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UNITED STATES GENERAL ACCOUNTING OFFICE
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STATEMENT OF
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RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

BEFORE THE

HOUSE SUBCOMMITTEE ON MANPOWER AND HOUSING
COMMITTEE ON GOVERNMENT OPERATIONS

ON

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
POLICIES CONCERNING
MULTIFAMILY PROPERTY MANAGEMENT AND DISPOSITION

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in its deliberations on the Department of Housing and Urban Development's (HUD's) policies concerning multifamily property management and disposition. As requested, our testimony addresses (1) work we have underway examining the basis for the prices HUD receives on project sales and the financing mechanisms involved, (2) the latest available status of delinquencies on HUD's multifamily assigned mortgages, (3) HUD's responsiveness to our prior recommendations concerning loan servicing, and (4) the results of a recently issued report (GAO/RCED-83-78, March 14, 1983) concerning HUD's contracting with the private sector for loan servicing and accounting for HUD-held multifamily mortgages.

HUD, pursuant to the provisions of the National Housing Act, as amended, insures mortgage loans made by private lending institutions on various types of housing. For various reasons,

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many owners of multifamily projects insured by HUD default on their mortgage payments. When this occurs, HUD normally pays the mortgagee 99 percent of the outstanding mortgage balance and the mortgage is assigned to HUD. Under an assignment, the mortgage is transferred to HUD, while the mortgagor retains ownership of the property. Once the mortgage has been assigned, HUD becomes responsible for requiring the mortgagor to bring the project's debt service current, or foreclosing and ultimately disposing of the project in an expeditious manner. In fiscal year 1982, for each multifamily acquired project that it sold, HUD records showed that it lost over $10,500 per unit, or about $87 million in total.

Historically, HUD has not been effective in keeping track of its multifamily assigned mortgages. HUD has also had difficulty in requiring that these mortgages be brought current in their payments and in foreclosing on the properties in an expeditious manner. Previously we reported that foreclosure of multifamily mortgages assigned to HUD takes an average of 2-1/2 years to accomplish and that projects were susceptible to deterioration and diversion of project funds by project owners or their management agents prior to HUD's obtaining control. Also, 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 for the Internal Revenue Service to recapture these benefits after HUD acquires the projects.

We have made a number of recommendations to HUD to improve its management of assigned multifamily mortgages. These recommendations concern the need for HUD to develop a comprehensive management information system; to make expeditious determinations, after assignment, as to whether a mortgage can realistically be brought current or to foreclose; and to improve efforts to control project operations once a decision to foreclose is made. We also recommended that HUD work with the Department of Justice and the Internal Revenue Service to identify causes for delays in the foreclosure process and to develop ways, including legislative remedies, to speed up foreclosures and reduce Federal losses. HUD has taken a number of actions, but more needs to be done.

BASIS FOR PRICES HUD RECEIVES ON PROJECT SALES

We are currently reviewing HUD's sales process for acquired multifamily projects at the request of Senator William Proxmire. As part of this request we are examining the basis for the prices HUD receives on project sales, including the adequacy of HUD's appraisal methodology, whether tax shelter benefits are recognized in the sales price, and the financing arrangements involved.

We have not completed our work on this request and accordingly emphasize that our testimony today on these issues is tentative. Also, because of the highly technical nature of these issues we have contracted with two consultants--one from the

National Housing Law Project and the other, an independent appraiser. Their analyses of these issues is also not complete.

However, we previously reported to Senator Proxmire on August 16, 1982 (GAO/CED-82-117), that HUD policies and procedures do not provide for factoring tax shelter benefits into HUD's minimum bid prices on negotiated sales. Generally, HUD agrees that tax shelter benefits should be included for negotiated sales, but believes that it is unnecessary on competitive sales where the bidding process is expected to consider these factors. We are currently determining, with our consultants, the actual impact the lack of tax considerations has had. We also are determining how HUD's appraisal methodology could be improved to reflect these benefits in establishing minimum bid prices.

Concerning HUD's financing of project sales, our work to date shows that HUD, in December 1982, introduced a new degree of flexibility into the financing of properties. Under the December 1982 HUD procedures, a property may be bid under any one of the following financing options: (1) a HUD-provided mortgage--known as a purchase money mortgage--at 8 percent interest, (2) purchase money mortgages at the current FHA multifamily interest rate (presently 12.5 percent), or (3) all cash. The purchase money mortgages may cover up to 80 percent of the cost of the properties and are callable in 10 or more years depending on whether subsidy for housing low- and moderate-income persons is available and, if so, the term of the subsidy contract.

The flexibility offered by the purchase money mortgage options should greatly facilitate the disposition of properties. The 8 percent interest rate should attract attention as a matter of course. For profit-motivated owners, the low 8 percent interest rate fits nicely into the tax shelter format. For example, the lower interest rate permits a larger mortgage to be supported by the property's net operating income, and in most instances, the larger mortgage will increase the property's sale price and tax base, and thus increase the available depreciation deductions.

At the same time, however, the flexibility in financing options also results in different potential values for the property being sold. HUD attempts to deal with the value differences by discounting the purchase money mortgages and determining a cash equivalence value for the assorted bids it receives containing significantly different financing terms. Theoretically, the cash equivalence value of a property under differing financing assumptions should be the same, with the cash equivalence calculations eliminating the value disparity attributable solely to financing. We are presently determining whether the value differences are eliminated by HUD's methods of discounting the purchase money mortgages.

An issue relative to the prices HUD receives on project sales concerns a new HUD procedure for determining its bid price for projects at foreclosure sales. HUD is proposing to bid, and in a few instances has in fact bid, far less at foreclosure than the amount of mortgage indebtedness owed to HUD. HUD is authorized by statute to bid any sum up to but not in excess of the total unpaid indebtedness secured by the mortgage, plus taxes, insurance, foreclosure costs, fees, and other expenses. In most instances, the mortgage indebtedness plus expenses may exceed the value of a HUD property. Under such circumstances, HUD clearly would become the owner of the property, and this was what generally happened under HUD's former procedures.

On June 18, 1982, HUD announced (1) its intention to bid at foreclosure sales the estimated market value of the property less its estimated holding costs and (2) its plan to advertise its intended bid prior to the foreclosure sale. Currently, HUD's holding costs are estimated to be approximately $2,000 per unit. Thus, it appears that HUD intends to bid at foreclosure proceedings an amount equal to $2,000 per unit less than the estimated market value of the project.

HUD provided us information on eight projects where, using this new procedure, it was recently outbid at the foreclosure sale. The successful bids at the foreclosure sales exceeded HUD's bids by an average of about $240,000 per project and ranged from $708,000 for one project to $1 for another project where there was only one bidder.

One of the eight projects was a formerly subsidized project. HUD told us that section 8 subsidies were reserved for low- and moderate-income tenants, who were then residing in about 50 of the project's 165 units. Although the remaining seven projects were formerly unsubsidized, the preacquisition report on two of the projects indicated that subsidy may be needed for 40 percent of the projects' 148 units.

When HUD is outbid at the foreclosure sale, the potential exists for losing those units serving low- and moderate-income persons. If HUD acquires these properties at the foreclosure sale, then HUD is required to dispose of them in accordance with section 203 of the Housing and Community Development Amendments of 1978, as amended. Section 203 requires HUD to balance objectives of protecting the financial interests of the Government along with preservation of housing for low- and moderate-income persons. If the Congress wants the section 203 requirement to apply at the foreclosure sale, then this would require a legislative change.

STATUS OF HUD's MULTIFAMILY ASSIGNED MORTGAGES

In a January 1980 report (CED-80-43, January 16, 1980) on multifamily assigned mortgages, we recognized that HUD has a difficult task in managing its multifamily assigned inventory, which admittedly are troubled mortgages. We reported that many mortgages were so delinquent that the possibility of reinstatement was unlikely. We reported that as of September 30, 1979, delinquencies totaled about $500 million for the over 2,000 multifamily assigned mortgages HUD held.

Of particular concern was the large percentage of projects that were neither in a foreclosure status nor being serviced under a workout arrangement to reinstate the mortgage. HUD's accounting records indicated about 34 percent of the total multifamily assigned mortgages were delinquent and neither in foreclosure nor under a workout plan.

In recognition of the large number of these projects, HUD established goals for focusing attention on the management of HUD-held mortgages. The goal established was to maintain 90 percent of the HUD multifamily assigned projects under an approved plan. Mortgages were to be considered under an approved plan if they were current under the terms of their original mortgage, were recommended for foreclosure, or had a workout agreement in effect.

Based on readily available data, HUD has not achieved its goal. According to Housing's Office of Multifamily Financing and Preservation records, only 76 percent of the multifamily assigned mortgages as of April 30, 1983, were under an approved plan under HUD's definition. According to these manual records as of April 30, 1983, HUD had an inventory of 1,857 assigned mortgages with an unpaid principal balance of about $3.6 billion. Of these 1,857 assigned mortgages, 853 were current under the terms of their original mortgage. Of the 1,004 delinquent mortgages, 437 were in neither a workout nor foreclosure status, 370 were in the foreclosure process, and 197 were being serviced under a workout arrangement. Although all 197 mortgages under workout were considered by HUD to be under an approved plan, 51, or 26 percent, of those under workout were delinquent under the terms of the workout.

With regard to the information reported on the status of multifamily assigned mortgages, we found, as we had in our earlier work, that HUD is still experiencing difficulties in reconciling the various HUD statistics and categories of the multifamily assigned inventory. We recommended in our January 1980 report that HUD achieve consistency in data used by various HUD offices by developing a single, comprehensive management information system.

In response to this recommendation, HUD advised us that it had established the Multifamily Insured and Direct Loan Information System (MIDLIS) which was to provide comprehensive management information quickly and accurately at each stage of a project's development and operation. HUD said MIDLIS would be its principal system for tracking major actions on each project and would be the official Department informational source for all insured and assigned multifamily project mortgages. We requested HUD to provide us with a report on the MIDLIS inventory also as of April 30, 1983. The resulting information varied considerably from the information in Housing's manual records.

When we discussed the variances with HUD, officials from the Offices of Finance and Accounting and Multifamily Financing and Preservation indicated that they believed the information shown in Housing's manual records to be a more accurate portrayal of the status of the multifamily assigned mortgages even though it does not contain detailed information on mortgage delinquencies. Some of the differences, according to the officials, are readily explainable because of the differences in definitions for classifying the subject projects. However, HUD officials said they were aware that discrepancies exist between Housing and MIDLIS data and cited a number of actions that have been taken to reconcile the various data sources. Housing officials believed the major reason for the discrepancies is the untimely flow of documents among various field and headquarters offices resulting in a delay and/or failure to update the necessary systems. In December 1982, HUD established revised procedures regarding the flow of necessary documentation.

HUD's RESPONSIVENESS TO OUR PRIOR LOAN SERVICING REPORTS

We have issued four reports 1/ since January 1980 concerning HUD's loan servicing and accounting functions for multifamily assigned mortgages. Generally we think the Department has attempted to address the problems and recommendations cited in our prior reports. Perhaps most significant are some of the legislative and administrative changes HUD has attempted and is attempting to accomplish with regard to expediting the foreclosure process, which as previously discussed was taking an average of 2-1/2 years to accomplish. First, HUD was successful in

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1/(1) "Analysis of Multifamily Assigned Mortgages" (CED-80-43, January 16, 1980), (2) "HUD Should Make Immediate Changes in Accounting for Secretary-Held Multifamily Mortgages" (FGMSD-80-43, May 16, 1980), (3) "Problems Continue in Accounting for and Servicing HUD-Held Multifamily Mortgages" (GAO/AFMD-82-18, August 18, 1982), and (4) "HUD's Loan Servicing Contracts for Multifamily Mortgages Need Better Management" (GAO/RCED-83-78, March 14, 1983).

obtaining the enactment of the Multifamily Mortgage Foreclosure Act of 1981--a nonjudicial foreclosure procedure expected to be implemented this summer which should reduce unnecessary litigation by removing many foreclosures from the courts. Also, HUD is seeking to amend provisions of the Bankruptcy Code to assure the Department adequate and timely recourse against defaulting multifamily mortgagors. Also, we were informed that HUD and Justice have recently agreed to a new procedure allowing HUD to forward foreclosure complaints directly to a U.S. Attorney and to assume increased "in-court" responsibilities. HUD also has been establishing a tracking system for following foreclosures.

Also, HUD and the Internal Revenue Service have been cooperating in exchanging taxpayer identification information for ownership changes of profit motivated owners of multifamily projects. The need for this cooperation was recognized in hearings held before this Subcommittee in June 1979 and before the Senate Subcommittee on HUD-Independent Agencies, Committee on Appropriations, in January 1980. At these hearings we testified that certain income tax benefits are available to project owners when they are delinquent in their mortgage payments or while foreclosure is in process. In fact, Justice, HUD, and Internal Revenue Service officials told us 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. The Internal Revenue Service, just this week, told us that preliminary results of a study of the agencies' joint efforts shows that several millions of dollars have not been reported as income in accordance with the recapture provisions of the tax code.

SUMMARY OF OUR REPORT (GAO/RCED-83-78, MARCH 14, 1983) ON HUD's LOAN SERVICING CONTRACTS

Another significant action HUD has taken to address the problems we have identified with HUD's servicing of multifamily mortgages was the decision to contract with the private sector to perform functions such as tracking multifamily assigned mortgages, requiring that these mortgages be brought current in their payments, and foreclosing on these properties in an expeditious manner. In December 1981, HUD contracted with a private mortgage firm to perform loan servicing and accounting functions for its inventory of HUD-held mortgages in its region III area. The 4-year, sole-source negotiated contract, not to exceed $800,000 the first year, was intended as a demonstration to test the concept of private sector loan servicing and to develop a program to go nationwide within 3 years. However, 2 months after the contract became operational, HUD requested proposals on a competitive basis to engage a contractor for similar services on a nationwide basis.

The primary functions the contractor will perform are billing and collecting mortgage payments; collecting and maintaining escrow accounts; monitoring hazard insurance policies; performing annual project evaluations; and monitoring delinquent loans, including recommending terms for workout arrangements, mortgage modifications, transfers of ownerships, and foreclosure actions. The primary benefits HUD expects to achieve under the contract are (1) to increase revenues from the collection of outstanding debts, (2) to prevent increasing delinquencies, and (3) to stabilize and cure mortgage delinquencies.

In March 1983, we reported on several aspects of HUD's award and administration of the region III contract. Among other things, we found (1) that the value of the demonstration project was diminished by expediting the award of the nationwide contract, (2) that HUD has not established an adequate basis for judging the success of private sector servicing, and (3) no documented evidence that HUD considered the income accruing to the contractor from holding escrow funds for the mortgages in determining the contractor's fees. We made recommendations to correct the problems with the region III contract and prevent similar problems from occurring with the nationwide contract, which has not yet been awarded.

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Mr. Chairman, this concludes my statement. We will be pleased to respond to your questions.