classified as follows:

No current workout agreement	696
Under current workout agreement	382
Undergoing foreclosure	364

As noted above, 696 of the financially troubled projects did not have current workout agreements and were not in foreclosure. We found no evidence that many of those mortgages had ever been placed under a workout agreement. Others had been under workout agreements which expired many years ago.

During the period owners are delinquent in their mortgage payments and while foreclosure is in process, the project owners can claim Federal 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 during which they can benefit from these deductions.

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 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, 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. These and other matters are discussed in our January 16, 1980 report to the Chairman of the Senate Subcommittee on HUD and Independent Agencies (CED 80-43).

CURRENT SYSTEM PROVIDES INADEQUATE COLLECTION INFORMATION TO THE FIELD OFFICES

HUD's accounting system for Secretary-held project mortgages, which provides monthly payment and billing data to the mortgagors and the HUD field offices, did not provide servicing personnel with sufficient information to aggressively service their workloads. Specifically, we noted that:

--The monthly bills were based on the payment terms of the original mortgages and did not reflect the status of the accounts under workout agreements which provide for reduced payments.

--The monthly bills were generally received by the loan servicers after the payment due date on the bill, thus making aggressive servicing of troubled projects difficult.

--Interim billing procedures did not exist for newly assigned mortgages, resulting in delayed initial billing.

--The lack of inventory controls caused some bills to go to the wrong field offices.

--Adequate incentives did not exist to encourage mortgagors to pay by the due date.

--The accounting system did not provide annual account statements or produce sufficient delinquency data.

--The system had no effective mechanism to reconcile the tax status of the properties with the records of the local taxing authorities.

Accounting System Does Not Track Payment Status Under Terms Of Workout Agreements

Once a defaulted mortgage is assigned, the appropriate HUD field office should determine if the mortgage can be brought current (reinstated) or if it should be foreclosed. If reinstatement is possible, a new payment agreement, called a workout agreement, should be negotiated. After arranging the workout agreement, the HUD servicer must know if the mortgagor meets the agreement's terms. Under HUD's current system, the bills continue to be based on the terms of the original mortgage and do not reflect the payment status under the workout agreement, a copy of which is filed at headquarters. Thus, payment status under the workout agreement cannot be easily determined.

Nonetheless, the payment status under the workout agreement can be determined with this system, but the time required is not a good use of resources. Only by reviewing each bill in detail, or by maintaining a local payment history and then comparing that history to the terms of the workout agreement, could a servicer determine the payment status. Several servicers in HUD's New York field office stated they did not know the payment status of the cases they serviced, or gave us incorrect information when we asked for the payment status.

In San Francisco we found that the field office, contrary to the HUD procedures for centralized payment, was receiving payments locally for most of its inventory of Secretary-held multifamily mortgages. This practice enabled the field office to develop its own payment histories and aggressively service its inventory.

We believe that the Department should provide servicing personnel with the mortgagors' payment status under the workout agreements. This information would simplify the servicing efforts of the field offices. However, to determine the payment status of the mortgages under the workout agreements, all workout agreements must specify a minimum payment due. We found that not all workout agreements specified a payment amount. Some New York workout agreements called only for cash remaining after the payment of reasonable and necessary operating expenses. Therefore, mortgagors submitting no payments could be current under their workout agreements.

Monthly Bills Received in Field Offices Late

In both field offices we visited, personnel complained that the monthly bills sent from the Department's Office of Finance and Accounting in Washington were generally received late and were of limited use in servicing the projects. During our review, we noticed the following:

--The June 1979 monthly bills for the New York field office, which showed both the amount due June 1, 1979, and the payments received in May, were received by the field office July 2, 1979, over a month late.

--The September 1979 monthly bills for the San Francisco field office, which reflected both the amounts due September 1, 1979, and the amounts paid in August, were received in the field office September 17, 1979, at least 17 days late.

--Some monthly bills were sent to the wrong field offices. For example, in May 1979 the New York field office received bills for six projects it does not service.

Aggressive servicing is not possible when field offices do not get timely payment data. We believe the monthly bills should be in the hands of the servicers by the due date of the payments. In addition, collection data should be transmitted to field offices shortly after payments are received.

Late First Bills on Newly Assigned Secretary-Held Mortgages

HUD is responsible for aggressively servicing newly assigned mortgages and emphasizing to mortgagors their obligation to make full mortgage payments to HUD. However, we found delays in billing newly assigned mortgagors.

We selected 26 of the 126 New York projects and 12 of he 49 San Francisco projects for further review. Our review revealed that for the New York projects, the Office of Finance and Accounting took an average of 4.6 months from the date of assignment to the first bill. The range was from 1 to 16 months. The average for the San Francisco projects was 2.8 months, with a range of 1.5 to 5 months.

After assigning a defaulted mortgage to HUD, the original lender has 45 days to file for payment of the insurance claim. The Office of Finance and Accounting was not preparing the first bill until the necessary documents were received from the original lender. Since some claims are not filed on time, or are filed with incomplete information, the Office of Finance and Accounting often took many months to prepare the first bill. Therefore, the servicer did not know the status of the account. We believe interim billing procedures should be implemented to ensure that once the notice of assignment is received, the mortgagor is immediately billed for the normal payment due under the mortgage.

System Does Not Provide Adequate Penalties for Late Payments

HUD did not provide adequate incentives to mortgagors to make their payments on time. At the time of our review, late penalties were charged only when mortgagors were current under their mortgage terms and made a late payment. Since the majority of the Secretary-held mortgages are delinquent under the mortgage terms, few late penalties are actually assessed. Late charges could not be charged delinquent mortgagors because the accounting system did not track compliance with the payment terms of workout agreements.

We believe that late penalties should be assessed either on the minimum payment specified in the workout agreements, or when workout agreements are not in effect, on the payment due under the mortgage. HUD officials informed us that they are considering revising their late charge policy.

Better Controls Needed to Reconcile Records Of Taxing Authorities with HUD Records

Taxes on Secretary-held multifamily mortgages are paid centrally from HUD's Office of Finance and Accounting in Washington. In the past, we have reported on a number of problems with centralized tax payment systems. Subsequent to our 1975 report to the Congress entitled "Action Being Taken to Correct Weaknesses in the System of Paying Taxes on Acquired Residential Properties," HUD assigned the responsibility for the tax payment function for acquired single-family property to the field offices.

In addition to that decentralization, HUD recently changed its procedures for tax payments on Secretary-held, single-family mortgages by requiring field offices to obtain tax bills, post them to local records, and forward the bills to Washington for payment. However, the tax payments for the multifamily projects remained centralized.

To determine the tax status of the New York Secretary-held project mortgages, we reviewed 26 selected projects at the taxing authorities in the cities of New York and Yonkers. Numerous underpayments and overpayments were reflected on the records of the taxing authorities:

--8 of the 26 projects owed delinquent real estate taxes totaling $39,883.

--$111,427 was owed to the projects or HUD for overpayments of real estate taxes on nine projects.

--Nine projects owed delinquent water and sewer charges of $41,003.

--$16,983 was owed to the projects or HUD for overpayments of water and sewer charges on nine projects.

--$33,182 had been paid on 14 projects for interest and penalties on delinquent taxes.

We found one project which HUD listed as exempt from taxes, but according to taxing authority records it was exempt only from real estate taxes, not water and sewer charges. Because the water and sewer charges on this project had not been paid for 4 years, New York City had started action to take over the property.

New York City taxing authorities said that overpayments of taxes are not netted against underpayments, and overpayments are refunded only if the overpaying party submits a claim for refund and proves the overpayment. Furthermore, there is a 6-year statute of limitations on refunding overpayments. Therefore, if the refund is not applied for within 6 years of the overpayment, the city retains the funds. These problems point out a need for HUD and taxing authority records to be reconciled periodically. We believe these reconciliations can best be performed by the HUD field offices where fewer different taxing authorities need to be dealt with and where visits to the taxing authorities to periodically reconcile records are feasible.

RECOMMENDATIONS

To correct the problems noted, we recommend the Secretary of HUD direct that the Department's accounting function be changed so that

--servicing personnel are provided with information that reports mortgagors' payment status under the terms of workout agreements,

--an interim billing system is established for newly assigned mortgages,

--late charges are assessed on payments due under the mortgages or the workout agreements,

--headquarters' and field offices' inventories are reconciled periodically,

--the responsibility to obtain tax bills on multifamily housing projects is transferred to the field offices, and

--records of HUD and the taxing authorities are reconciled periodically

MAJOR IMPROVEMENTS NEEDED IN SERVICING AT HUD'S NEW YORK OFFICE

We selected at random 26 of the 126 multifamily projects for detailed analysis at HUD's New York field office. On May 1, 1979, the 26 projects were in the following status:

--Five projects had never been under a workout agreement since assignment even though they were assigned as far back as 1975.

--Nine projects had expired workout agreements but were still delinquent.

--Two projects were serviced under an informal agreement. (No written agreement existed.)

--Ten projects were either under a permanent mortgage modification, a current workout agreement, or had been recommended for foreclosure.

We determined the change in delinquency status for the 26 projects from the date of assignment to May 1, 1979. Of the 26 projects:

--Four, or 15 percent, showed some decrease in the number of months delinquent.

--Twenty-two, or 85 percent, showed an increase in delinquency since assignment. Seven of the 22 were recommended for foreclosure; 9 of the remaining 15 increased the amount of their delinquency by 12 or more mortgage payments and 4 increased their delinquency amount by over 3 years.

Some Delinquent Mortgagors Have Never Had a Workout Agreement

Five of the 26 New York projects we reviewed had never been under any workout agreements even though two of the five had been assigned as far back as February 1975. As of May 1979, these two projects were delinquent $840,505 and $909,347, and both had increased their delinquencies by 49 months since assignment. We were recently informed that these two projects have been recommended for foreclosure.

FINANCIAL ANALYSIS IS LIMITED AND REQUIRES IMPROVEMENT

HUD requires that annual financial reports for each project be prepared in accord with the Department's requirements. These statements are due within 60 days after the end of each fiscal year and are certified as accurate by both an independent public accountant and an officer of the mortgagor. Upon receipt of financial statements from mortgagors, HUD requires a prompt review and evaluation of the statements to determine their completeness and accuracy.

HUD's audit guide sets forth standards to be followed by independent public accountants in auditing multifamily mortgagors whose mortgages are or have been insured by HUD. The audit guide must be followed by independent public accountants who audit projects for any fiscal year ending on or after December 31, 1978.

The audit guide also requires that the independent public accountants will have to judge the correctness of project disbursements. The accountants' judgment is important because HUD has no precise definition of expenses reasonable and necessary for the operation and maintenance of the projects.

According to HUD regulations, delinquent mortgagors must submit monthly accountings showing cash receipts and disbursements. HUD considers those monthly reports essential to monitoring multifamily projects at such critical times as when a project is in default. These reports provide basic data and, since they show all cash receipts and disbursements during the previous month and cash on hand at the end of the month, they should be carefully reviewed shortly after receipt.

A followup system is required to assure that the monthly reports are received promptly. Reports are due by the 10th of the month. Failure to submit the required accountings is contrary to the agreement between the mortgagor and the Department. If the mortgage is under an approved workout agreement, failure to submit the reports also is contrary to the terms of this agreement.

Reviews of financial statements not always made

The required reviews of monthly and annual financial statements must be made promptly, and questionable items must be investigated. However, we found that these reviews were not always made.

Our analysis of 11 financial statements for New York projects, which reported on periods covered by the audit guide, revealed that none of the 11 statements fully complied with the guide. All 11 statements were missing one or more of the required statements or supporting data. In addition, eight of these projects did not submit their statements within the required 60 days and in no case did the independent public accountants question any expenses of the projects as unreasonable and/or unnecessary.

A review of the files of these 11 projects revealed only two instances where the mortgagor was requested to submit revised financial statements to conform to the audit guide requirements. We found that the revised statements for one of the two projects were still incomplete at the time of our review and had not been checked by the responsible servicers. The other project had not submitted revised statements.

Our review of the monthly accountings of 26 New York projects for January through June 1979 revealed

--no evidence that eight of the 26 projects had their monthly statements reviewed,

--failures to submit reports and HUD's failure to request such delinquent reports.

--various expenditures which needed clarification,

--unsigned reports, and

--late reports.

In discussing our findings with field office officials, they admitted that their analysis of financial information did not conform to HUD requirements. They stated that servicing personnel do not have the financial background to adequately review financial information.

We feel this failure to receive and/or review required financial information is a serious breakdown in HUD's internal control system and creates a situation where project receipts can be easily diverted.

Similar problems previously reported

In the past, both GAO and the HUD Inspector General have reported on problems similar to those we found in New York. In a March 1979 report prepared by the HUD New York Regional Inspector General for Audit, New York's servicing of HUD-insured and HUD-held mortgages was found inadequate. According to the report, because financial statements and monthly accounting reports are not reviewed, the New York office failed to detect such problems as

--possible diversions of project funds,

--excessive management fees,

--questionable withdrawals of project funds while a mortgage was in default, and

--workout agreements not in accordance with HUD regulations.

In addition, in a December 11, 1979, summary audit report to the Assistant Secretary for Housing, the HUD Inspector General summarized the findings of 82 audit reports covering 93 insured and HUD-held projects for the 12 months ending June 30, 1979. The report identified a total of about $12.3 million of project funds questioned or disallowed in these 82 audit reports. Of the $12.3 million, $7.8 million was attributed to the improper or questionable use of operating revenues by 72 of the 93 projects reviewed.

Also, in a November 20, 1979, report to the Chairman, Senate Committee on Appropriations, the committee's investigative staff identified problems with loan servicing. The staff's review was of HUD's field offices in Washington, Boston, Chicago, Detroit, and Los Angeles.

As mentioned earlier, our analysis of monthly and annual financial statements raised a number of questions about the appropriateness of expenditures and whether all receipts are accounted for. In cases where all receipts are not credited to HUD projects or where improper expenditures are charged to projects, funds that could have been used to make payments to HUD can be diverted to the owners and/or managing agents.

The following facts concern two of the cases we examined. In the first case, the independent public accountant's reports on the projects showed that between 1974 and 1978, the mortgagor had distributed $1.6 million to its partners and had loaned another company $1.1 million. This was done despite section 1715Z-4 of title 12, United States Code, which prohibits the use of project funds for other than necessary operating expenses. Because HUD's New York field office did not adequately review the financial statements for 1974 through 1978 until 1979, these problems were not discovered for almost 5 years. Our own review work showed expenses charged to the projects which we believe should have been charged to the management fee paid the mortgagor's managing agent. These included annual charges of approximately $3,000 for Christmas parties and $9,300 for a rental agent's salary. We understand negotiations are in process to enter into a workout agreement and obtain the return of the $2.7 million.

In the other case, we also identified charges to projects which apparently should have been charged to the managing agent's fees. These charges included telephone expenses (for one project such expenses were $5,000 in 1 year), association dues, and other administrative expenses.

In both cases, our work was greatly hampered because neither of these two mortgagors had complied with HUD regulations which specify separate cash accounts for each project. Instead, the managing agents commingled HUD project funds with other funds which made auditing difficult and made it difficult to tell whether funds have been used in unauthorized ways.

These problems are not new. In March 1974, we reported similar problems to the House Committee on Government Operations. Since adequate corrective action was not taken by HUD in response to our 1974 report--even though Department officials cited corrective actions underway to the House Committee on Government Operations--we again recommend increased monitoring by HUD.

RECOMMENDATIONS

To improve HUD's mortgage servicing efforts--in addition to our recommendations on page 7--we recommend that the Secretary of HUD direct that the loan servicing function be changed so

--workout agreements that provide for a specific payment amount are established within 90 days after assignment,

--field offices are required to obtain adequate financial statements when they are not submitted promptly or fail to meet HUD regulations,

--servicers be further trained in financial statement analysis, and

--aggressive action will be taken to obtain repayment of project funds that have been diverted.

(906440)

AN EQUAL OPPORTUNITY EMPLOYER

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

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE, $300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE

U.S. MAIL

THIRD CLASS