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Briefing Report to the Chairman, Subcommittee on HUD-Independent Agencies, Committee on Appropriations, U.S. Senate

April 1988

# HOUSING PROGRAMS

# HUD Policies to Minimize Costs in Acquiring Foreclosed Properties

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Resources, Community, and
Economic Development Division

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April 18, 1988

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

Dear Mr. Chairman:

As requested in your September 9, 1987, letter, this briefing report provides information that we had developed earlier on the Department of Housing and Urban Development's (HUD) policies and procedures for acquiring foreclosed properties. Our objectives were to determine whether property acquisitions can be avoided and, when they cannot, whether HUD's acquisition costs can be reduced.

In summary, we found that, by revising its policies and procedures, HUD can avoid certain property acquisitions and, for properties it must acquire, improve the property acquisition process to reduce costs. In this regard, HUD can

-- avoid acquisitions and the related costs by taking actions to (1) encourage homeowners to sell their property prior to foreclosure and (2) stimulate more competitive bidding at foreclosure sales by parties other than lenders and

-- establish procedures and policies to expedite property acquisition to reduce costs by (1) obtaining more property deeds through the voluntary conveyance of borrowers, (2) not delaying foreclosure actions while HUD is deciding whether to provide borrowers long term assistance, (3) obtaining less expensive title insurance policies, (4) requiring lenders to convey properties in a more timely manner, and (5) ensuring that property under foreclosure is preserved and secured in an economical manner.

HUD provides mortgage insurance to facilitate home ownership and the construction and financing of housing. On the properties it insures, HUD expects lenders to develop and implement policies and procedures to prevent unnecessary foreclosures. In this regard, the lender is expected to refrain from foreclosure when it is possible for the borrower to cure the loan delinquency and resume monthly payments to the lender. However, when the lender determines that the delinquency cannot be cured, HUD expects the lender to resolve the problem in an accelerated manner to minimize the costs of interest on the loan, property taxes, and other expenses that accrue during the foreclosure process. In attempting to minimize the costs, a lender is expected to (1) give the homeowner sufficient time to sell the property; (2) obtain the property deed through the voluntary conveyance of the borrower, if appropriate; or (3) foreclose on the property.

The foreclosure process is usually concluded with a sale of the property at which the lender is usually the highest bidder. After foreclosing, the lender generally conveys the property deed to HUD, which pays the lender the amount of the borrower's outstanding debt plus foreclosure costs. HUD then prepares the property for sale, prepares a market analysis, and sells the property.

In September 1986, we briefed HUD on the results of our work completed as of that date. Subsequently, HUD made several changes to its policies and procedures in response to our observations and is currently initiating or evaluating the need for other changes. In preparing this report, we updated our information in March 1988 through discussions with officials representing HUD's Office of Insured Single Family Housing. Our observations and HUD's actions are discussed further in sections 2 and 3.

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In performing our work, we reviewed HUD's policies and procedures for acquiring single-family properties when homeowners default on federally insured mortgages. Our work was performed at HUD's headquarters in Washington, D.C., and at its Philadelphia and Pittsburgh, Pennsylvania, field offices.

We obtained the views of officials representing HUD's Office of Insured Single Family Housing on this report and included their comments where appropriate. However, as requested by your office, we did not obtain official agency comments. We plan no further distribution of this report until the Subcommittee's hearing on HUD's fiscal year 1989 budget request, scheduled for April 18, 1988, or 30 days from the date of this letter, whichever comes first. At that time, we will send copies to interested parties and make copies available to others upon request.

Should you need additional information on this briefing report, please call me at (202) 275-6111. Major contributors to the report are listed in appendix I.

Sincerely yours,

John H. Luke

John H. Luke
Associate Director

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ABBREVIATIONS

| | |
|---|---|
| GAO | General Accounting Office |
| HUD | Department of Housing and Urban Development |
| VA | Veterans Administration |

# SECTION 1

# INTRODUCTION

## SECTION 1

## INTRODUCTION

### BACKGROUND

Title II of the National Housing Act of 1934, as amended (12 U.S.C. 1707, et seq.), authorizes the Department of Housing and Urban Development (HUD) to provide mortgage insurance for qualified buyers to purchase new and existing single-family homes, mobile homes, or condominiums. HUD promotes home ownership by extending to prospective home buyers more liberal mortgage program features, such as smaller down payments and longer mortgage terms, than are available to them under conventional mortgage loans, while simultaneously insuring lenders against loss caused by default and subsequent foreclosure. Furthermore, HUD encourages lenders to make loans to low-income individuals who otherwise would be unable to finance a home purchase. As of September 30, 1987, HUD had mortgage insurance in force on over 6 million homes with outstanding mortgage balances of about $227 billion.

In fiscal year 1987, HUD paid mortgage lenders over $3.6 billion after they conveyed to HUD the 64,269 single-family properties they acquired after the homeowners were unable to make the mortgage payments. During the same period, HUD sold 59,194 single-family homes that it had acquired and lost $1.2 billion on these sales. The loss is based on the sales price less all HUD costs to acquire, manage, and dispose of the properties, except for normal internal program administrative costs.

The following sections provide our observations on HUD's single-family property acquisition process. We recognize that there are differences in state foreclosure laws which could dictate the need for HUD to tailor state-specific courses of action for acquiring properties. We have summarized HUD's comments on our observations and, if applicable, HUD's actions initiated or planned to improve the process.

## SECTION 2

## METHODS TO AVOID ACQUISITIONS

### SECTION SUMMARY

-- HUD could provide financial assistance to homeowners so that they could sell property before foreclosure. This would enable HUD to avoid expenses related to the foreclosure and the subsequent acquisition and disposition of the property.

-- HUD could reduce property acquisitions if it performed a property appraisal before the foreclosure sale. Such appraisals would provide a basis for more competitive bidding at foreclosure sales. They also would provide a basis for HUD deciding whether it would be less costly to pay the lenders' insurance claims before the lenders foreclose.

# SECTION 2

## METHODS TO AVOID ACQUISITIONS

### PROPERTIES CAN BE SOLD TO AVOID FORECLOSURE

As an alternative to foreclosure, homeowners may sell their homes and pay the outstanding loan balances. Avoiding foreclosure enables the homeowners to keep their good credit ratings intact and enables HUD to avoid expenses related to the foreclosure and the subsequent acquisition and disposition of the property. It is not always feasible for the homeowner to sell the property, however, because the proceeds from the sale are not always adequate to pay both the outstanding loan balance and the selling expenses.

### GAO Observations

HUD does not have a program to provide homeowners the financial assistance necessary to sell their properties and pay their outstanding loan balances and selling expenses. Our review shows that such financial assistance is available under the mortgage insurance programs of the Veterans Administration (VA) and private mortgage insurance companies.

The purpose of the VA and private-sector assistance programs is to avoid the costs of foreclosing on the mortgage and acquiring and selling the property. VA and private mortgage insurers provide this assistance when they believe the homeowner can obtain the fair market value for the property.

The potential amount of savings to HUD through a home sale assistance program is not known. The amount would depend on a number of variables beyond HUD's control, such as the value of the properties and the amount of costs incurred and time needed to sell them. The potential savings, however, might be significant. For example, assuming a homeowner could sell the property for the same amount that HUD could if it acquired the property, HUD would save the interest costs associated with carrying the property in its inventory until it is sold. In fiscal year 1987, HUD's average selling price was $38,200 after holding properties for 7 months. The imputed interest carrying costs on such property would be approximately $2,200, based on an annual percentage rate of 10 percent. On each 1 percent of its fiscal year 1987 acquisitions, HUD would have saved $1.4 million if it had been able to eliminate these interest costs through a home sale assistance program. In addition to the interest costs, HUD potentially could save several thousand dollars per property in foreclosure and post-acquisition costs; but, as stated above, these savings would be subject to variables beyond HUD's control.

## HUD Comments

We discussed our observations with HUD's Office of Insured Single Family Housing officials. They believed property sales during foreclosure could save HUD a significant amount of money. Accordingly, they have asked the HUD Office of General Counsel to determine if HUD's existing legislation provides this authority. They also told us that, regardless of the General Counsel's determination, they have asked the Secretary of HUD to submit a legislative proposal requesting that this authority be specifically provided to HUD.

## PROPERTY ACQUISITIONS CAN BE REDUCED

When HUD-insured mortgages are in default, lenders can initiate foreclosure proceedings. Each state has its own foreclosure process but, generally, the process terminates with a foreclosure sale. At the foreclosure sale, lenders and others (known as third parties) are allowed to bid on the property. When the property is acquired by a third party, the bid amount of the third party is deducted from the insurance claim of the lender, and HUD has no further involvement with the property. However, when the lender acquires the property, under the terms of HUD's mortgage insurance program, it has the right to and generally does convey the deed to HUD and is paid the amount of the total indebtedness on the defaulted loan. HUD must then incur post-acquisition costs associated with holding and selling the property, including the costs of property maintenance, repairs, and taxes.

## GAO Observations

Third-party bidding at foreclosure sales is advantageous to HUD because, when third parties purchase HUD-insured property, HUD does not have to use its management and financial resources to acquire, hold, and resell the property. Third parties can be expected to bid on a property only if they would be able to obtain it for market value or less. However, HUD does not have a property appraisal performed to provide a basis for bidding at foreclosure sales and the bids offered by lenders generally exceed the market value of the property. The lenders base their bids on the borrower's total indebtedness plus the amount of the foreclosure costs. HUD then reimburses the lenders for their costs when it acquires the properties from them. In effect, the lenders' bidding practice restricts third parties from obtaining properties through competitive bids.

As an option to the lenders' current bidding practice, we believe HUD could have a property appraisal performed before the foreclosure sale and use the appraisal to establish a minimum amount for lenders to bid. The minimum bid amount would reflect the net value of the property to HUD--i.e., the appraised value less the property acquisition and disposition costs that HUD would incur if the lender conveyed the property to HUD. Winning bids by third parties would result in HUD not acquiring the properties and avoiding the acquisition and disposition costs. If lenders bid more than HUD's minimum bid price, HUD would pay the lender the difference between the borrower's total indebtedness and the amount of the bid, the lender would retain and dispose of the property, and HUD would avoid the acquisition and disposition costs.

HUD's practice of not performing a property appraisal can also result in unnecessary foreclosures. In this regard, without an appraisal, neither HUD nor the lender can determine if the costs related to HUD's acquiring and disposing of a property, such as legal fees, taxes, property maintenance, and selling costs, are greater than the value of the property. If such costs exceed the value of the property, it would be economically advantageous for HUD to pay the lender's insurance claim and give the property to the homeowner, rather than to foreclose and incur the costs.

For example, HUD records for fiscal years 1986 and 1987 show that it incurs average post-acquisition costs of more than $4,000 per property. Nonetheless, HUD acquires many properties with values less than $4,000. The most recent data available when we performed our work show that 36 properties, or about 11 percent, of the 325 properties which the Philadelphia HUD office held during a 6-month period in fiscal year 1986 sold for $4,000 or less.

If property appraisals resulted in HUD's not acquiring certain properties, cost reductions could be substantial. For example, based on HUD's fiscal year 1987 foreclosure data, each 1-percent reduction in the number of foreclosures, with a corresponding savings of $1,000 per property, would result in a reduction of about $640,000 in HUD's annual foreclosure and post-acquisition costs.

## HUD Comments and GAO Analysis

In an attempt to encourage third-party bidding at foreclosure sales, effective August 15, 1987, HUD field offices were instructed to obtain an appraisal for each property which is vacant or occupied by a party other than the owner when the foreclosure process begins. According to officials representing the HUD Office of Insured Single Family Housing, they will evaluate the results of this procedure before deciding whether to extend the requirement for an appraisal to properties which are occupied by the owners at the time the foreclosure begins.

In regard to using the appraisal to determine if it is cost effective to foreclose, HUD officials said that they believe it is better to evaluate whether to foreclose on a case-by-case basis, considering factors such as the impact that foreclosure might have on other properties in the neighborhood, rather than by using a dollar limit. We agree with this approach but believe that it generally would not be appropriate for HUD to foreclose on properties when the costs of acquisition and disposition are greater than the property value.

## SECTION 3

## METHODS TO REDUCE ACQUISITION COSTS

### SECTION SUMMARY

-- HUD could ease restrictions on lenders obtaining properties through the borrower's voluntary conveyance of the property deed, which is less costly to HUD than obtaining properties through foreclosures.

-- HUD could reduce costs by not delaying foreclosure actions during the 90-day period that HUD offices are given to make a decision on whether to provide the borrower with long-term assistance.

-- Lenders could obtain less expensive title insurance policies, for which HUD reimburses their costs.

-- HUD could reduce its property holding costs by requiring lenders to convey properties in a more timely manner after they have completed the foreclosure process.

-- HUD could reduce its costs by assuring that property under foreclosure is preserved and secured in an economical manner.

## SECTION 3

## METHODS TO REDUCE ACQUISITION COSTS

### VOLUNTARY CONVEYANCE OF PROPERTY DEEDS

The homeowner's voluntary conveyance of the property deed in lieu of foreclosure is an expeditious means of terminating a delinquent loan. The homeowner voluntarily conveys the property deed and is released from liability to repay the government for any claim which HUD pays the lender as a result of the loan termination. The conveyance of the deed enables HUD to avoid the foreclosure process. Consequently, HUD is able to acquire the property more quickly and avoid the foreclosure and related costs, such as interest, taxes, and legal expenses.

### GAO Observations

Although actual data are not available, officials of HUD's Office of Insured Single Family Housing estimate that HUD, on the average, loses about $400 each month a loan is in the foreclosure process. The actual losses depend on a HUD-insured borrower's inability to pay (1) interest on the outstanding loan balance and (2) property taxes during the foreclosure process. Based on the above data, each 1-percent increase in the annual use of voluntary conveyances as a means to obtain property deeds could reduce HUD's costs by about $1.7 million.

Our analysis of the almost 36,000 acquisitions HUD made between March 1985 and March 1986 showed that about 11.5 percent were obtained by voluntary conveyance of the property deed rather than by foreclosure. The acquisition period, which is the time elapsed from the date of the last mortgage payment to the date of the acquisition, averaged 10 months for voluntary conveyances, compared with 16.7 months for foreclosures nationwide. Our analysis of individual states showed the time differences varied depending on the states' foreclosure laws. In some states, the acquisition period was reduced in half by voluntary conveyances. For example, in Illinois, the deeds were obtained in an average of 12 months when voluntary conveyances were used, compared with 25 months when the foreclosure process was used.

Nonetheless, despite the opportunities to reduce costs, HUD allows lenders to accept voluntarily conveyed deeds only under certain circumstances because such acceptance releases the borrower from financial liability. In this regard, the deeds may be accepted only when the mortgage default is caused by a hardship beyond the homeowner's control (such as unemployment or illness) and, even with financial assistance, the homeowner is unable to cure the mortgage default and keep it current. Under this policy, therefore, HUD would not accept a voluntary conveyance of the deed in all instances in which it would be in HUD's best financial interest to do so.

We also found that HUD does not evaluate the performance of its lenders in obtaining voluntary conveyance of deeds and the reasons for success and failure. Further, lenders and their attorneys hired to perform the foreclosure actions may not have an incentive to pursue voluntary conveyances. For example, if the delinquent mortgage loan has a higher interest rate than the current market rate for a mortgage loan, it would not be in the lender's best financial interests to seek the acceleration of the property acquisition process to terminate the loan. Likewise, according to a staff member of HUD's Insurance Claims Division, attorneys are generally paid a few hundred dollars less for negotiating the voluntary conveyance of deeds than for performing foreclosure actions. Therefore, they do not have any financial incentive for seeking voluntary conveyances.

### HUD Comments

HUD officials in the Office of Insured Single Family Housing said that more aggressive attempts on the part of lenders to obtain deeds through voluntary conveyances could result in obtaining a greater number of deeds through this means. They pointed out, however, that they do not want to encourage unnecessary conveyances from borrowers who are capable of meeting their mortgage payment responsibilities. HUD officials said that they would review the criteria for voluntary conveyances. Additionally, they said that in February 1988 HUD started to evaluate lenders' performance to determine if they are adequately pursuing opportunities for the voluntary conveyance of deeds.

## NOT DELAY THE FORECLOSURE PROCESS

Before a lender may initiate a foreclosure proceeding on a HUD-insured mortgage, the lender must inform the delinquent borrower of HUD's Mortgage Assignment Program. If HUD accepts the borrower into this program, HUD will provide assistance by giving the borrower an extended period to cure the mortgage delinquency. Under the program, HUD pays the lender the outstanding mortgage indebtedness and the borrower thereafter makes monthly mortgage payments to HUD, tailored to the borrower's financial condition. At the end of fiscal year 1987, HUD had in its assignment program over 50,000 mortgages with an outstanding balance of about $1.2 billion.

### GAO Observations

Under procedures for the assignment program, HUD field offices are given 90 days to make an assignment decision, during which time the foreclosure process is delayed. It is important that the assignment decision be made expeditiously because each month that the foreclosure process is delayed results in about $400 in interest costs and taxes. According to HUD's Office of Insured Single Family Housing officials, these costs are covered by HUD's mortgage insurance and must be paid by HUD if the loan delinquency results in a foreclosure. HUD records show that, during fiscal year 1987, HUD made assignment decisions on about 31,500 assignment requests. Based on these decisions, about 5,300 borrowers were accepted into the assignment program.

According to Office of Insured Single Family Housing officials, the assignment decision is usually made within 2 to 3 months after the request. Therefore, for the approximately 26,200 loans that HUD did not accept, the foreclosure process was delayed for this period while HUD was making its acceptance decision. Based on the $400-per-month estimate mentioned above, the cost HUD incurred for the 26,200 loans not accepted into the assignment program was about $21 million.

As an alternative to delaying the foreclosure process and incurring these additional costs, HUD could allow the foreclosure process to continue while it makes its decision on whether to accept the borrower into the assignment program. HUD could require the borrowers to pay for any foreclosure costs incurred on those mortgages which are accepted into the assignment program.

## HUD Comments

Officials representing HUD's Office of Insured Single Family Housing agreed that the foreclosure process could continue while the assignment decision is being made. They told us that HUD would analyze the foreclosure processes in different states to identify time-consuming but inexpensive preliminary foreclosure activities that could be done while the assignment decision is pending.

## OBTAIN LESS EXPENSIVE TITLE INSURANCE

Lenders, after foreclosing on HUD-insured mortgages, are required to provide HUD with good and marketable title to the property. Lenders can provide assurance of title by several means, and HUD's policy is to have lenders use the means most prevalent in their communities. Title insurance policies, which generally cost several hundred dollars, are the most common form of evidence used to demonstrate good and marketable title. The specific amount of the costs for title insurance varies depending upon the state in which they are purchased and the amount of insurance coverage they provide. For example, in Philadelphia title insurance costs $7 to $8 per $1,000 of insurance coverage. HUD pays two-thirds of title policy costs, and the mortgage holder pays one-third.

## GAO Observations

Our work shows that lenders generally pay, and are reimbursed by HUD, for more insurance coverage than is necessary. In this regard, the lenders generally purchase insurance coverage on the basis of the amount of the borrower's indebtedness on the mortgage loan. For example, during fiscal year 1987, the value of acquired property, based on HUD's nationwide sales, was an average of about $16,000 less than the average borrower's indebtedness on foreclosed loans.

In contrast, under VA's program, lenders obtain insurance coverage for the appraised value less anticipated acquisition and disposition costs. This would generally be for a lesser amount of insurance than would be obtained based on the borrower's indebtedness. Because title policy rates differ in different areas of the country, we could not make an estimate of savings that HUD could achieve by acquiring insurance based on the appraised value.

## HUD Comments

In our initial discussions, officials representing HUD's Office of Insured Single Family Housing agreed that it may be feasible for HUD to obtain title policies for lesser amounts and reduce costs. These officials told us that HUD would examine the possibility of obtaining policies on appraised properties for the appraised value of the properties rather than for the amount of the borrower's indebtedness. As of March 4, 1988, HUD had developed draft instructions for its field offices to require that title insurance policies on appraised properties be based on the amount of the appraisal.

## TIMELY NOTIFICATION OF THE INTENT TO CONVEY PROPERTY

HUD starts its property disposition activities after lenders notify HUD of their intent to convey the property to HUD. HUD requires notification from the lender within 30 days of the date the lender obtains possession of the property and has good and marketable title. HUD cannot determine how soon after the foreclosure sale this occurs because the lender is not required to report the foreclosure date to HUD. In contrast, VA requires notification from the lender within 15 days of the foreclosure sale. Even if the lender obtains possession of the property and has good and marketable title as soon as possible (on the foreclosure sale date), HUD's procedures would allow lenders at least 15 days more than VA does to make notification of the intent to convey property.

## GAO Observations

According to HUD's Director of Single Family Property Disposition, HUD incurs a cost of $10 or more for each day's delay in selling a property after it is acquired by HUD. Such delays are significant in view of the large number of properties which lenders convey to HUD. In fiscal year 1987, HUD's holding costs for all properties in its inventory were about $430,000 per day. Therefore, by providing lenders the additional 15 days to convey the property, HUD could be incurring $6.4 million annually ($430,000 x 15 days) in unnecessary costs. The unnecessary costs could be even greater if the lenders do not obtain possession of the property in a timely manner after foreclosure, and since HUD does not require lenders to report the foreclosure date, HUD does not know if this occurred in a timely manner.

## HUD Comments

HUD officials representing HUD's Office of Insured Single Family Housing told us that they would consider establishing a shorter period during which lenders would be required to notify HUD of property conveyance. They also said that they believe lenders should inform HUD of the foreclosure date and would consider making this a requirement.

## IMPROVE CONTROL OVER PROPERTY PROTECTION AND PRESERVATION

Lenders are responsible for protecting and preserving HUD-insured properties from the date of foreclosure to the date the property is conveyed to HUD. HUD reimburses the lenders for such costs.

## GAO Observations

There is no financial incentive for lenders to obtain the most economical contracts for property protection and preservation. In contrast to HUD's policy of allowing lenders to award these contracts, our work showed that, after foreclosure sales, VA contracts for protection and preservation of its insured properties and does so at lower costs than HUD lenders do. Our review of 61 HUD property sales and 36 VA sales in the Philadelphia region during fiscal year 1986 showed that HUD's average expenses for property preservation and security were more than three times those of VA--$1,145 per property for HUD compared with $310 for VA.

## HUD Comments and GAO analysis

According to officials in HUD's Office of Single Family Housing, protection and preservation costs have been a continuing concern to HUD. They said that HUD was concerned that the administration costs of contracting for the services might be too high. They said that, in attempting to control the costs, HUD has implemented a procedure which requires a review of 10 percent of lender claims to determine the appropriateness of the costs for these services. They said, however, that even with the new procedure, they are concerned about the amount of these costs and will continue to consider ways to reduce them. We agree that HUD should pursue other potential methods to reduce the cost of property protection and preservation. Such methods could include contracting for the services and performing more extensive reviews of lender claims.

## MAJOR CONTIBUTORS TO THIS BRIEFING REPORT

### RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, WASHINGTON, D.C.

John H. Luke, Associate Director, (202) 275-6111
Ed Kratzer, Group Director
Steven R. Gazda, Evaluator-in-Charge
Vernesia Middleton, Typist
Laura Trainham, Typist

### PHILADELPHIA REGIONAL OFFICE

David Toner, Adviser
John R. Kirstein, Staff Member
Marilyn K. Wasleski, Site Senior

(385145)

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