

March 1998

# SINGLE-FAMILY HOUSING

## Improvements Needed in HUD's Oversight of Property Management Contractors



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**Resources, Community, and  
Economic Development Division**

B-278827

March 27, 1998

Congressional Requesters

Each year thousands of single-family mortgages insured by the Department of Housing and Urban Development (HUD) go into default.<sup>1</sup> In many cases, HUD takes ownership of and subsequently sells these properties. HUD is also responsible for preserving and maintaining some abandoned single-family properties awaiting foreclosure. To safeguard and maintain the approximately 30,000 properties HUD has in its inventory at any given time, the Department obtains the services of real estate asset management (REAM) contractors. These contractors are to secure and inspect the properties, report their condition to HUD, notify interested parties of HUD's ownership, perform exterior maintenance, and ensure that the properties are free of debris and hazardous conditions. REAM contractors are therefore essential to HUD's achieving its goal of returning these properties to private ownership as soon as possible while obtaining a maximum sale price for HUD. In connection with its downsizing efforts, HUD is currently planning changes in the way it handles the disposition of single-family properties that would, among other things, affect the role of REAM contractors.

Concerned about identified instances of poor contract administration and the ability of HUD's shrinking workforce to adequately oversee the property management services being provided by the Department's contractors, you asked us to evaluate (1) whether HUD is ensuring that REAM contractors meet their contractual obligations and (2) what actions HUD has planned or under way to change its handling and disposition of the single-family properties in inventory. To meet these objectives, we performed audit work at the Illinois State Office in Chicago, the Massachusetts State Office in Boston, and the Texas State Office in Fort Worth. We selected the Chicago and Fort Worth offices on the basis of their geographic locations and relatively large inventories of single-family properties and the Boston office because of the problems it has experienced with oversight of REAM contracts in the past.

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**Results in Brief**

HUD does not have an adequate system in place to assess oversight of real estate asset management contractors, and the three HUD field offices we visited varied greatly in their efforts to monitor these contractors' performance. None of the offices adequately performed all of the functions

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<sup>1</sup>HUD defines a single-family property as a residential dwelling of one to four units.

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needed to ensure that the contractors meet their contractual obligations to maintain and protect HUD-owned properties. Our physical inspection of properties for which the contractors in each location were responsible identified serious problems, including vandalism, maintenance problems, and safety hazards. These included such things as broken windows, graffiti, leaking roofs, and broken steps. These conditions may decrease the marketability of HUD's properties; decrease the value of surrounding homes; increase HUD's holding costs; and, in some cases, threaten the health and safety of neighbors and potential buyers.

In connection with HUD's plans to reduce staff by about 29 percent (from 10,500 to 7,500) by the year 2002, HUD's single-family property disposition operations, including the real estate asset management function, are in a period of transition: Substantial changes are either planned or under way. These changes are closely linked to HUD's agencywide 2020 Management Reform Plan.<sup>2</sup> They include a reduction in property disposition staff and the consolidation of all field offices' single-family housing operations into four homeownership centers; plans to sell the rights to properties before they are assigned to HUD's property disposition inventory so that they can be quickly disposed of once they become available; and, to some degree, the use of contracts similar to a pilot program started in September 1996 to test the approach of contracting out all marketing and management functions associated with acquired properties. While HUD envisions that these changes will eventually limit the need for real estate asset management contractors' services, there will continue to be properties in need of such services for the foreseeable future, even if on a smaller scale. As a result, HUD's oversight of such contractors will remain an important function.

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## Background

When borrowers default on single-family mortgages insured by HUD, the Department encourages lenders to work with the borrowers to bring their mortgage payments up to date. If that is not possible, the homes may be sold to third parties, voluntarily conveyed to the lenders, or surrendered to the lenders through foreclosure. When lenders obtain properties, they generally convey them to HUD in exchange for payment of an insurance claim.<sup>3</sup> HUD also takes possession of abandoned properties secured by

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<sup>2</sup>In June 1997, HUD issued the "HUD 2020 Management Reform Plan" to address weaknesses that make the agency high-risk and to downsize to 7,500 staff by the year 2002.

<sup>3</sup>In most cases, HUD pays the lender's claim. However, in some cases, for example, if the property was damaged while in the lender's possession, HUD may refuse to accept the property until the lender has repaired the damage.

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HUD-held mortgages and protects and maintains these properties, referred to as “custodial” properties, pending acquisition of title. HUD has the largest real estate portfolio and operation in the nation, selling approximately 55,000 properties each year. The Department estimates that at any given time, its inventory averages about 30,000 properties. The properties remain in HUD’s inventory an average of approximately 6 months. As of September 30, 1997, HUD owned 29,898 single-family properties. The inventory included 1,784 custodial properties as of December 12, 1997. Custodial properties remain in inventory an average of 2-1/2 years, but some have been in HUD’s inventory for more than 8 years.

HUD manages and sells properties in inventory under its Real Estate Owned program.<sup>4</sup> Each of HUD’s 73 field offices<sup>5</sup> currently managing single-family properties may use one REAM contractor to manage its entire inventory or allocate the properties in its inventory among multiple REAM contractors. Of the three field offices we visited, both the Massachusetts and Texas state offices have one REAM contractor, whereas the Illinois State Office divides its inventory into geographic regions and issues separate contracts for each region; at the time of our review, Illinois had nine REAM contractors with 23 contracts.

REAM contracts are awarded by HUD contracting staff in three administrative service centers, using a standard format provided by HUD headquarters. Provisions or clauses may be added to that format to meet the needs of a particular geographic region, but requirements may not be deleted.<sup>6</sup> The standard base contract term is 1 year, plus two 1-year options that HUD can use to extend the contract. Contractors are paid a flat fee for maintaining and managing each property in HUD’s inventory or custody.<sup>7</sup> HUD pays this fee in two installments; the standard contract fee is 30 percent when the property is listed for sale, and the remaining 70 percent is paid when the property is sold. However, some field offices have deviated from these standard terms. For example, the Fort Worth office’s contract term is 1 year with three 1-year options, and 60 percent of

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<sup>4</sup>In HUD’s Illinois and Texas state offices, the branch of the Single-Family Housing Division responsible for management and sales of properties in inventory is called the Real Estate Owned Branch. In HUD’s Massachusetts State Office, this branch is called the Real Estate Owned/Asset Management Branch.

<sup>5</sup>Although there are 81 offices with single-family housing operations, as of September 1997 only 73 were managing an inventory of foreclosed properties.

<sup>6</sup>Revisions necessary to comply with changes to the Federal Acquisition Regulations are allowed.

<sup>7</sup>The flat fee varies according to the terms of each individual contract. For example, under the Illinois contracts in effect at the time of our review, the flat fees for the base contract years ranged from \$642 to \$1,763 per property.

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the maintenance and management fee is paid when the property is listed for sale, and the remaining 40 percent is paid when the property is sold. Paying the fee in installments is designed to encourage contractors to maintain the properties well and expedite property sales.

HUD's field office staff are responsible for overseeing REAM contractors. Day-to-day contract administration is performed by the staff member in the Single-Family Housing Division who is designated as the government's technical representative on the contract. At the beginning of fiscal year 1997, the total value of HUD's active REAM contracts was approximately \$165 million. In addition, in September 1996, HUD entered into pilot contracts with one corporation to test the approach of contracting out all management and marketing functions associated with HUD's inventory of acquired single-family properties at three field offices—the Maryland and Louisiana state offices and the Sacramento Area Office—that, according to HUD's Single-Family Property Disposition Director, were already understaffed in relation to the sizes of their inventories.<sup>8</sup> The property disposition pilot contracts were worth an additional \$22.4 million.<sup>9</sup>

Since 1991, HUD's Inspector General (IG) has repeatedly identified problems with the administration of property management contracts in some field offices.<sup>10</sup> Among other problems, the IG identified instances in which (1) HUD was being billed and was paying for services that contractors and subcontractors never provided; (2) field staff were not making routine inspections of acquired properties; (3) field staff were deviating from procurement policies and procedures; and (4) HUD's files were so poorly maintained that it was impossible to document or evaluate contractors' performance.<sup>11</sup>

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<sup>8</sup>HUD initially intended to issue a national contract similar to the pilot for the management and marketing of all acquired single-family properties; however, it is no longer pursuing the national contract concept.

<sup>9</sup>This amount is the value of the contract through the current modification only and does not reflect the potential value if all options are exercised.

<sup>10</sup>HUD currently calls its property management contracts REAM contracts, but HUD's IG also found problems with the field offices' administration of area management broker contracts, which were used prior to REAM contracts.

<sup>11</sup>In our 1992 report entitled *HUD Reforms: Progress Made Since the HUD Scandals, but Much Work Remains* (GAO/RCED-92-46, Jan. 31, 1992), we reported that HUD's IG, our office, and others had identified problems in the disposition of single-family properties, including inadequate oversight of property management.

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## Weaknesses Exist in HUD's Oversight of REAM Contracts

We found that HUD does not have a system in place for monitoring its field offices' administration of REAM contracts. In addition, HUD's field office staff are not consistently providing adequate oversight of the REAM contractors. Key oversight responsibilities that were not always performed by staff at the three HUD field offices we visited included (1) conducting periodic risk-based monitoring and carrying out performance evaluations before extending REAM contracts; (2) maintaining fully documented files on REAM contractors' performance; (3) inspecting a percentage of properties in the contractors' inventory; (4) ensuring that the contractors submit appropriate property inspection reports to HUD; and (5) ensuring the preservation and protection of custodial properties.

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## HUD Does Not Have a System for Monitoring Administration of REAM Contracts

HUD's property disposition handbook<sup>12</sup> gives headquarters staff the ultimate responsibility for overseeing the administration of REAM contracts. Specifically, the handbook requires regional offices to ensure that field offices are consistently and uniformly monitoring REAM contractors. To ensure that this task is being performed, the guidance requires headquarters staff to review regional offices' oversight actions through regional reviews. We found, however, that headquarters staff have not been conducting these reviews since HUD reorganized its field office structure in 1995 and eliminated the regional offices. According to HUD Single-Family Property Disposition officials, the regional offices' oversight function was never absorbed into headquarters after the regional offices were eliminated. Also, after the reorganization, HUD's guidance was not updated to ensure that REAM contract administration was monitored by headquarters.

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## HUD Does Not Always Perform Required Risk-Based Monitoring and Performance Evaluations

HUD requires field offices to perform an assessment of a contractor's risk of unsatisfactory performance, on the basis of such factors as the timeliness with which the contractor carries out duties under the contract, the frequency of complaints about the condition of properties managed by the contractor, and the contractor's fiscal and subcontracting procedures. At the conclusion of this review, staff are to assign the contractor a risk designation of low, moderate, or high, which determines the frequency of HUD's future monitoring activities, ranging from monthly for high-risk contractors to semiannually for low-risk contractors.

We found that compliance with this requirement varied among the three field offices we reviewed. Specifically, the Fort Worth office has

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<sup>12</sup>HUD Handbook 4310.5 REV-2, "Property Disposition Handbook," May 1994.

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conducted risk assessment reviews and on-site monitoring as required. On the other hand, the Boston office has not been doing the risk assessment reviews. As a result, Boston officials (1) lack information about whether the contractor's accounting, recordkeeping, and subcontracting practices comply with the terms of its contract and (2) have no basis for determining the appropriate frequency of future on-site monitoring. According to a 1996 report by HUD's IG,<sup>13</sup> the Boston office also did not conduct risk assessments for the prior REAM. Also, although the Chicago office has carried out the risk assessment reviews, it has not completed them as often as required, nor monitored the REAM contractors as frequently as their risk assessments indicate that they should be. Specifically, each of the nine REAM contractors under contract with the Chicago office at the time of our review should have had an on-site monitoring review at least every 6 months because the minimum frequency of reviews required by HUD is semiannual (REAM contractors designated moderate- or high-risk are to be reviewed more frequently). However, at the time of our review, five of the nine REAM contractors had not had an on-site monitoring review in over 8 months, and one of these had not had an on-site review in 16 months. The other four REAM contractors had on-site reviews within a week before we began our file review. However, for two of those contractors, there was no evidence that HUD had ever completed an on-site review prior to that time; for the other two contractors, the next most recent reviews had been completed more than 8 months earlier.

HUD also requires field office staff to prepare an evaluation of a contractor's performance every year in the month prior to the contract's anniversary date, using a standard monitoring guide issued by headquarters. This annual evaluation is ultimately used to make decisions on contract extensions and, if necessary, to act on inadequate performance. However, we found that these evaluations are not always conducted or are not always completed in time to provide useful information for contract renewal decisions. For example, Boston's field office has evaluated the REAM contractor's performance only once since the contract was awarded on June 30, 1995, and that evaluation was conducted several weeks after the contract had already been extended beyond the base year. Officials in HUD's Boston field office told us that performance evaluations were not performed because they did not have the staff resources or travel funds to visit the contractor's office, located about 37 miles from HUD's field office. In the one evaluation conducted,

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<sup>13</sup>Controls Over Real Estate Asset Manager Contracts, Massachusetts State Office, HUD, Office of the Inspector General (96-BO-123-0001, June 1996).



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HUD cited the contractor for sometimes failing to meet contractual time requirements for removing debris from properties. Furthermore, contrary to HUD's guidance, Boston field office staff did not send the contractor a copy of the assessment report. According to a Boston HUD official, the staff simply neglected to send the results to the REAM contractor. As illustrated in figure 1, our August 1997 inspection of 24 Massachusetts properties revealed that the debris removal problem still exists. We found that 17 of the 24 properties contained either interior or exterior debris that had not been removed within the contractual time frame; consequently, prospective buyers were sometimes viewing properties littered with household trash, personal belongings, and other debris.<sup>14</sup>

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<sup>14</sup>Because locks on one property had been changed, denying us access with HUD's keys, we were unable to determine whether the contractor had removed interior debris.

Figure 1: Debris Found at One Massachusetts Property We Visited



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Our work in HUD's Fort Worth and Chicago offices also found instances of contracts' being renewed without a current evaluation of the REAM contractor's performance to justify the extension. In the Fort Worth office, the evaluation of the contractor was conducted in August 1997, after the REAM contract had been extended in July 1997. As a result of the August 1997 evaluation, HUD staff increased the risk of nonperformance associated with the contractor from low to moderate. According to a HUD official in Fort Worth, the office did not complete the required annual evaluation of the contractor before extending the contract because HUD headquarters had limited the field office's travel funds. Also, at the time of our review, the Chicago office had extended 21 of its 23 REAM contracts without having evaluated them with headquarters' standard monitoring guide in the month prior to their extensions. For example, the Chicago office extended the contract for one of its contractors in March 1997 but did not conduct the annual evaluation until July 1997. At that time, Chicago staff rated the contractor as being high-risk. Had the evaluation been completed earlier, HUD would have been in a better position to determine whether or not the contract should have been extended. As in Boston and Fort Worth, HUD officials in the Chicago office attributed their untimely evaluations to resource constraints.

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### HUD Does Not Always Maintain Files on Contractors' Performance

In addition to the risk-based monitoring and the performance evaluations, HUD property disposition staff in the field offices are required to maintain a file containing any correspondence between HUD and a REAM contractor. This file should contain any instructions given to the contractor, including oral instructions; documentation of any contractor monitoring conducted; and any other documentation that reflects the contractor's performance. However, we found that the Boston field office does not maintain a REAM file. Boston officials told us that they did not need a separate REAM file because they did not have any performance-related correspondence with the contractor. However, an internal memorandum maintained by HUD's contracting office indicated significant problems with late or missing inspection reports shortly after the contract was awarded. In addition, immediately following our August 1997 site inspection of properties, HUD and the REAM contractor corresponded about the deficiencies in property conditions we identified. Without fully documented files on contractors' performance, HUD may have difficulty supporting contract extension decisions and acting on inadequate performance. As a result of our review, the Boston field office established a REAM file that contains information related to the contractor's performance.

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Although the Chicago field office maintains files for each of its REAM contracts, we found that the files did not always include the documentation necessary to support that staff had been completing monitoring requirements as directed by HUD's guidance. For example, on-site monitoring reviews for four of the nine REAM contractors, accounting for 12 of the 23 contracts, were not contained in the REAM files maintained by the Real Estate Owned Branch. Rather, they were provided to us by Real Estate Owned staff subsequent to our file review. For two of the REAM contractors that had multiple contracts with HUD, the reviews provided by Real Estate Owned staff pertained to only one contract area for each of these two contractors; there was no evidence that Real Estate Owned staff had conducted on-site office reviews relating to the contractors' activities in their other contract areas.<sup>15</sup>

Like the Chicago office, the Fort Worth field office maintains a REAM file, but the file did not contain all of the information required by HUD's guidance. For example, the file did not contain time frames for correcting performance deficiencies. If time frames are not properly documented, it may be difficult for HUD to take appropriate actions to ensure that the deficiencies are corrected.

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## HUD Does Not Require Physical Inspections of Properties Managed by REAM Contractors

HUD's guidance does not require field office staff to physically inspect properties managed by REAM contractors. However, HUD recognizes that physical inspections are the best method for monitoring the contractors' work, and HUD's guidance suggests that field office staff conduct monthly physical inspections of at least 10 percent of the properties assigned to each contractor in each stage of processing.<sup>16</sup> The guidance also allows the field offices to use contractors, such as fee inspectors and REAM contract monitors, for property inspection services. The guidance suggests increasing the number of physical inspections, as necessary, for high-risk REAM contractors or contractors whose performance is deemed to be unsatisfactory. In addition, the guidance requires that HUD staff prepare a monthly log to reflect the inspections made by field office staff, fee inspectors, or REAM contract monitors in the previous month.<sup>17</sup>

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<sup>15</sup>At the time of our review, one of these REAM contractors had separate contracts to provide service in six areas, and the other had contracts to provide service in three areas.

<sup>16</sup>A property goes through 10 stages from the time it is conveyed to HUD to the sale of the property.

<sup>17</sup>HUD's guidance states that the report is to be submitted to the Regional Director of Housing for review. However, in September 1995, HUD reorganized its field structure and eliminated its 10 regional offices. Since HUD reorganized from a regional to a field office structure, it is unclear who is now responsible for this review function.

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Without adequate on-site inspections, HUD cannot be assured that it is receiving the services for which it has paid. On the basis of our review of approximately 50 property files in each location, we found that Boston field office staff had not inspected any properties in their inventory. Boston field office staff told us they do not get out to inspect properties because they do not have the travel funds or staff resources to do so.

The Boston field office's lack of property inspections and inadequate staffing resources were also discussed in a June 1996 HUD IG report<sup>18</sup> that prompted field staff to conduct such inspections in the fall of 1996. However, the Single-Family Housing Director in the Boston office noted that in the middle of fiscal year 1997, the Single-Family Housing Division was forced to combine its asset management and Real Estate Owned functions to accommodate a 50-percent reduction in staff, leaving a small, inexperienced staff to manage the inventory. According to the Boston office Single-Family Housing Director, the staff focused on meeting HUD's management plan's goal of selling properties, which did not leave enough resources to conduct property inspections. Therefore, in April 1997 the Single-Family Housing Division contacted HUD's Administrative Service Center to solicit proposals for contracting out property inspection services. Subsequent to our visit, in December 1997, the Boston field office started using contractors to make property inspections.

Chicago officials reported that they inspect 10 percent of their entire inventory every month. However, it was difficult for us to verify that this many inspections are completed because Chicago staff neither file inspection reports in a separate property inspection file for each REAM contractor nor prepare the required report documenting inspections made by field office staff each month. While staff in the Fort Worth office did not prepare the required report of monthly inspections either, the Real Estate Owned Property Management Supervisor in that office maintains a file containing reports on each of the monthly inspections. According to a HUD official in Fort Worth, the staff have a performance standard requiring them or a fee inspector to inspect a minimum of 10 percent of the properties in their individual inventories. For the Chicago and Fort Worth offices, our review of 50 property files maintained by each location indicated that field office staff had, at some time, inspected approximately 22 percent and 10 percent, respectively, of those properties.

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<sup>18</sup>Controls Over Real Estate Asset Manager Contracts, Massachusetts State Office, HUD, Office of the Inspector General (96-BO-123-0001, June 1996).

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## HUD Does Not Routinely Ensure That REAM Contractors Are Submitting Inspection Reports

The REAM contractor's submission of initial and routine inspection reports is essential for HUD to determine its marketing strategy for the properties and to mitigate potential losses on the properties. For example, the initial inspection reports, along with appraisals, are the primary tools for determining what repairs must be made and whether a property meets certain standards that would allow it to be sold with Federal Housing Administration-insured financing. HUD's guidance requires a REAM contractor to submit initial inspection reports to the field office within 5 working days of being notified that a property has been assigned, but there is no specific guidance on the submission of routine inspection reports. We found considerable differences among the three field offices we reviewed both in terms of the requirements they placed on REAM contractors for submitting inspection reports and the extent to which the reports were actually submitted to the field offices.

For example, the Boston field office has not placed a contractual requirement on its REAM contractor for when initial inspection reports must be submitted to the field office.<sup>19</sup> Of the 42 property files we reviewed in Boston, 18 (43 percent) did not have an initial inspection report.<sup>20</sup> The Chicago field office requires REAM contractors to submit initial inspection reports within 10 calendar days of the assignment of properties to the contractors, but 20 percent of the files that we reviewed in Chicago did not have an initial inspection report. The Fort Worth field office requires REAM contractors to submit initial inspection reports within 10 working days of the notification that a property has been assigned, and all of the property files that we reviewed in Fort Worth contained an initial inspection report.

The three field offices we visited also had varying requirements for the submission of routine inspection reports and oftentimes did not know if the routine inspections had been conducted as required. The Massachusetts REAM contract requires that the contractor perform and document routine inspections every 30 days after the initial inspection. Although the contract does not specifically require the contractor to send the inspection reports to HUD, field office staff expect the contractor to submit the inspection reports. According to the contractor, it strives to submit routine inspection reports to HUD no later than 5 days into the

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<sup>19</sup>The Boston field office requests the REAM contractor to send initial inspection reports to HUD within 5 days after the inspection is completed, but this time frame is not a contractual requirement.

<sup>20</sup>We planned to review 50 files in each location, but in Massachusetts several of the properties listed in inventory were under sales agreement when we began our review. The files for these properties had been sent to a closing attorney and were unavailable to us.

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month after they are performed. However, of the 31 files we reviewed in Boston for properties that had been in inventory long enough to have received a routine monthly inspection, 17 (55 percent) did not contain the required monthly inspection reports. Furthermore, inspection reports that were in the files were not always complete, including some which stated that a property had problems or damage but did not describe what it was. The Chicago office requires the contractor to inspect properties every 10 calendar days but to submit only those routine inspection reports that contain negative findings. The Fort Worth office requires contractors to inspect properties on a biweekly schedule but does not require them to submit the inspection reports at all—the routine inspection reports are maintained by the contractors. Since neither the Chicago nor the Fort Worth field office requires the contractors to submit all routine inspection reports, HUD is unable to readily determine whether the contractors are conducting inspections as required.

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### Inadequate Performance by REAM Contractors and Weaknesses in HUD's Oversight Contribute to Poor Property Conditions

We found instances in all three locations of properties that were not maintained as required by the REAM contracts. During our inspection of approximately 20 properties in each location, we identified properties that (1) were not properly secured, (2) had physical conditions that did not match those that the REAM contractor had reported to HUD, (3) were not properly identified as HUD homes, or (4) had imminent hazards.

For instance, of the 66 properties we visited in all three locations, we found that 26, or approximately 39 percent, were not sufficiently secured so as to prevent access. Failure to properly secure properties can lead to trespassing, vandalism, and properties' deterioration. For example, in Massachusetts three of the eight unsecured properties had exposed walls in the bathrooms where copper piping had been ripped out, and seven had broken windows; three properties had graffiti, and one contained a syringe. Figure 2 illustrates vandalism at one unsecured property in Massachusetts. In addition, we found that one Massachusetts property had been poorly secured by nailing a large piece of plywood to the door, which prevented the door from closing, and then propping a thin piece of wood against the door from the inside, effectively leaving the house wide open. Moreover, two of the Massachusetts properties were inaccessible to us and the REAM contractor because in one, the locks had been changed and in the other, someone had nailed the door shut. Both conditions were noted in the contractor's inspection reports prior to our visit.

Figure 2: Copper Piping Ripped Out of Wall at an Improperly Secured Property





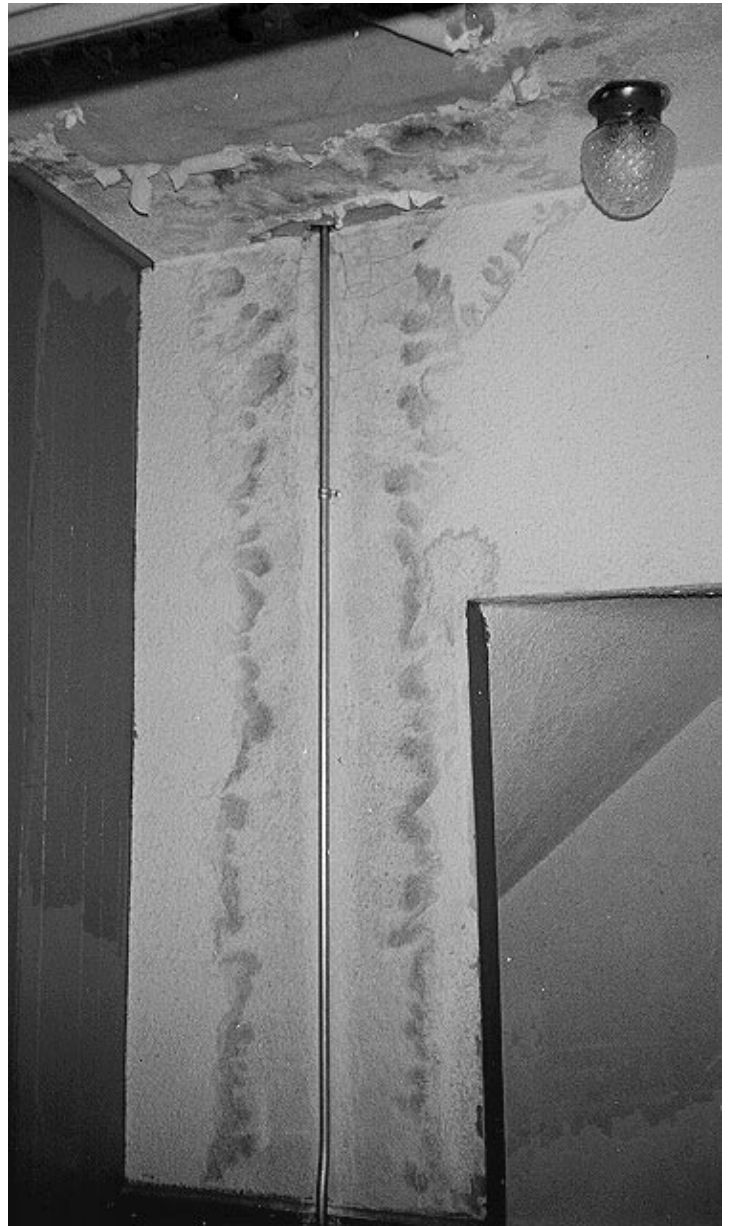
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In addition, we found physical conditions that did not match those that the REAM contractor had reported to the three HUD field offices. Some of the examples we found included (1) a property containing personal possessions, animal feces, and fur, while the contractor's inspection report indicated that the house was free of debris; (2) a property that had roof leaks and extensive water damage, although the contractor had certified to HUD that the roof had been repaired; (3) a contractor's inspection report claiming that a property had extensive defective paint surfaces that would cost \$2,000 to treat, although the property had almost no painted surfaces because the exterior was aluminum siding and the interior was primarily paneling and tile; (4) a property that had suffered a major fire, although the inspection report did not indicate the problem; and (5) a property that had both extensive water damage in several rooms, some of which apparently resulted from a broken skylight secured by taping a plastic trash bag over it, and bathroom walls that were torn apart by vandals to obtain valuable copper piping, none of which was reported to HUD. Figure 3 illustrates the conditions at two of these properties.

Figure 3: Physical Conditions at Two Properties That Did Not Match Those Reported to HUD



Water damage resulting from active roof leaks



Extensive water damage resulting from a broken skylight

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If contractors do not accurately report on the condition of properties, HUD may lack vital information on which to make disposition decisions and to address safety hazards. As a result, the government may sell properties for less than they are worth or incur unnecessary holding and maintenance costs because the properties are not marketable.

Furthermore, we found that about 38 percent of the properties we visited in Massachusetts had either no HUD signs or signs that were difficult to read. The REAM contract requires contractors to post HUD signs on properties in a conspicuous location. Failure to post appropriate signs can make it difficult for neighbors to determine whom to contact when problems concerning a HUD-owned property arise.

We also found that almost 71 percent of the properties we visited in Massachusetts and about 37 percent in Illinois contained imminent hazards. Failure to address imminent hazards endangers would-be buyers as well as neighbors and puts the government at risk of litigation. As illustrated in figure 4, hazards that we observed included broken or rotting stairs, a refrigerator on a back porch with the door intact, a broken cellar bulkhead door, household waste, food and soiled diapers, and numerous properties with paint and solvents in the basement that had not been removed by the contractor.

**Figure 4: Hazardous Conditions We Observed at Two Properties**

Broken cellar bulkhead door



Broken stairs leading to property's front entrance

In some cases, the problems that we saw at these properties had been reported to HUD by the contractor, but HUD did not act promptly to address them. The files and properties that we reviewed in Illinois and Texas did not reveal contractor-reported conditions to which HUD had not responded. However, in Massachusetts, we found four instances in which HUD had not acted on problems. In two cases, inspection reports submitted to HUD noted that the front steps to the properties were dangerous, a condition warranting immediate repair by the contractor. Nonetheless, when we inspected the properties about 3 months after the contractor initially reported the problems, the stairs still had not been repaired. We also found the initial inspection report for a Massachusetts property conveyed to HUD in May 1997 which indicated that the property had suffered heavy water damage as the result of frozen pipes, yet the insurance form from the lender reported that the property was conveyed undamaged. Although these documents were in the property file, according to Boston's Single-Family Housing Director, the property would

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have been reconveyed to the lender if the HUD staff had been cognizant of the property's condition before it went under sales agreement.

We recognize that some of the problems we found may have occurred after a contractor's last routine inspection. However, we believe that it is unlikely that all of them could have occurred during the time between inspections. In fact, in one instance, a routine inspection report completed by the contractor for one of the Illinois properties indicated that all of the exterior doors were secure, the interior was free of debris, and no emergency repairs were needed. However, we had inspected the property on the previous day and found that it had hazardous stairs, debris in the basement, and an unsecured cellar door through which the entire house was accessible.

Also, we found in our review of files and properties in the three locations that the properties were generally in better condition in the locations that monitored the contractors' performance. For example, in HUD's Fort Worth office, where field office staff generally perform oversight as suggested by HUD's guidance, the properties that we visited had few deficiencies. In contrast, in Boston, where many of the key oversight functions were not conducted properly, the general condition of the properties was far worse than that of the properties managed by the Chicago and Fort Worth field offices. We recognize, however, that the condition of the properties is not totally attributable to HUD's oversight of the contractors. Other factors can contribute to the condition of the properties, including the overall quality of the contractors' work and the susceptibility of the neighborhood to crime and vandalism.

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## HUD Does Not Always Ensure the Preservation and Protection of Custodial Properties

Also among the properties that HUD's field offices assign to REAM contractors are those in custodial status. A custodial property is a vacant or abandoned property secured by a HUD-held mortgage; HUD takes possession of such properties for the sole purpose of preserving and protecting them until HUD acquires title. REAM contractors receive a monthly fee for each custodial property assigned to them for preservation and protection. Because HUD does not yet own properties that are in custodial status, the contractors are not required to perform all of the services that they must perform on other properties in HUD's inventory. As with other properties in HUD's inventory, the responsibilities of a REAM contractor with respect to custodial properties are generally governed by the individual REAM contract. However, HUD's guidance requires contractors to inspect custodial properties, post a HUD warning sign within

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48 hours after being assigned the properties, and initiate action to remove imminent hazards from custodial properties no later than 24 hours after discovering them, although contractors may not remove any personal property.

We conducted a limited review of custodial properties in Illinois because it has a high number of properties in custodial status; of the 61 field offices with custodial properties in inventory as of December 1997, the Chicago field office had 167 custodials, or 9 percent of the total inventory of custodials, more than any other field office. Under the Illinois contract format, REAM contractors are required to perform services at custodial properties such as securing them, completing initial inspections within 10 days of being assigned custodial properties, and conducting routine inspections every 10 days thereafter. If damage is discovered during the initial inspection of a custodial property, the REAM contractor is required to provide photographs of the damage and submit them with the inspection report to HUD. For routine inspections, the contractor is to submit a copy of each negative inspection report to HUD within 24 hours after the inspection is performed, including a narrative description of any damage or condition that could create a health hazard.

Our review of nine custodial properties in Illinois revealed that six had been in that status for at least 3 years. We visited these nine properties and found six of them to have seriously deteriorated and/or hazardous conditions. However, for five of these six cases, we found no evidence in the Real Estate Owned files that the contractor responsible for preserving and protecting the properties had notified HUD of their condition, as required by the contract, nor any evidence that a HUD Realty Specialist maintained a file of current information about the properties. For example, one of the properties we visited was completely burned out and too dangerous to enter, but the only inspection report in the Real Estate Owned file for this property was dated in 1994 and did not note any major structural or fire damage. The Real Estate Owned Branch's file for another of the properties, which had significant water damage, contained no inspection reports and no documentation to show that HUD was aware of the property's condition. Inside another property, we found the potential health hazard of dead and rotting pigeons along with bird droppings. The most recent inspection report in the Real Estate Owned Branch's files on this property was dated in 1995. Another property had old meat and dead maggots in the refrigerator; the most recent inspection report in the Real Estate Owned file for this property was dated over 5 months earlier and

did not identify the potential health hazard of the spoiling food. Figure 5 illustrates the conditions at two of these properties.

Figure 5: Conditions We Found at Two Custodial Properties



Significant water damage at a custodial property



Dead and rotting pigeons, and bird droppings, at another custodial property

## HUD's Planned and Ongoing Efforts to Change Property Disposition

HUD is in the process of changing its handling and disposition of single-family properties. These changes are motivated primarily by HUD's larger effort to downsize the agency and to substantially reform management practices agencywide. HUD envisions that these changes, when implemented, will limit the need for REAM contractors' services. Nevertheless, it appears that HUD's property disposition operations will continue to rely on contractors' services to some extent for the foreseeable future. In addition, there is still uncertainty about how HUD will implement some of the reforms it is planning and the extent to which the reforms will produce a feasible and effective alternative for achieving the goals of HUD's property disposition process.

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## Proposals to Revise Single-Family Property Disposition Activities

HUD has been considering changes to its property disposition process as a part of its broader effort to fundamentally revise the agency's organization and management under the HUD 2020 Management Reform Plan.<sup>21</sup> An integral part of the 2020 Plan is the downsizing of HUD's workforce from approximately 10,500 to 7,500 employees by the year 2002. Many of these staff reductions will come from single-family housing operations, including Real Estate Owned functions. According to HUD's Single-Family Property Disposition Director, as of December 1997, approximately 475 staff members were supporting Real Estate Owned operations, but by the year 2002, this number will have been reduced to 66 employees.

In addition to downsizing, the 2020 Management Reform Plan also identifies and seeks to address flaws in HUD's current structure for single-family housing operations, including poorly controlled and monitored disposition of properties. As a part of the solution under the 2020 Plan, HUD is consolidating all single-family housing operations from 81 locations across the nation into four single-family homeownership centers (HOC). The HOCs will carry out the work traditionally performed in HUD's field offices, including oversight and management of contractors and sales of remaining inventory. According to Single-Family Property Disposition officials, the 66 staff devoted to Real Estate Owned operations under the 2020 Plan will be located in these HOCs. According to these officials, as of December 1997, some single-family housing functions had been transferred to some of the HOC locations, but the transition was still in process and no target date had been set for completing the consolidation. However, these officials said that a Real Estate Owned presence will be maintained in HUD's field offices as long as necessary to carry out property disposition functions, up until the year 2002, when the Real Estate Owned portion of the downsizing plan is expected to be complete. This presence will be made up of staff who are not among the 66 assigned to Real Estate Owned positions at the HOCs and who choose to remain in their current positions while the changes to property disposition are being implemented.

As part of its restructuring of single-family housing operations, HUD is also considering alternative methods for disposing of the Real Estate Owned inventory. According to Single-Family Property Disposition officials, the pursuit of alternative methods is motivated primarily by the significant decrease in Real Estate Owned staff resources, as well as by the increased

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<sup>21</sup>In June 1997, HUD issued its "HUD 2020 Management Reform Plan," intended to fundamentally redesign HUD's mission, programs, and organization.



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number of properties in HUD's inventory.<sup>22</sup> In a June 1997 advanced notice of proposed rulemaking in the Federal Register, HUD stated its intent to develop innovative methods for disposing of HUD-owned single-family properties. Specifically, according to the Deputy Assistant Secretary for Single-Family Housing, the Department plans to sell the rights to properties before they enter inventory, thus enabling them to be quickly disposed of once they become available.<sup>23</sup> According to the Single-Family Property Disposition Director, as a result of these sales, HUD anticipates having only a minimal inventory of properties in the future and, therefore, only a limited need for REAM contractors' services.

In September 1997, HUD issued a request for proposals soliciting a financial adviser to help design a specific structure for these sales, which HUD refers to as "privatization sales." Although the details of the privatization sales concept remain to be developed by the financial adviser, Single-Family Property Disposition officials envision that properties would be pooled on a regional basis and purchased by entities that could use their existing structures to sell the properties in the same way that HUD currently does, through competitive sales to individuals. Rather than taking possession of a large number of properties at one time, buyers would receive a "pipeline" of newly acquired properties as they come into inventory, at a rate of about 3 or 4 per day.

While HUD further develops the privatization sales concept, staff reductions and the transfer of functions to the HOCs are already in progress. According to Single-Family Property Disposition officials, field office staff are still responsible for managing and disposing of the existing inventory of properties, which numbered about 30,000 as of September 1997. According to these officials, until the privatization sales program is successfully implemented, Real Estate Owned staff will be responsible for disposing of the current inventory and any new properties coming into the inventory by using property management and marketing contracts similar to those issued under a recent pilot program, which tests the approach of contracting out all property management and marketing

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<sup>22</sup>According to Single-Family Property Disposition officials, the inventory of HUD-owned properties is increasing because of (1) the termination of HUD's Mortgage Assignment Program, which has resulted in thousands of properties that would formerly have entered the Mortgage Assignment Program being conveyed to HUD, and (2) downturns in some local economies and housing markets.

<sup>23</sup>In addition, as part of its budget request for fiscal year 1999, HUD is proposing new legislation to allow the Department to take back a note when a claim is paid, rather than requiring lenders to foreclose and convey properties. HUD would then transfer the note to a third party for servicing and disposition. Although the legislation is proposed for enactment in 1999, the program would not take effect until 2002, to allow HUD time to issue regulations and mortgage lenders time to adjust to the new procedures.

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services.<sup>24</sup> Furthermore, even after the privatization sales approach is implemented, there will likely continue to be a relatively small number of properties that HUD does not dispose of through privatization sales. For instance, HUD is considering retaining a percentage of foreclosed properties in inventory to sell to nonprofits and state or local governments. Such properties would be managed and disposed of using contracts similar to those used in the pilot.

Under the pilot contracts, a contractor performs both the marketing functions traditionally carried out by HUD staff and the property management functions traditionally obtained through REAM contracts. Although the pilot program allows many of the tasks traditionally performed by HUD staff to be carried out by a contractor, according to a HUD official in one of the pilot locations, Real Estate Owned staff must still monitor the contractor's performance. According to Single-Family Property Disposition officials, as operations are transferred to the four HOCs, these locations will be responsible for obtaining contracts similar to those under the pilot and for overseeing those contracts. The headquarters Single-Family Property Disposition Division is recommending to the HOCs that they acquire services similar to the pilot program to supplement existing staff in field offices with few remaining Real Estate Owned employees. HOCs would have the option of choosing which specific services to obtain under contract, depending on the needs of the field offices in their jurisdictions. Although the HOCs will have ultimate responsibility for overseeing property disposition contractors, staff will likely be designated in the field offices to monitor the contractors and report to the HOCs, to the extent that any Real Estate Owned staff remain in the field office locations.

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### Uncertainties Exist About HUD's Efforts to Revise Property Disposition Activities

While HUD deserves credit for seeking improvements to its single-family property disposition process, it is not yet clear precisely how the reforms that HUD is pursuing will take shape and to what extent, if at all, they will be better than the existing process at meeting HUD's property disposition goals of ensuring the highest return to the government on acquired properties, promoting homeownership, and strengthening communities. Furthermore, if the reforms do not work as HUD envisions, the Department will have a difficult time reverting to its current property disposition approach because the downsizing and consolidation of single-family operations is already under way.

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<sup>24</sup>According to Single-Family Property Disposition officials, field offices with fewer than 10 remaining Real Estate Owned staff will use contracts similar to those issued under the pilot, but field offices with 10 or more Real Estate Owned staff will continue to use REAM-type contracts.

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As discussed above, the details of HUD's plans to carry out privatization sales have not yet been formulated. As a result, it is difficult to assess the impact of the reforms on HUD's property disposition goals. According to HUD staff, the reforms can improve on the current process by reducing HUD's property disposition costs. They said that this view is supported by a study prepared in September 1997 by Hamilton Securities Advisory Services, Inc., a former HUD contractor. This study analyzed the costs of the current property disposition system and identified several alternatives to the current system. The study noted that although the revenue that HUD obtains on sales of single-family properties has been similar to housing industry standards, its property disposition costs have been "a little higher." Accordingly, the study evaluated options, such as bulk sales of properties or awarding the right to sell properties to contractors, that could allow HUD to lower its property disposition costs and associated administrative costs.<sup>25</sup> However, as the study noted, to the extent that alternative approaches result in lower returns to HUD because of purchasers' increased risk and financing costs, savings in property disposition costs could be offset to some degree.<sup>26</sup> Considering these factors, the study projected that bulk sales of properties or awarding the right to sell properties to contractors could achieve annual savings of \$43 million or \$183 million, respectively, over HUD's current property disposition process. The study did not assess the potential effects of the reform options on HUD's ability to promote homeownership or strengthen communities through the single-family property disposition process.

Another uncertainty about HUD's revised process is that it may take longer than anticipated to complete the transition to the privatization sales approach. According to Single-Family Property Disposition officials, HUD expects to publish a proposed rule amending the current property disposition regulations in about March 1998, have a financial adviser hired by April 1998, conduct the first privatization sale in the summer of 1998, and publish the final rule amending the current regulations by September 1998. The first sale would offer the rights to properties that HUD

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<sup>25</sup>Commenters on the advanced notice of rulemaking raised concerns about HUD's proposals, especially any attempts to use bulk sales. The concerns were that such an approach would potentially reduce the returns that HUD receives on property sales, could interfere with homeownership goals, could depress the value of properties in the neighborhoods in which HUD's properties are located, and could be subject to fraud and abuse. According to the Single-Family Property Disposition Director, these comments refer to "bulk sales," wherein a large number of hard-to-sell properties are disposed of all at one time; the privatization sales concept would provide for purchasers to receive a "pipeline" of newly acquired properties that have just been foreclosed, at a rate of about 3 or 4 per day.

<sup>26</sup>Furthermore, to the extent that lower property disposition costs achieved by the private sector relate to differences in the properties they dispose of and the neighborhoods in which the properties are located, as opposed to differences in the processes they use, HUD will experience difficulty in lowering its disposition costs to private-sector levels.

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will acquire in fiscal year 1999. According to these officials, if the sale is national in scope, then new properties would stop coming into HUD's inventory at the end of fiscal year 1998, and about 6 months into fiscal year 1999, only a relatively small inventory would remain.<sup>27</sup> However, most of the details of the privatization sale concept have yet to be determined; for example, HUD does not yet know who will be the potential purchasers for these sales, or the scope of the first sale. Even if the first sale is on a national basis and HUD is able to meet its target dates, a sizable inventory of properties will continue to need management and marketing services until at least the middle of fiscal year 1999. If the first privatization sale is delayed, only partial in scope, or does not work according to plan, HUD's sizable inventory will need property management and marketing services even farther into the future.

In any case, contractors are likely to still be involved in the property disposition process to some degree for the foreseeable future, to assist the decreasing field office staff in handling the current inventory and any future inventory of properties not sold through privatization sales. Furthermore, if the privatization sale concept does not operate as well as hoped, according to Single-Family Property Disposition officials, HUD will rely heavily on contracts similar to those issued under the pilot. In light of this situation, it will continue to be important for HUD to ensure adequate controls over contractors' activities.<sup>28</sup> HUD's single-family housing officials recognize that a system for monitoring contractors' performance will be needed under the new approach; according to these officials, the function of the Real Estate Owned divisions within the HOCS will be almost exclusively to monitor contracts. Although these officials anticipate that a monitoring guide developed in connection with the three pilot contracts will be largely transferrable to the HOCS' monitoring operations, as of February 1998, they had not yet developed specific guidance for the HOCS to use in their monitoring role.

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<sup>27</sup>According to Single-Family Property Disposition officials, because 6 months is the average turnover time for properties in inventory, field offices can be expected to have disposed of much of their existing inventories about 6 months after HUD stops taking possession of newly acquired properties.

<sup>28</sup>In addition to the weaknesses that we identified in HUD's oversight of REAM contracts, in our February 1997 report entitled *High-Risk Series: Department of Housing and Urban Development (GAO/HR-97-12)*, we identified monitoring as a weakness in HUD's current operations. In connection with that work, in August 1996, we surveyed 155 persons serving as the directors of major program areas at HUD's 40 largest field offices, including Single-Family Housing Directors. Sixty-nine percent of the Single-Family Housing Directors responding said that HUD should increase the amount of contractor monitoring, and 57 percent said that HUD headquarters should place greater emphasis on completing essential program monitoring.

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## Conclusions

Because HUD headquarters has no mechanism for routinely monitoring field offices' oversight of REAM contractors, it has no assurance that its field offices are consistently and effectively applying HUD's guidance for overseeing contractors' performance. Although HUD's guidance suggests and, in some instances, requires various methods for monitoring REAM contractors' performance, such as conducting monthly on-site property inspections, maintaining files on contractors' performance, and providing contractors with written results of performance evaluations, for the three field offices we reviewed, we found that these activities have not consistently been used in a way that assures HUD that REAM contractors are meeting their contractual obligations. As a result, field offices may extend contracts without current information on the quality of the REAM contractors' past performance; do not consistently receive the timely information they need to make informed marketing decisions for the properties in inventory; and may compensate contractors for services that were not provided in accordance with contract requirements. In addition, we believe that oversight weaknesses at the three locations we visited have contributed to poor conditions at some of the properties in HUD's inventory, including custodial properties, potentially decreasing the value of these properties and negatively affecting the surrounding neighborhoods.

Although this is a transitional period for HUD's Single-Family Property Disposition operations, with major changes being planned and implemented, there will continue to be a need for contractors to perform property management and/or marketing services into the foreseeable future. Furthermore, whereas property management services currently obtained under both the pilot and REAM contracts are overseen by field offices located in the same general area for which the contractors have responsibility, HUD staff in the future will be responsible for monitoring contractors' activities throughout the nation from only four locations. Because of this situation, it will, if anything, be even more critical for HUD to ensure that it has effective systems in place to oversee property disposition contractors' activities.

As Single-Family Property Disposition officials have acknowledged, the uncertainty about the potential impacts of privatization sales on HUD's property disposition goals will require HUD to carefully monitor the effects of the new process as it is implemented and assess these effects in relation to the results under other possible alternatives, such as, for example, issuing management and marketing contracts similar to those under the

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pilot program.<sup>29</sup> It will be difficult for HUD to revert back to its current property disposition approach if its planned reforms do not work as HUD envisions because of the substantial downsizing and consolidation of operations that is already under way.

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## Recommendation

We recommend that, so long as contractors are involved in providing asset management services for properties in HUD's single-family inventory, the Secretary of Housing and Urban Development establish a process for monitoring the administration of such contracts at field offices and homeownership centers. This process should include controls sufficient to ensure that these field locations consistently implement HUD's guidance and effectively oversee contractors' performance. Specifically, these controls should require that (1) field locations complete performance evaluations of contractors (using the standard monitoring guide in HUD's Property Disposition Handbook) prior to renewing contracts and communicate the results of these evaluations to the contractors in writing in a timely manner; (2) field location program offices maintain files on contractors' performance; (3) HUD staff or contractors hired to perform monitoring duties conduct monthly on-site inspections of a sample of properties in inventory; (4) contracts contain clear and consistent requirements on when contractors' routine inspection reports must be submitted to HUD for review; (5) HUD staff ensure that real estate asset management contractors notify HUD of deteriorated or hazardous conditions at custodial properties; and (6) HUD headquarters obtain sufficient information to monitor homeownership centers' and field offices' administration of the contracts.

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## Agency Comments

We provided a draft copy of this report to HUD for its review and comment. HUD's Acting General Deputy Assistant Secretary for Housing told us that HUD takes the findings in our report very seriously and will take steps to ensure that properties identified as hazardous to buyers and neighborhood residents will be made safe. He noted that our report was based on a review of properties in three locations, a small sampling of the approximately 30,000 homes in HUD's inventory. Nevertheless, the Department is reviewing its internal procedures for managing REAM contracts under the new homeownership centers to identify immediate corrective steps and to ensure that any management weaknesses that existed under the previous field structure will not recur in the new

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<sup>29</sup>As of December 1997, HUD's Single-Family Property Disposition officials said that staff were in the process of evaluating the results of the pilot program's first year.

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organization. As discussed in our report, the Department is also currently assessing alternative contract vehicles and other initiatives for managing and disposing of its inventory. HUD believes that these changes should strengthen management control over the property management and disposition process, result in a substantially reduced real estate inventory, and limit the use of REAM contracts.

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We conducted our review from July 1997 through February 1998 in accordance with generally accepted government auditing standards. (See app. I for a discussion of our scope and methodology, including the statistical methodology we used for evaluating oversight of REAM contracts.)

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies of this report to the Secretary of Housing and Urban Development. We will make copies available to others on request.

Please call me at (202) 512-7631 if you or your staff have any questions. Major contributors to this report are listed in appendix II.



Judy A. England-Joseph  
Director, Housing and Community  
Development Issues

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B-278827

List of Requesters

The Honorable Rick A. Lazio  
Chairman, Subcommittee on Housing  
and Community Opportunity  
Committee on Banking  
and Financial Services  
House of Representatives

The Honorable Christopher S. Bond  
Chairman, Subcommittee on VA, HUD,  
and Independent Agencies  
Committee on Appropriations  
United States Senate

The Honorable Lauch Faircloth  
Chairman, Subcommittee on Financial  
Institutions and Regulatory Relief  
Committee on Banking, Housing,  
and Urban Affairs  
United States Senate



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## Abbreviations

FHA	Federal Housing Administration
GAO	General Accounting Office
HOC	homeownership center
HUD	Department of Housing and Urban Development
IG	Inspector General
REAM	real estate asset management
REO	Real Estate Owned

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# Objectives, Scope, and Methodology

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As requested by the Chairman, Subcommittee on Housing and Community Opportunity, House Committee on Banking and Financial Services; the Chairman, Subcommittee on VA, HUD, and Independent Agencies, Senate Committee on Appropriations; and the Chairman, Subcommittee on Financial Institutions and Regulatory Relief, Senate Committee on Banking, Housing and Urban Affairs, we evaluated (1) whether the Department of Housing and Urban Development (HUD) is ensuring that real estate asset management (REAM) contractors meet their contractual obligations and (2) what actions HUD has planned or under way to change its handling and disposition of the single-family properties in its inventory.

We obtained most of the information used to determine whether HUD is ensuring that REAM contractors meet their contractual obligations from HUD field offices since they are responsible for administering REAM contracts. Specifically, we performed audit work at the Massachusetts, Texas, and Illinois state offices. We selected Massachusetts because of past problems it has experienced with oversight of REAM contracts. We chose Texas and Illinois on the basis of their geographic locations and relatively large inventories of single-family properties (nationally ranking third and fourth, respectively, in the number of properties).

To obtain information on HUD's policies and procedures for monitoring REAM contracts, we reviewed the HUD Property Disposition Handbook and other relevant documentation. We discussed the implementation of these policies and procedures with single-family housing officials in both headquarters and the three field offices we visited. We also interviewed Administrative Service Center officials, who are responsible for awarding contracts, about contract administration issues.

In the selected field offices, we reviewed property files and REAM contract files maintained by the Single-Family Housing Real Estate Owned Branch and other documentation related to oversight of contractors' performance. We gathered information on oversight of REAM contracts by using an automated data collection tool to compile standardized information from the single-family property files. The sampling methodology we used to select case files for review and an explanation of the statistical precision of the samples we used is described below.

To determine how well REAM contractors' services were being provided, we inspected approximately 20 properties in each location. Using HUD's inventory listing and information from property inspection reports, for each field office we judgmentally chose two geographically dispersed

clusters of properties for inspection. One group of properties was located relatively close to the HUD office, while the second group was located several hours away from the office. In addition, we made site visits to REAM contractors' offices in each field location to review their property and subcontractor files. We also discussed contract obligations and contractors' policies and procedures with REAM representatives.

To identify what actions HUD has planned or under way to change its handling and disposition of the single-family properties in its inventory, we gathered information on HUD's planned and ongoing efforts from HUD documents and discussions with the Director, Single-Family Property Disposition, other single-family housing officials, and HUD's Office of Inspector General.

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## Statistical Methodology for Evaluating Oversight of REAM Contracts

This section describes the sampling methodology and statistical precision of the estimates we used in our review of single-family property files.

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### Sampling Methodology

To review documentation on oversight of REAM contracts, we used an automated data collection tool to compile standardized information from a sample of single-family property files at HUD's Illinois, Massachusetts, and Texas state offices. The data collected included dates of property assignments to REAM contractors and dates of property inspections by the contractors, HUD staff, or someone hired by HUD to conduct the inspections.

We obtained a property inventory from the Single-Family Accounting Management System for the HUD field office in each location to identify the universe of properties listed for sale.<sup>30</sup> Table I.1 displays the total inventory and properties listed for sale in each location. On the basis of the total number of properties listed for sale and the amount of time needed to review individual property files, we decided to review a minimum of 50 randomly selected files in each location. Although as of July 28, 1997, the Massachusetts State Office's inventory listing showed 57 properties listed for sale, 15 of them were under sales agreements as we conducted our property file review in July and August 1997. Therefore, we reviewed only 42 property files in the Massachusetts State Office because

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<sup>30</sup>HUD refers to properties listed for sale as step-6 properties.

the files for the properties under agreement had been sent to a closing attorney and were unavailable to us.

**Sampling Errors and Confidence Intervals of Estimates**

Since we used a sample (called a probability sample) of property files to develop our estimates from the automated data collection instruments, each estimate has a measurable precision, or sampling error, which may be expressed as a plus/minus figure. A sampling error indicates how closely we can reproduce from a sample the results that we would obtain if we were to take a complete count of the universe using the same measurement methods. By adding the sampling error to and subtracting it from the estimate, we can develop upper and lower bounds for each estimate. This range is called a confidence interval. Sampling errors and confidence intervals are stated at a certain confidence level—in this case, 95 percent. For example, a confidence interval at the 95 percent confidence level means that in 95 out of 100 instances, the sampling procedure we used would produce a confidence interval containing the universe value we are estimating. Table I.2 provides the estimates and confidence intervals from single-family property file reviews in the Illinois and Texas state offices. Since we reviewed the files for all the properties listed for sale in the Massachusetts State Office, there were no sampling errors.

**Table I.1: Inventory and Sample Size**

<b>Description (as of our review date)</b>	<b>Illinois State Office</b>	<b>Massachusetts State Office</b>	<b>Texas State Office<sup>a</sup></b>
Number of properties in inventory	1,441	215	1,519
Number of properties listed for sale	255	57	191
Number of files reviewed for properties listed for sale	51	42	50

<sup>a</sup>Includes inventory for the Texas State Office in Fort Worth but does not include inventory for the Dallas, Houston, Lubbock, or San Antonio area offices.

**Appendix I**  
**Objectives, Scope, and Methodology**

**Table I.2: Estimates and Sampling Errors of the Estimates From Single-Family Property File Reviews in the Illinois and Texas State Offices**

Description	Estimate		95-percent confidence interval—lower limit		95-percent confidence interval—upper limit	
	Illinois	Texas	Illinois	Texas	Illinois	Texas
Average no. of days between property assignment to initial inspection	3.2	11.7	1.5	5.1	4.9	18.3
Missing initial inspection reports <sup>a</sup> (percent)	19.6	0	9.8	0	29.4	5.2
Average no. of days between initial inspection completed and report received by HUD	16.6	3.6	3.4	3.0	29.8	4.2
Number of property files with inspection reports from REAM monitors <sup>a</sup> (percent)	7.8	4	1.2	1	14.4	11
Number of property files with inspection reports from HUD Realty Specialists (percent)	21.6	10	11.4	2.8	31.8	17.2

<sup>a</sup>The 95-percent confidence intervals for the percentage of missing inspection reports and the percentage inspected by REAM monitors in Fort Worth were computed using the hypergeometric distribution.

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