HUD LOSING $1 MILLION PER DAY—PROMISED “REFORMS” SLOW IN COMING

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

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HUD LOSING $1 MILLION PER DAY— PROMISED "REFORMS" SLOW IN COMING

TUESDAY, MARCH 23, 1999

HOUSE OF REPRESENTATIVES,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The committee met, pursuant to notice, at 12:15 p.m., in room 2154, Rayburn House Office Building, Hon. Dan Burton (chairman of the committee) presiding.

Present: Representatives Burton, Gilman, Morella, Mica, Terry, Biggert, Ose, Chenoweth, Waxman, Kanjorski, Mink, Norton, Cummings, Kucinich, Tierney, Allen, and Schakowsky.

Staff present: Kevin Binger, staff director; Daniel R. Moll, deputy staff director; Barbara Comstock, chief counsel; David A. Kass, deputy counsel and parliamentarian; Jane Cobb, professional staff member; Mark Corallo, director of communications; John Williams, deputy communications director; Carla J. Martin, chief clerk; Lisa Smith-Arafune, deputy chief clerk; Corinne Zaccagnini, systems administrator; Jacqueline Moran, legislative aide; Maria Tamburri, staff assistant; Phil Schiliro, minority staff director; Phil Barnett, minority chief counsel; Cherri Branson and Michael Yeager, minority counsels; Ellen Rayner, minority chief clerk; Jean Gosa, minority staff assistant; and Barbara Wentworth, minority research assistant.

Mr. BURTON. The committee will come to order.

A quorum being present, we will proceed.

Several weeks ago, this committee held a hearing about Federal programs that are wasting billions of taxpayer dollars every year. These programs are on GAO's high risk list, because mismanagement and internal weaknesses make them very vulnerable to waste, fraud and abuse. Today's hearing is the second in a series of full committee hearings that will examine these high risk areas.

During the February 10th hearing, I promised to try to work with our appropriators to hold agencies accountable for addressing the high risk areas. Since then, I co-signed a letter with Chairman Bill Young of the Appropriations Committee to every major agency. It puts them on alert that we want to see serious efforts to resolve these problems, starting with specific, measurable performance goals and their annual Results Act plans.

Without objection, I would like to enter this letter into the record at this time. This is the letter we sent to all the agencies from Chairman Young and myself. Without objection, so ordered.

[The information referred to follows:]

Congress of the United States
Washington, DC 20515

March 9, 1999

The Honorable Andrew M. Cuomo
Secretary
U.S. Department of Housing and Urban Development
451 Seventh Street, SW
Washington, DC 20410

Dear Secretary Cuomo:

The General Accounting Office and your inspector general recently provided Congress with reports on the most serious fraud, waste, mismanagement, and performance problems facing your agency. Their reports are enclosed. The problems they identify are based on extensive, and often recurring, audit work. These problems waste millions, if not billions, of tax dollars each year and undermine your agency's ability to perform the basic functions that our citizens need and legitimately demand from it.

We, as Chairmen of the House Committee with broad oversight over government management practices, and the House Committee that funds all government agencies, plan to work together to make sure that the most serious problems facing our government are being addressed appropriately.

Most of these problems have been documented many times before. The purpose of this letter is not to call them to your attention once more, since you should already be thoroughly familiar with them. Rather, we write to inform you of our intention to target these problems during the 106th Congress.

Many laws enacted in recent years give agencies the tools needed to address these problems—and give Congress and the American people the ability to hold agencies accountable for achieving results. The most important is the Government Performance and Results Act, popularly know as the "Results Act." We expect you to use these tools vigorously during the next two years to address your problems; you can be assured that we will also use them vigorously to assess your agency's performance. Specifically:

- We expect you to adopt firm commitments to address your agency's problem areas in your annual Results Act performance plans through specific and measurable annual performance targets. We don't expect you to solve the most serious problems overnight. What we do expect are commitments that set a clear course to resolving each problem as soon as practical, with measurable road marks of progress along the way, for which you will be accountable.

- You can expect to be asked about your problem areas, and your efforts to address them, in connection with your appropriations requests this year. Among other things, we will explore where your agency stands in implementing GAO and IG audit recommendations directed at these problems.

- Where we find a lack of adequate commitment or specific action to address the problem areas, you can expect to see the results in our funding decisions. We simply are unwilling to subsidize wasteful, inefficient, or ineffective programs and activities where no serious effort is being made to fix them.

Every American has the right to expect the federal government to work honestly and efficiently. Every American has the right to demand that the government be accountable for delivering concrete results in return for their hard-earned tax dollars. We are sure that you share these obvious principles, and we hope that you will work with us to turn them into reality.

Sincerely,

Dan Burton, Chairman
Committee on Government Reform

Bill Young, Chairman
Committee on Appropriations

Enclosures

Mr. BURTON. I plan to share what we learn here today with the Appropriations Committee, and I'm going to work with them to do whatever is necessary to get the agencies to turn these problems around. What Chairman Young and I wanted to stress to all of the agencies about the Results Act is that there has been an attitude of, well, maybe we'll comply and maybe we won't.

A number of the agencies that are supposed to comply with the Results Act have done almost nothing. Some have done minimal things. And some have tried a little bit harder. But the fact is, the Results Act is the law and it needs to be complied with.

One of the things I said to Chairman Young that I think is very important is that the Results Act did not appear to have any teeth in it. The way to make sure there were teeth in it was to have the Appropriations Committee, as well as myself, let them know that there were penalties to be imposed if each agency did not comply with the Results Act, which means very simply that there will be a very hard look taken at their budgets and their expenditures. If they don't comply with the Results Act, then we find ways that they should have complied. There may be some substantial cuts. We think that's something they ought to understand.

Our hearing today will focus on the Department of Housing and Urban Development. It would have been helpful if we had HUD's performance plan by now. Every other major agency has submitted a performance plan at this point. But HUD has not. If we had it, we would have been able to see how specifically HUD plans to address some of the problems that we will look at today.

I sincerely hope we're going to see that plan soon. In the meantime, I expect FHA Commissioner Apgar to tell the committee his specific goals and measures for resolving the high risk problems as I requested in the invitation letter to him. I've talked to Secretary Cuomo a number of times. He's a very nice fellow and I think he has the best interests of the Department of HUD at heart, and I think he wants to do the right thing. But evidently, he needs more help from his assistants to make sure they have a plan and they get on with it.

Today the high risk program we will examine is HUD's Federal Housing Administration [FHA]. FHA is the home mortgage insurer for many people who wouldn't ordinarily qualify for a home loan in the private marketplace. For example, first time home buyers and people with not so perfect credit histories. Every year, thousands of these mortgages go into default, and the FHA is responsible for reselling these homes.

This is where the problems start. HUD is sitting on a huge backlog of repossessed properties, and the list is growing every year. A lot of these properties sit in HUD's inventory for months, some even for years. Some abandoned properties have been in HUD's inventory for more than 8 years.

HUD's contractors are so poorly managed that the properties have become run-down and vandalized. The value of the properties is plummeting and hurting the whole neighborhood. The management of this process is such a fiasco that HUD is losing over $1 million every single day.

This is not a new problem. It's been going on for years. They've been on GAO's high risk list since 1994.

Just as significant as the cost to the taxpayer is the cost to individuals and neighborhoods. Management failures and staffing shortages have resulted in lax oversight of the contractors responsible for maintaining these properties. One HUD office in Florida was so shortstaffed that they did not visit their contractor handling these properties in 3 years. In another case, the contractor performed the work, inspected the work and approved the payment to himself with no oversight.

As you can see from the pictures on these easels that we have over here to the left, some taken as recently as this month, the lack of proper attention to these properties exposes them to vandalism, maintenance problems and safety hazards. How would you like to live in that one on the left?

The longer they sit in these conditions, the more the value deteriorates and the more money HUD loses and the more the neighborhood suffers, and the more everybody that lives in the neighborhood complains.

One of HUD's primary missions is expanding home ownership. But evidence and testimony you will hear today indicates this program is not achieving this mission. Home ownership is clearly a problem when the rate of FHA foreclosures is rising.

Look at the recent trends. In fiscal year 1996, there were just under 61,000 foreclosures. In fiscal year 1997, the number was 71,000 foreclosures. For fiscal year 1998, it was 76,000 foreclosures. Why is the number of FHA insured families defaulting on their loans increasing in an economy that's growing like ours is? How long can neighbors living next to blighted HUD properties expect to wait for HUD reforms while their property values continue to go into the tank?

HUD's mission is not to drive down communities, its mission is to make communities better. Communities do not deserve this from their Government, and the tax dollars that support it.

Three of our witnesses testified before Congress 1 year ago almost to the day. At that time, they talked about the condition of many of the HUD homes in their neighborhoods, and what these poor conditions do to them and to the surrounding community and the property values. One witness even had the personal experience of foreclosure on his FHA mortgage.

I've asked these witnesses to return today to give us a status report. I want to ask them if the situation over the past year has improved at all.

In fairness to HUD, this agency has been troubled for many years. I'm sure this administration inherited more than its share of problems when it took the helm 6½ years ago. HUD will testify today that FHA's property disposition program is in transition. We'll hear about the enormous undertaking to contract out all the responsibilities for reselling these homes.

How long do HUD officials expect the transition to these new contracts to take? And what will HUD's oversight of the new contracts look like?

Poor contractor oversight has been a serious problem for this program in the past. If the FHA couldn't manage these contractors in the past, and now they're going to give them even more responsibility. Is it going to work any better?

I'd also like to know when HUD expects the trends I mentioned earlier to take a positive turn. Even though the population that FHA serves is considered more risky than that of the private sector mortgage industry, it seems to go against all reason to see foreclosure rates going up and up during this good economy. It's not what is happening in the private mortgage industry.

Our witnesses today will help us understand the present state of affairs with this program. I hope we'll get some answers from HUD on what their reforms are and when we can expect them to be realized.

As part of my opening statement, I want to show a segment of the NBC Nightly News called Fleecing of America that aired several weeks ago about HUD's FHA properties. But first, I want to say something to HUD. My understanding is that in the days prior to NBC's original piece, HUD led an all-out offensive against NBC not to show it. It has also come to my attention that HUD has gone on an offensive against the General Accounting Office.

I know there was heavy lobbying going on leading up to the release of the high risk list. I also have a copy of a letter dated March 12, 1999 that HUD Deputy Secretary Saul Ramirez sent to Comptroller General David Walker that personally attacks him because HUD is on GAO's high risk list.

Also, the battles HUD has engaged in with its Inspector General are no secret, and we had a manifestation of that when the IG spoke here just a couple of weeks ago.

I know that HUD has taken its share of knocks over the years, but not without reason. The management problems at HUD exist now. They are affecting communities and families today. HUD officials need to understand that shooting the messenger is not going to solve their problems. More than ever, HUD needs to focus its resources on solving problems and not fighting the messenger, such as the IG or the GAO. So let's move forward, recognize the problems where they exist, try to find solutions and give the American public the accountability that they deserve.

Now I'd like to have this piece shown from "Fleecing of America."

[Video shown.]

Mr. BURTON. Let me just say before I turn to my colleague from California, Mr. Waxman, that evidently one house, not all of them, but one house in that piece was characterized as one of the homes that was controlled by HUD, and evidently there was some question about that. So NBC made a mistake, but that was only one of them. All the rest of the homes shown in that piece were actually HUD controlled properties.

With that, Mr. Waxman.

Mr. WAXMAN. Thank you, Mr. Chairman.

While we have an obligation to scrutinize HUD, we also have an obligation to bring balance and fairness to our scrutiny. Unfortunately, that's not always the case, as is clear, I think, by the video you just showed us. Paul Harvey used to say, and now here's the rest of the case.

What bothers me about this broadcast we just saw is that the filthy, run-down house NBC featured as exhibit A against HUD isn't even a HUD property. HUD had no responsibility for maintaining that house, and they shouldn't be blamed for its condition.

The chairman just acknowledged the fact that NBC doesn't dispute this. They even ran a retraction on March 19th, making it clear that this dilapidated property is not in HUD's inventory. You say, well, that was only one of the houses in that video. That was the house that this story was all about. And it wasn't even a HUD building.

I'm also bothered by the story's emphasis on a 1998 GAO report that ignores a more comprehensive evaluation by Arthur Andersen Consulting that reaches a markedly different conclusion. I'm bothered by the misleading and inaccurate allegation that HUD is losing $1 million a day. I noticed that the chairman is even using that statistic as fact.

But as we'll see by the end of this hearing, HUD isn't losing $365 million a year on the FHA program. Instead, the FHA program is actually responsible for a net gain of $1.5 billion in 1998, and is projecting a net gain of over $2 billion in 1999. There's no evidence of any demonstrable waste, fraud or abuse in the program.

Indignation must never be a substitute for fact. I'm sure if NBC were a bit more careful, it could have found an actual HUD property in abysmal condition. They do exist. But I suspect they are exceptions.

While it's probably inevitable that some problems will arise in a small number of HUD's 40,000 properties, our goal must be to continue to have every property in the best condition possible.

The chairman said HUD was trying to intimidate NBC before they ran this broadcast. I don't know anything about that. Maybe HUD was trying to tell NBC that they were featuring a house that wasn't even under HUD's control.

Mr. Chairman, ensuring that all Americans have access to safe housing is one of our Nation's highest priorities. So I welcome this opportunity today to evaluate HUD's performance. The scandals and mismanagement that has plagued HUD in the 1980's has recently given way to a new approach and a strong commitment to improve Government service.

GAO, which has been critical of HUD in the past, has recognized these reforms, and recently noted that "HUD continues to make credible progress in overhauling its operations to correct its management deficiencies." While further improvements are still needed, I want to commend Secretary Cuomo for the significant accomplishments he and the Department have already achieved.

I think he's a nice guy, too, as the chairman pointed out. But that has nothing to do with anything. If he's doing the job he's supposed to do, he should be commended. If he's doing things he shouldn't be doing, he should be corrected. But simply to use a hearing to beat up on HUD, without substantial evidence to back it up, is not a responsible oversight.

We have to scrutinize HUD. We also have an obligation to bring balance and fairness to our scrutiny. The FHA program is a lifeline for home ownership to thousands of families across our country. Over 75 percent of first-time homeowners have FHA approved mortgages. FHA insures more mortgages for African-Americans and Hispanics than any other insurer. And 93 percent of FHA mortgages have no problems, and do not result in default.

Now, that's a significant figure, because 93 percent of the loans are fine, but 7 percent do end up in default. That's higher than other lenders who have a lower rate of default. But the loans of FHA are to people who wouldn't be able to otherwise get these loans to buy a home. That's why the Federal Government established the FHA program.

I look forward to today's testimony and our testimony that we're going to receive. But I was taken by surprise when the chairman talked about, why are we having more homes foreclosed when our economy is doing so well.

Well, in 1993, there were 918,700 bankruptcy cases in the United States. In 1997, we had 1,317,000 bankruptcies in the United States. Our economy is doing very well for most people, we're all grateful for that fact. But we are seeing many of our people not holding up well under these circumstances, and we see more and more people going into bankruptcy as a result. Not all of the bankruptcy cases involve HUD, but they are an illustration of the fact that some people cannot sustain themselves, some people do go into default on their loans. And some of those loans are HUD loans, some are not. And when they are HUD loans, the properties are to be maintained properly, and we want to make sure HUD is doing their job.

I thank you, Mr. Chairman, for this opportunity to make this opening statement, and I yield back the balance of my time.

Mr. BURTON. Mr. Gilman.

Mr. GILMAN. Thank you, Mr. Chairman.

I want to commend Chairman Burton for moving forward with today's hearing. I think it's important for this committee to examine any waste, fraud or abuse, wherever it may be. It's important that we in the Congress, and more specifically, those of us on the Government Reform Committee, hold our Federal agencies accountable for the funds we provide to them.

As the chairman mentioned, HUD has been on GAO's high risk list of Federal programs that are vulnerable to waste, fraud and abuse since 1994, which has cost our budget millions of dollars a day. I find that more appalling when we consider that today, I'll be meeting later on with housing authority directors from my own congressional district who undoubtedly will be asking for increased funding for Section 8 funding in the appropriation process.

While I have and will continue to insist on adequate availability of Federal housing vouchers and subsidies to those who are in need for such housing, I want to make certain HUD is not wasting these funds that we in the Congress have appropriated.

So again, Mr. Chairman, I want to thank you for bringing this issue to the attention of the Congress. I'd be pleased to yield to the gentleman.

Mr. BURTON. Let me just say that although the piece that we just saw did have a piece of property that was not technically under the control of HUD, I have been in HUD projects myself, personally. I have walked through some of them. The stench was terrible. And it wasn't that long ago that I was going through those.

As a matter of fact, I want to cite one multi-housing project in Indianapolis that was built, this was several years ago, called Rivers Point. There were two high rise buildings. They were so poorly managed by HUD and so poorly watched that they were completely destroyed. The elevators didn't work, this was within 4 or 5 years after their construction.

People had defecated in the bathtubs, there were rats, it was just an absolute disaster.

They sold those for about a nickel on the dollar, or 10 cents on the dollar to a private contractor. He went in and cleaned them up, fixed them up, and now they are high rise apartments, some are even luxury apartments.

That's just tragic, the billions of dollars that are wasted, the millions of dollars that were wasted on that one project.

Now people can say, well, this isn't the case, this one piece of property is not really, it's the exception rather than the rule. I want to tell you, I've been through these houses. I was in the real estate business. That was my business, I was a realtor before I came to Congress. My brother still is a realtor.

We have been through these houses, a lot of them, in Indianapolis, one of the cities that was mentioned. And I want to tell you, there's a lot of improvement that can be made and HUD needs to do it.

I thank the gentleman for yielding.

Do any other Members wish to be heard? The gentlelady from Hawaii.

Mrs. MINK. Thank you, Mr. Chairman.

I yield to the ranking minority member.

Mr. WAXMAN. Thank you for yielding. I'm sort of taken aback by the chairman's statement of his own personal experience. I don't doubt that he experienced what he claimed. But public housing is different than houses that were under discussion where there's a loan to a purchaser for a single family dwelling. A lot of these multi-family residences are public housing, sometimes run by the local people with some Federal dollars, sometimes they are run by private owners who have received help from tenants that have Section 8 vouchers.

So I think we ought to be indignant whenever we see any abuse or fraud. But because we see some abuse or fraud doesn't mean that everything is abused and fraud is the norm rather than the exception.

I point out the high number of bankruptcies, I just want to say that I pulled off the Web this statistic, more Americans filed for bankruptcy in 1998 than ever before. That's pretty startling, when we recognize we've had such a good economy for most people. But for a lot of people, it wasn't a very good economy and they weren't able to hold onto their homes, weren't able to pay their bills, had to go into bankruptcy as a consequence.

I thank you for yielding, and I just raise this doubt in my own mind whether we're not comparing apples and oranges, and whether HUD had the responsibility for the public housing the chairman walked into or whether they didn't. Let's hear from the witnesses and maybe we'll be able to sort through these different claims as we go through a scrutiny, which is appropriate for our committee, and I commend the chairman for calling an oversight hearing, so that we can look into the HUD activities.

Mr. BURTON. Our first panel will be Ms. Nancy Cooper. Excuse me, did you wish to speak? The gentlelady is recognized for 5 minutes.

Mrs. BIGGERT. Mr. Chairman, I would like to enter a statement into the record.

[The prepared statement of Hon. Judy Biggert follows:]

Statement of Representative Judy Biggert
Government Reform Committee Hearing
"HUD Losing $1 Million Per Day – Promised 'Reforms' Slow in Coming"
March 23, 1999

Thank you Mr. Chairman. I am very pleased to participate in today's hearing about the need for reforms at the Department of Housing and Urban Development (HUD). Since 1965, HUD has been the governmental department charged with helping our nation's communities meet their development needs; rehabilitating and providing low-cost housing for the poor; and enforcing our Fair Housing Laws. HUD is charged with an important mission – to help every American find a safe home.

We are here today because serious deficiencies in management at HUD cripple the effectiveness of the HUD mission. Indeed, in 1994 the General Accounting Agency (GAO) named HUD a department at "High-Risk." HUD is the only federal department on the "High-Risk" list, GAO's catalogue of the federal agencies, departments and programs at most risk of wasting taxpayer dollars.

Since 1997 HUD has made significant improvements in management -- departmental leadership made reform a priority. While I am pleased to see this progress, continued Congressional oversight is necessary to ensure that HUD continues to move forward. Today's testimony will focus on FHA's Single Family Housing -- Real Estate Owned Program. I am interested to hear our witnesses discuss the 41,000 properties in the inventory of this program. I would like to hear their perspective as to how HUD and Congress can ensure the success of the Real Estate Owned program. Thank you again to our witnesses for being here, and to the Chairman for his leadership on this issue.

Mr. BURTON. Would you yield to me for just one moment?

Let me just say in response to my colleague, before we have our first panel, real estate was my business. Single family dwellings were part of my business. I know of what I am speaking. I know who was financing them and who was controlling the properties that I went into. There's no question about it.

So I just want to make sure the gentleman from California understands that I know these were properties managed by HUD that were FHA financed that weren't properly taken care of. There's just no question about it.

Mr. WAXMAN. When was that, Mr. Chairman?

Mr. BURTON. I went out with my brother in Indianapolis probably 6 months ago. My brother is still a realtor, and vice president of a company in Indianapolis.

[The prepared statements of Hon. Helen Chenoweth and Hon. Bernard Sanders follow:]

Statement of Representative Helen Chenoweth
Committee on Government Reform
Regarding HUD Reforms
March 23, 1999

Thank you, Mr. Chairman. I am pleased that these hearings are taking place today. Quite frankly, Mr. Chairman, I have some concerns that the HUD reforms which are intended to save taxpayer money, might result in the opposite in my district.

First, the changeover from Real Estate Asset Management contractors to the so-called "M&Ms" could mean a loss of business and employment in my district. Our local REAM contractor -- a company by the name of Deanco -- has worked for HUD for five years. Bob and Jeanie Dean take pride in their work, cleaning up houses, making fundamental structural and cosmetic repairs, and preparing these homes to be resold. With the consolidation of single-family housing operations into the four Home Ownership Centers, a contractor from Atlanta, Georgia will conduct all future HUD property management in Idaho and this family-owned local business might go under.

I am concerned that HUD's new management system not only could threaten local businesses, Mr. Chairman, but that it could also undermine local property values and waste federal taxpayer dollars.

The new management program attempts to solve the delay problems by eliminating the refurbishment process and reselling default homes in their existing condition. Many times families who default on HUD loans do so because they are short on cash and may have been for quite some time. These families most likely have not been able to afford home maintenance or regular repairs. By the time HUD repossess the home, the damage may be extensive. By reselling the home in this condition, HUD will force American taxpayers to take a loss on the property. Not only that, but families who must purchase the lower-cost homes are again unlikely to be able to invest in repairs or enhancements. This could seriously impact neighborhood property values. The net result is that HUD is peddling garbage homes at taxpayer expense and creating slum neighborhoods. Is that consistent with the Agency's desire to produce affordable, quality housing for families?

Mr. Chairman, there are clearly management concerns within the Housing Administration. Losing $1 million dollars per day due to poor management is clearly a problem. But this is not the solution. By not refurbishing these homes before they are resold this government is being irresponsible and lazy. We are attempting to fix management problems by defaulting on our responsibility to maintain homes in our ownership -- the very definition of a slum-lord.

I hope that today we will have some answers to these concerns. I hope to have some information I can bring home to the people of Idaho -- in particular to Bob and Jeanie Dean -- that will help them understand why their government is persisting in this course of action.

BERNARD SANDERS
MEMBER OF CONGRESS
VERMONT, AT LARGE

2202 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–4501
TELEPHONE: (202) 225–4115
FAX: (202) 225–6790
E-MAIL: Bernie@mail.house.gov

1 CHURCH STREET, SECOND FLOOR
BURLINGTON, VT 05401–4417
TELEPHONE: (802) 862–0697
TOLL FREE: (800) 339–9834
FAX: (802) 860–6370

Congress of the United States
House of Representatives
Washington, DC 20515–4501

COMMITTEE ON BANKING AND FINANCIAL SERVICES
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DOMESTIC AND INTERNATIONAL MONETARY POLICY

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
SUBCOMMITTEES:
NATIONAL ECONOMIC GROWTH, NATURAL RESOURCES, AND REGULATORY AFFAIRS
HUMAN RESOURCES
CO-CHAIR: PROGRESSIVE CAUCUS

TESTIMONY OF CONGRESSMAN BERNIE SANDERS (I-VT)
GOVERNMENT REFORM COMMITTEE HEARING ON THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
MARCH 23, 1999

I am glad that the Government Reform Committee is looking into a number of problems with the administration of several programs at the Department of Housing and Urban Development (HUD). I specifically would like to raise my serious concerns today about HUD's performance regarding the disposition of HUD-acquired single family properties. I am also concerned with the direction HUD is taking in order to remedy what is undeniably a bad situation.

On June 29, 1998, I submitted written comments to the Rules Docket Clerk of HUD's Office of General Counsel regarding the May 29, 1998 Proposed Rule on the disposition of HUD-acquired single family properties (Docket No. FR-4244-P-02, RIN 2502-AG96). On November 12, 1998, I reiterated those concerns in a letter to Morris "Bud" Carter, Director of the Philadelphia Homeownership Center, and proposed an alternative for the disposition of HUD's real estate-owned (REO) properties in my state of Vermont. It was with a certain amount of disappointment that I learned that HUD released a Final Rule on February 9, 1999, and has already awarded a contract for the sale of REO properties - a contract that covers six New England states, including Vermont.

Clearly, I appreciate HUD's efforts to identify and implement a more timely and cost effective method to dispose of its REO inventory. The longer REO properties remain in HUD's inventory, the more HUD's holding costs increase, the longer the properties remain unavailable as home ownership opportunities for potential purchasers, and the longer communities have to endure the destabilizing effects of vacant, and many times unsafe, properties.

I also recognize that in order to keep the costs of federal mortgage insurance low, we must minimize losses to, and ensure the stability of, the Federal Housing Administration's Mortgage Insurance Fund (MIF). However, I am concerned that privatizing the REO process may compromise long-term goals of providing affordable home ownership opportunities in favor of short-term fiscal concerns.

Specifically, I am concerned that HUD's new "REO acquisition method" does not adequately address, or have provisions to ensure, the affordability of the REO properties once they are sold. Nor, for that matter, do I see provisions to ensure that the properties will remain owner-occupied after they are sold.

As a matter of federal housing policy, we recognize that home ownership -- the ultimate symbol of the "America Dream" -- remains out of reach for many ordinary Americans. More and more, even two-income working families find that they can not afford to purchase a home in today's market. Yet, buying a home is the most important step on the road to economic independence for most Americans. When families buy a home, not only do they stabilize their housing expenses, but they also begin building an asset that can be used to finance a college education, start a business, or be passed on to their children.

That is why the Federal government has long encouraged home ownership through a variety of mechanisms, including FHA-insured mortgages. Clearly, it is unfortunate that some families with FHA-insured mortgages can't meet their obligations, and end up in foreclosure.

To my mind, the American people have already indirectly invested in these REO properties through mortgage subsidies and guarantees. I believe it is important to protect that investment, just as I think it is esstential to stabilize excessive losses to the MIF. However, I find it quite troubling that with the "REO acquisition method" HUD appears to be promoting a profit-driven property disposal strategy that to my mind can only adversely effect the affordability of the housing.

I believe that whenever possible, these properties should be used to provide affordable home ownership opportunities for additional American families. This can be efficiently accomplished through the direct sale method to housing development non-profits. By utilizing the direct sale method, not only is HUD's mission of providing home ownership opportunities for American families furthered, but those opportunities will be provided for low- and moderate-income families.

The use of direct sales to non-profits in HUD-designated revitalization areas makes particular sense. They are the areas of greatest need for affordable housing, and home ownership efforts in those areas are an important tool in reclaiming abandoned and distressed properties and in stabilizing and revitalizing neighborhoods. However, I can not stress enough that there is a demonstrated need for affordable homeownership opportunities in virtually all communities of our nation. In my state of Vermont that is certainly the case.

I commend HUD for recognizing that many non-profits have come to depend on HUD-acquired properties as a resource for their housing programs, and for stating that the Department is committed to continuing its partnership with those groups. Similarly, I am pleased that the Rule provides HUD with the discretion to use other methods of sale, on a case-by-case basis or as a regular course of its business, as defined in 24 CFR §291.90. However, I am concerned that now that the "REO acquisition method" is available to HUD, it may be utilized to the detriment of other sales methods, and to the detriment of the larger goal of providing *affordable* housing. Accordingly, I urge HUD to act aggressively to follow through on its commitment to make available a portion of the properties acquired to nonprofit organizations.

In summary, while I agree that moving REO properties out of HUD's inventory quickly and efficiently is a crucially needed reform, I am very concerned with HUD's admission that the implementation of the "REO acquisition method" will result in fewer properties available for direct sales to nonprofit organizations and municipal government. It seems to me that in order to achieve one important and fundamental agency goal (ensuring the stability of the MIF), HUD may be turning its back on another (providing affordable home ownership opportunities). To my mind, this would be the wrong solution to a very real problem.

In Vermont, my staff has been working with the local HUD office, the City of Burlington, and the Burlington Community Land Trust (BCLT) to deal with REOs in a very different manner. Last June, the local kick-off of National Homeownership Week was at the site of a REO property in Burlington. I was very pleased to participate in that event, and to meet the home buyer on the back porch of her new home - a HUD-owned property that had stood vacant and boarded up, deteriorating, for three years. Working with HUD, the BCLT was able to rehabilitate the now blighted property, and put it back into the affordable housing portfolio. All HUD had to do was commit to selling the property to the BCLT in a timely manner and at a discount.

Since June, HUD has sold to the BCLT several other discounted REO properties just weeks after they became available, including three in the in the heart of Burlington's HUD-designated Enterprise Community. By partnering with the BCLT, these HUD REO properties are now providing additional affordable homeownership opportunities for low- and moderate-income Vermonters. Since these properties are now in a housing land trust, they will remain affordable in perpetuity. And because the process has been quick and efficient, HUD is avoiding the carrying charges it normally would have incurred.

This is the kind of model I would like to see regarding the disposition of HUD-foreclosed properties. But I'm afraid what is esstentially the privatization of the REO disposal process may bring this arrangement to a halt. Accordingly, I would like to know if:

- Under the February 9, 1999 Rule, does HUD intend to continue to offer REO properties to housing development non-profits and municipal governments before the properties are put on the open market?
- If so, will this be limited to HUD-designated revitalization areas?
- Who will make the determination as to which how many properties, and which properties may be offered?
- How will the purchase price be determined?
- When does HUD intend to issue a Rule implementing Section 602 of the FY 1999 VA-HUD Appropriations Act that mandates the Secretary to provide a preference in the sale of HUD acquired single family homes to non-profit organizations and municipal governments?

Mr. BURTON. We will now bring forward Ms. Nancy Cooper.

[Witness sworn.]

Mr. BURTON. Ms. Cooper is the District Inspector General for Audit in HUD's Office of Inspector General. Her office is responsible for ongoing work in the field regarding FHA's single family program. She will testify regarding the current status of the single family property disposition program.

She is up here today from Atlanta and we welcome her and thank her for her responsiveness under the heavy time constraints the committee has put her team under.

Ms. Cooper.

STATEMENT OF NANCY H. COOPER, DISTRICT INSPECTOR GENERAL, SOUTHEAST/CARIBBEAN DISTRICT, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Ms. COOPER. Good afternoon. Mr. Chairman and members of the committee, my name is Nancy Cooper. I'm District Inspector General for the Southeast/Caribbean District in the Department of Housing and Urban Development. With me are members of my district team, Mike Gill and Jerry Kirkland. I thank you for inviting us.

I'm speaking today about our ongoing audit of HUD's single family property management and disposition program, known as the real estate owned, or REO operation.

When we began our work late last year, HUD was well into its HUD 2020 reform and had reduced its single family staff by over 50 percent. Plans to pipeline or privatize management and marketing of properties had not materialized.

Our objective was to see what impact this was having on HUD's performance. We were concerned that poor property conditions and management inefficiencies reported by GAO in March 1998 might still exist and if there existed an increased risk of fraud.

Our results show that conditions overall have not improved since GAO's report. Our findings mirror those of KPMG in its audit report issued just this month on FHA's financial statements. Simply put, HUD has not fulfilled its core mission. Here's why.

HUD's ability to turn over its acquired properties declined. Inventory increased 70 percent over the last 2½ years to over 42,000 properties, and homes held in inventory over 6 months increased 76 percent.

Sales to homeowners went down, while sales to investors rose. HUD's ability to maximize returns to the mortgage insurance fund also declined. Average loss per property increased from $28,000 in fiscal year 1996 to over $31,000 in fiscal year 1998.

The care of HUD properties is essential to protect the neighborhoods around them. Yet our own property inspection confirms what contract inspectors have been reporting to HUD, that the rate of non-compliance by the companies hired to manage our properties is unacceptable. At the committee's request, we brought a few pictures of our current inventory.

This is a property in Rockford, IL, acquired in May 1998. It lists for $17,001, or $900 less than it was appraised. HUD's cost to date is $28,600, including $2,300 paid to maintain it. The inspector who took this picture last December also reported the kitchen and bathroom were filthy. Records show the asset manager visited regularly.

Next is a photo of the front of a property in Miami, acquired in November 1997. We took this picture a week ago. The back of the property is overgrown and littered with debris inside and out. In January, HUD inspectors reported significant vandalism. The asset manager did not visit regularly.

HUD's cost is $79,690, a loss already over $45,000 based on list price.

Next is the condition of a property in Los Angeles in September 1998. Our inspection showed debris outside and neglect by the asset manager. Here's the same property in mid-March 1999. The property continues to be neglected, with the lawn obviously not mowed for some time.

These final photos are of another property in Los Angeles taken in September 1998. The roof is leaking and the asset manager was under contract to fix it. We took a picture of the ceiling again just a week ago. The roof wasn't repaired, and the ceiling has fallen in. Now it will be much more expensive or more likely the list price will have to be lowered.

It would be unfair to criticize HUD's field staff for these conditions. Last October, we observed the Santa Ana staff barely keeping its head above water. The staff of 18 was expected to manage a portfolio of 16,000 properties.

Around the country, workloads were shifted among offices when suddenly, no REO staff remained. Problems were so severe in Chicago, Birmingham, Jacksonville and Coral Gables that emergency contracts were let to handle many of the duties. These circumstances nearly paralyzed the monitoring efforts.

Next month, HUD faces still more new challenges. Current operations will be replaced by 16 management and marketing contracts nationwide. These companies will handle nearly every aspect of HUD's multi-billion dollar real estate portfolio at a 5-year estimated cost of $900 million.

I'd like to make one last point, important to the Department's future plans. Our preliminary data indicates HUD has not been effective or swift in dealing with non-performing contractors. We've seen no monetary sanctions, few contracts terminated, and no contingency plans when contractors fail. It is essential that HUD have a strong contract enforcement strategy if it expects to be successful in these future endeavors.

That concludes my opening remarks. Thank you.

[The prepared statement of Ms. Cooper follows:]

STATEMENT OF
NANCY H. COOPER, DISTRICT INSPECTOR GENERAL
SOUTHEAST/CARIBBEAN DISTRICT
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Tuesday March 23, 1999
BEFORE THE GOVERNMENT REFORM COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

PRELIMINARY RESULTS OF THE AUDIT OF HUD'S PROPERTY MANAGEMENT AND DISPOSITION ACTIVITIES

Chairman Burton, Ranking Member Waxman, and other members of the Government Reform Committee, I appreciate the opportunity to appear before you today to discuss the status of HUD's Single Family Property Management and Disposition Activities. Your interest is in the preliminary results of our ongoing nationwide audit and HUD's ability – while in transition to the new management and marketing service contracts – to monitor and oversee current property disposition activities. You also requested current statistical data on various aspects of HUD's operations.

Late last year, my staff began an audit of HUD's management of its single family property inventory, referred to in HUD as Real Estate Owned (REO). At that time, HUD was well into its HUD 2020 Management Reform Plan. HUD had reduced its single family staff by over 50 percent and its plans to privatize the management and marketing of its properties had not materialized. Our audit objective was to see what impact HUD 2020 organizational and staffing changes were having on HUD's mission and performance goals. We were concerned that the poor property conditions and management inefficiencies reported by the General Accounting Office (GAO) in March 1998 might still exist. We were also concerned that circumstances created by staff reductions increased the risk of program fraud.

Before I start, let me reiterate that we have not completed our audit, especially with respect to the future of HUD's REO operations. As of March 29, 1999, the current REO operation will dramatically change. It will be replaced by 16 management and marketing contracts nationwide. These contractors will handle nearly every aspect of HUD's multi-billion dollar REO program. The 5 year estimated cost for contractors to manage this portfolio is about $900 million. What I will discuss today is our preliminary assessment of HUD's REO operations from January 1, 1997 to date. Our preliminary results show that conditions have not changed since the GAO review. In fact, conditions today may be worse. Today, I cannot speak about the new contracts or predict their success. However, our final audit report will address these issues.

Background on Real Estate Asset Management and HUD 2020 Plan

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 lender, or surrendered to the lenders through foreclosure. When lenders obtain these properties, they generally convey them to HUD in exchange for payment of insurance claims. HUD also takes possession of abandoned properties secured by HUD-held mortgages and protects and maintains these properties, referred to as "custodial" properties, pending acquisition of title.

In March 1997, HUD issued its proposed 2020 Field Consolidation Plan for Single Family Housing. The plan was conceptualized in 1993 and 1994 to consolidate field functions into equal homeownership centers fully functioning for processing and underwriting, asset management, marketing and outreach, and quality assurance. The plan stated that these Homeownership Centers would be fully operational by October 1998, including outsourcing REO activities and selling nearly all assigned notes. It was never intended that Homeownership Centers would handle the full range of loan management and property management and disposition functions they are currently handling. HUD anticipated that it would need about 70 field employees for REO management and oversight by the year 2000.

HUD's consolidation of REO functions has not progressed as planned. There are currently about 300 REO field staff working under the following structure:

- Four Homeownership Centers located in Philadelphia, Atlanta, Denver, and Santa Ana
- 73 HUD field offices offering varying degrees of staff and support
- Over 300 real estate asset management (REAM) contractors responsible for securing, maintaining and preparing properties for sale
- Three pilot Management and Marketing contracts (all to Golden Feather Realty, Inc.)

- Four emergency Management and Marketing contracts in Birmingham, Jacksonville, Coral Gables, and Chicago

- Property inspection contracts to facilitate HUD's monitoring needs

Our audit has focused on performance of HUD and its contractors, record keeping and reporting, and condition of HUD held properties. We have visited the Homeownership Centers in Atlanta, Denver and Santa Ana. We have also performed work in HUD's Chicago, New Orleans, and Coral Gables field offices. We plan to visit the Philadelphia Homeownership Center and return to Santa Ana. To date, we have inspected 37 homes, reviewed over 1,600 inspection reports, and evaluated 8 asset management contractors.

Preliminary results indicate overall conditions have not improved since GAO's report in March 1998. HUD's own statistics indicate, and our audit confirms, that some areas have worsened. Although results are preliminary, they mirror the recent Independent Auditor's report by KPMG issued on March 12, 1999. KPMG performed an audit of FHA's Financial Statements for Fiscal Year 1998.

REO Mission

HUD's REO mission is to reduce the inventory of acquired properties in a manner that:

- expands homeownership
- strengthens neighborhoods and communities
- ensures maximum return to the mortgage insurance fund.

...to reduce the inventory of acquired properties

Chart 1 shows HUD's inventory over the last 2 ½ years. Despite HUD's intentions, the property inventory has increased 70 percent from about 24,700 properties on October 1, 1996, to over 42,000 on February 28, 1999. An unusual increase in defaults and claims could be a contributing factor. If so, HUD was unprepared to handle it.

Chart 1

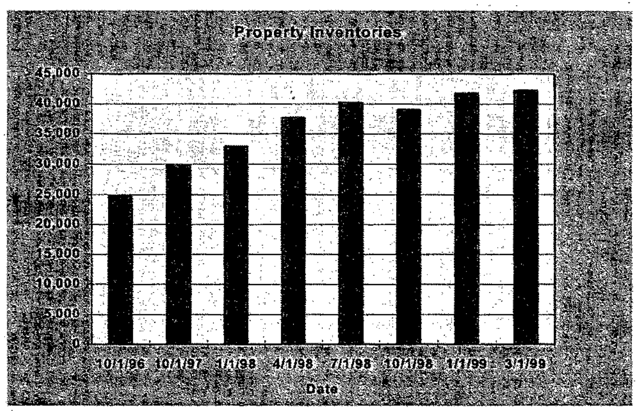
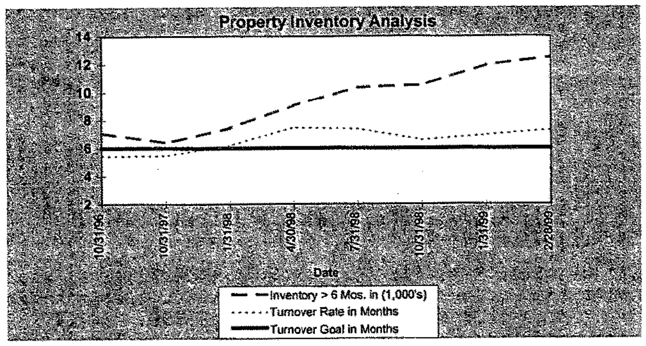


Chart 2 shows the turnover of properties in HUD's inventory. HUD strives to sell properties within 6 months after acquisition. HUD monitors its success by determining its property turnover rate and determining the number of properties that have been in inventory over 6 months. HUD's turnover is increasing and its inventory is aging. During the same period from October 1996 through February 1999, the turnover rate has increased 32 percent from over 5 months to over 7 months. Similarly, the inventory of properties over 6 months old has increased 76 percent from 7,100 properties to 12,500 properties.

Chart 2



...expands homeownership

HUD could do a better job in meeting its mission of expanding homeownership through the REO program. The percentage of property sales to homeowners has declined from 73 percent in October 1996 to 57 percent in February 1999. In contrast, sales to investors increased from 21 percent to 33 percent for the same period.

...strengthens neighborhoods and communities

We performed 37 property inspections which revealed extensive non-compliance by the contractors HUD hired to manage these properties.

Debris outside or inside - 53 percent
Property not secure - 27 percent
Defective paint outside or inside - 50 percent
Water damage - 23 percent
Vandalism - 31 percent
No HUD sign - 61 percent
No regular inspections - 39 percent

We identified one or more deficiencies at all 37 properties we inspected. Our review of 1614[1] inspections performed by contract inspectors within the last year noted many deficiencies:

Debris outside - 14 percent
Debris inside - 22 percent
Property not secure - 15 percent
Defective paint outside or inside - 11 percent
Water damage - 7 percent
Vandalism - 19 percent
No HUD sign - 7 percent
No regular inspections - 18 percent

We have photographs of several properties in HUD's current inventory. As requested, we have supplied these photographs separately for the record. Our inspections and review of inspection reports confirm that these examples are not isolated cases:

This property located in Rockford, Illinois (Photo 1) was acquired in May 1998. It was appraised for $18,000 and currently lists for $17,100. HUD's costs to date total about $28,000 including $25,800 paid to the mortgagee for its insurance claim, $2,300 paid to the maintenance contractor, and $500 for miscellaneous expenses. This picture was taken in December 1998 by a contract inspector. In addition to the damage shown here, he reported the kitchen and bathroom were filthy. The report said the maintenance contractor had made regular visits.

The next property (photo 2) shows the front of a property in Miami acquired in November 1997. We took this picture a week ago.

The back of the property (photo 3) is overgrown and littered with debris. A HUD inspection conducted in January 1999 showed that there was debris inside and out and significant vandalism. The inspector reported that the maintenance contractor did not make regular inspections. It was appraised in February 1999 at $34,200, as is, and is listed for sale at that price. HUD's cost to date is $79,690.

Next is property we inspected in Los Angeles, California in September 1998 (photo 4). Our inspection showed neglect by the maintenance contractor including debris outside.

[1] Our review of 1614 inspection reports was not selected statistically and therefore, may not be representative of HUD's property inventory as a whole.

This is the same property on March 13, 1999 (photo 5). The property continues to be neglected; the lawn has not been mowed for some time.

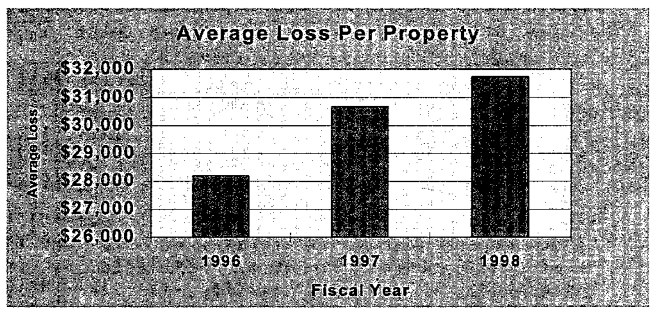
This is a view of a property (photo 6) in Los Angeles, California taken in September 1998. The roof is obviously leaking, and the REAM was under contract to fix it.

We took a picture (photo 7) of the ceiling again on March 13, 1999. The roof was not repaired and the ceiling has fallen in; now a much more expensive repair.

...ensures a maximum return to the mortgage insurance fund.

HUD did not meet its mission of ensuring a maximum return to the mortgage insurance fund. Chart 3 shows that HUD's average loss per property, based on acquisition costs (income from sales less all related expenses), increased from $28,202 in fiscal year 1996 to $31,728 in fiscal year 1998. As a result, the loss to the mortgage insurance fund increased from $1.5 billion in fiscal year 1996 to slightly over $2 billion in fiscal year 1998.

Chart 3



Staff Monitoring and Oversight

It is our opinion that HUD field staff have done all they could do to keep up. Last October, we observed a Santa Ana staff that were barely keeping their heads above water. There was a staff of 18, with plans to be fully staffed at only 22, to manage a portfolio of about 16,000 properties. They were given a yearly sales goal which computed to 1,145 sales per employee. Their workload per staff was twice that of other Homeownership Centers. The former REO Director who left after 31 years of service in HUD told us the staff reductions were having major negative impacts on REO's mission. He considered the situation unmanageable. Since our visit, Santa Ana has gotten some relief. We plan to visit them again.

Staff problems were so severe in Chicago, Birmingham, Jacksonville, and Coral Gables, that emergency Management and Marketing contracts were let for contractors to handle many of the normal field office staff duties. In Birmingham and Atlanta, REAM monitoring contractors were hired to perform property inspections. Workloads were shifted among offices because certain offices had no REO staff. Because of staff shortages, inexperienced staff, increased workload, limited travel funds, and ineffective compliance enforcement, HUD's monitoring has not been effective.

Timely reviews of property management contractors were not performed even when they were considered "high risk." For example:

> The Coral Gables Field Office reviewed a contractor on November 21, 1996, and rated it "low risk" meaning HUD should plan another review in 6 months. However, HUD did not review this REAM contractor again until June 16, 1998, 13 months later than required. This time, the contractor was rated "high risk." A high risk designation required HUD to perform monthly reviews. In this case, however, HUD did not visit the contractor again until December 1998, 5 months late. The contractor was again rated as high risk. As of last week, HUD had not been back to monitor the contractor. One of the properties in our photos were under contract with this company.
>
> The Coral Gables Field Office reviewed another REAM in October 1996 giving it a low risk rating. The next review was performed 21 months later in July 1998. This time, the REAM contractor was rated high risk. As of March 15, 1999, 9 months later, HUD had performed no other reviews of this contractor.

Affirmative enforcement actions, such as assessing monetary penalties or terminating contracts, were not taken even when deficient contractor performance was found. Let me focus briefly on this last point because it affects the future plans in the Department. Preliminary information indicates that HUD has not had an effective or swift enforcement procedure in place to deal with non-performing contractors. Effective enforcement becomes even more critical in HUD's future plans to contract out even more of its operations.

* * * *

We plan to complete our work and issue our audit report in July 1999. We will evaluate the adequacy of HUD's management controls in recently awarded Marketing and Management contracts, and HUD's newly published procedures to monitor contractors. We expect to focus recommendations on the adequacy of management controls to (1) track performance (2) see that mission goals are met, (3) enforce contract compliance, and (4) assess monetary penalties for contract non-compliance.

Mr. BURTON. Thank you, Ms. Cooper.

Right now, what kinds of penalties are imposed on these contractors if they don't comply with their contractual obligation?

Ms. COOPER. We see none.

Mr. BURTON. Are there any regulations over at HUD that would impose any kind of financial penalties on them if they don't do their job properly? Do you know?

Ms. COOPER. I do not know. I do know there are provisions within the contract that allows HUD to go against them to terminate the contract, for example. We've not seen them doing much of that, either.

What normally happens is that HUD will send a warning letter to an asset manager saying, we've inspected your property, three of your properties, you're not keeping them up. Please tell us what you'll do to correct these problems. Generally, the asset manager will write back, show evidence of having corrected those conditions in those properties, and that will be the last of it.

Mr. BURTON. The employees of HUD that oversee the contractors, do they go out and spot check to make sure the contractors are doing their job?

Ms. COOPER. They do, yes. They're doing less and less of it, but they do.

Mr. BURTON. If they're doing less and less of it, how do they know if the contractor is performing properly?

Ms. COOPER. They have contracts right now for inspectors to oversee the asset managers.

Mr. BURTON. So they have separate contractors for inspectors, private inspectors to go out and spot check properties to see that they're being taken care of properly by the contractors?

Ms. COOPER. That's correct. This is what HUD used to do. HUD no longer has the staff to do it, so they've hired companies to do it.

Mr. BURTON. They're contracting.

Ms. COOPER. Right.

Mr. BURTON. In some of the statements I've seen, you had a contractor that not only did the inspection but also did the billing, the oversight and the collection, and was never even reviewed by anybody, independent contractor or staff member at HUD. Is this an unusual situation?

Ms. COOPER. I believe it is unusual. I believe this was a situation involving one of the emergency contracts. I can check if you'll allow me.

Mr. BURTON. I wish you would check and let me know.

Ms. COOPER. One of the individual asset management companies was allowed to do this, but this was an unusual situation, and we're not sure why in this case.

Mr. BURTON. The new contractual agreements, the new contracts that are going to be let by HUD, I guess there are going to be six contractors nationwide, is that correct?

Ms. COOPER. I'm not sure of the number. There are 16 contracts, but something less.

Mr. BURTON. My staff says there are going to be six contracts. The policing is going to be done, I guess, by independent contractors as well who are going to go out and double check and make sure the contractors are doing their job, is that correct?

Ms. COOPER. That's our understanding, yes.

Mr. BURTON. Do the new contractual agreements impose any kind of financial penalties on the contractors if they do not do the job properly?

Ms. COOPER. I can't answer that. As you know, we're in the middle of our audit. That's one of the areas we intend to look at, is how well those contracts are written. Right now, we've not done that field work and I can't talk about it.

Mr. BURTON. What I wish you'd do for me, and we'll leave the record open, if you could send to me and my staff information about those contractual agreements and what they contain, it would be helpful. It seems to me there not only should be a severability clause in there, if they're not doing their job, they lose the contract, No. 1, but No. 2, if they're not doing the job and it's pretty prevalent among the work that they're performing, there ought to be substantial financial penalties imposed against them for not doing the job.

In other words, financial penalties for not doing the job, No. 1, because they're taking the taxpayers' money and they're not doing the job, and they know they're not doing the job, so there ought to be financial penalties, No. 1. Then No. 2, if that doesn't get the job done, the cancellation of the contract in addition to the financial penalties that are imposed against them.

Ms. COOPER. I couldn't agree with you more. We'll check for that information.

Mr. BURTON. See if their contractual agreements do have those stipulations in them.

Ms. COOPER. Certainly.

Mr. BURTON. I yield back the balance of my time to Mr. Waxman.

Mr. WAXMAN. Ms. Cooper, you just said you're in the middle of your audit?

Ms. COOPER. Yes, sir.

Mr. WAXMAN. Why are you testifying now if you haven't completed your audit?

Ms. COOPER. The committee asked me to.

Mr. WAXMAN. It just strikes me it would be more sensible to talk to us about an audit that's completed rather than one that's incomplete.

I want to ask you a couple of questions. Last year in December, the Washington Times reported that the Inspector General warned that HUD was losing $1 million every day by failing to dispose of the vacant properties in its inventory. Chairman Burton evidently agrees with that statement, because he was so alarmed that he named this hearing "HUD Losing $1 Million Per Day, Promised Reforms Slow in Coming." That's a title for a fact-finding hearing. Sounds like a conclusion was reached before we ever heard from any witnesses.

I'm sure you're familiar with that figure. My understanding is that HUD spends $1 million a day in managing its inventory of single family homes. Do you believe it's appropriate for HUD to spend money to manage its inventory?

Ms. COOPER. Sure.

Mr. WAXMAN. And I've read how this $1 million a day figure has been attributed to the Office of Inspector General. How did you arrive at that estimate?

Ms. COOPER. I'll explain it to you. That estimate is based on the cost per day for HUD to manage its portfolio. The cost per day is $29 a day. That number is based on an inventory at the time that that statement was written of 41,000 properties.

The point that we were attempting to make with the statement is that when HUD fails to turn over the properties, if they have 41,000 properties in their inventory, it costs $1 million a day.

Mr. WAXMAN. My understanding was that figure was not just for the 41,000 properties that came through foreclosure, but it represents holding costs for more properties than that. Am I incorrect?

Ms. COOPER. I'm not sure of your question. My understanding is that $29 is the cost to HUD.

Mr. WAXMAN. For each of the 41,000 foreclosed properties?

Ms. COOPER. To manage any piece of property.

Mr. WAXMAN. Any piece of property?

Ms. COOPER. Any piece of property.

Mr. WAXMAN. So it's not a net loss for these properties, it's the cost of maintaining the properties until they are sold. And when the properties are sold, HUD recoups these costs, doesn't it?

Ms. COOPER. Not always, no, sir.

Mr. WAXMAN. Well, not always, but sometimes?

Ms. COOPER. Sure, sometimes it does, yes.

Mr. WAXMAN. It's like saying Coca-Cola loses $1 million a day because they spend $1 million a day for sugar. But you forget about the fact that they turn around and sell Coca-Cola and make a profit on the sale of their product. We all know that we have costs of doing business. If Coca-Cola spends $1 million a day on sugar, it doesn't mean it loses it. We know they make a lot of money.

I have here the yearly financial results of a mutual mortgage insurance fund. That's the pool of money funded by premiums paid by borrowers used to finance the operation and cost of the FHA single family insurance program. We can see from the chart that, it's right over there, to your right, we can see from that chart that all expenses, including the cost of maintaining property, totaled $2.87 billion in 1998.

But we also see that their total receipts including sales of acquired properties, fees and premiums, totaled almost $4.43 billion. That's a net profit. In 1998, this fund actually netted $1.55 billion. I'm sure there are management challenges, but it seems to me we should really be thanking HUD, not only for keeping the opportunity available for middle class people in under-served communities to buy homes, but for writing us a check last year for $1.55 billion. And the net receipts estimate for fiscal year 1999 are even higher, $2.138 billion.

Do you disagree with my statement, when you look at it in that context?

Ms. COOPER. Sir, I don't have any information about that chart that you're looking at, and I didn't do any computation, and my staff didn't do any computation on the fund.

We are looking solely at the cost or profit of the property disposition portion of the HUD portfolio.

Mr. WAXMAN. Well, you're only looking at one part of the equation. You're only looking at the cost, but you're not looking at the rest of the picture. And it's not very helpful for us for you to come up with a figure that's then used to criticize HUD for losing us $1 million a day, when in fact, that figure is an inaccurate figure if you look at the total amount of money that HUD not only spends but generates from their properties.

Ms. COOPER. It's an important figure when HUD no longer is able to turn properties over according to their goal. Their goal is to get properties out of inventory in 6 months.

When that number declines, then it starts costing the taxpayer, it starts costing the fund unnecessarily. That's merely the point we were trying to make.

Mr. WAXMAN. Can you give us the breakdown of the 41,000 foreclosed homes, how many stayed off the market 6 months, how many were sold earlier? Wouldn't that be a more meaningful figure if we're being critical of HUD for not selling its property faster? Not how much it spends during the period of time it has to maintain that property and pay for costs.

Ms. COOPER. Yes, sir, I would agree it would. And in my full testimony, we talk about the inventory of properties over 6 months old increasing 76 percent from 7,100 properties to 12,500 properties. That 12,500 properties is in inventory longer than they should be. That's costing. That's the point we were trying to make.

An efficient operation turns properties over within 6 months. An inefficient one doesn't.

Mr. WAXMAN. I want to concede to you, as you've conceded to us on that million dollar figure, that that is an issue that is of concern. We want to look at that carefully. But obviously in the short time I have, maybe I'll have more opportunity, but others will want to ask questions, we can explore some of these inflammatory statements that seem to be coming out of an audit that isn't even complete, and for which a hearing has already been titled—this is the notice that went to all the press and the Members—HUD Losing $1 Million Per Day, Promised Reforms Slow in Coming.

Mr. BURTON. The gentleman's time has expired.

Mr. WAXMAN. Some fact-finding, some disinterested fact-finding oversight.

Mr. BURTON. Mr. Gilman.

Mr. GILMAN. Thank you, Mr. Chairman.

Just a couple of questions. How many HUD field staff will be in charge of contractor oversight, and how did HUD arrive at the number you have?

Ms. COOPER. The number we've seen is 70. And I'm not certain how HUD arrived at that number.

Mr. GILMAN. Is 70 going to be enough to do the kind of work you need to do?

Ms. COOPER. I can't answer that question. Once we take a look at HUD's new monitoring procedures, we may be in a position to try to predict whether or not that number of staff can do what needs to be done.

We hope to try to do some of that assessment between now and the end of our field work.

Mr. GILMAN. Have you increased the number this year, or is that decreased? What's the situation with regard to the oversight?

Ms. COOPER. With regard to the number of staff?

Mr. GILMAN. Yes.

Ms. COOPER. Let me see, I'll answer and if this isn't the answer to your question, you can ask me again. There are currently about 300 REO staff. The predictions are that with——

Mr. GILMAN. 300 what kind of staff?

Ms. COOPER. Pardon me; 300 HUD staff working on the real estate owned operations.

Mr. GILMAN. OK.

Ms. COOPER. Under these 16 new management marketing contracts, they will pare down that 300 staff to around 70. Those 70 staff will merely be contract monitors. They will monitor those 16 nationwide contracts to ensure they're complying with the terms.

Mr. GILMAN. How did you arrive at the reduction from 300 to 70?

Ms. COOPER. Sir, I didn't arrive at it, you'll have to ask HUD.

Mr. GILMAN. From your oversight perspective, do you think this is a practical reduction? Is this going to affect the ability of the agency to do the oversight?

Ms. COOPER. I wish I could tell you. And maybe I can tell you when we're finished.

It depends on what exactly HUD has in mind for these 70 people to do. HUD may be sure of that. We're not real sure of it yet. We haven't read their documentation.

Keep in mind also that HUD has plans, we understand, to let other contracts, besides just these 16 management and marketing contracts. We understand they still intend to have hired contractors to oversee those contractors. They'll have other contracts besides those 16, to help supplement the staff.

Mr. GILMAN. Has anyone made an analysis if these numbers are sufficient to do the kind of work that should be done?

Ms. COOPER. HUD made the statement that they have made that analysis.

Mr. GILMAN. Have you examined that?

Ms. COOPER. We have not yet.

Mr. GILMAN. Are you planning to do that?

Ms. COOPER. We're going to look at it from the perspective of the real estate owned operation, yes, sir.

Mr. GILMAN. When will you know that?

Ms. COOPER. We're hoping to know that by July. We're hoping to complete our audit and issue the report by July.

Mr. GILMAN. Would you notify this committee of your final audit, as to whether or not these people can provide the kind of oversight that's needed?

Ms. COOPER. Yes, sir, we'll do that.

Mr. GILMAN. Mr. Chairman, I'd like to request that a copy of that report when received be made part of this hearing.

Mr. BURTON. Without objection.

[The information referred to follows:]

U.S. Department of Housing and Urban Development
Office of Inspector General
451 7th St., S.W.
Washington, D.C. 20410
September 21, 1999

Honorable Dan Burton
Chairman
Committee on Government Reform
House of Representatives
Washington, DC 20515-6143

Dear Chairman Burton:

I am pleased to enclose two copies of our audit report on the Federal Housing Administration's (FHA) Single Family Property Disposition Program (99-AT-123-0001, dated September 17, 1999). While we have revised some of the data and analyses since our March 23, 1999, testimony before your Committee, our overall conclusions remain unchanged. The audit report confirms that:

- HUD's reorganization efforts adversely affected staff resources and its ability to adequately monitor the condition of properties and to enforce contractor compliance.
- FHA did not meet its basic program mission of reducing the inventory in a manner that expands homeownership, ensures a maximum return to the mortgage insurance fund, and strengthens neighborhoods and communities. Since FY 1996, property inventory increased, sales to homeowners declined, average losses from sales increased, and property conditions were deplorable.

Our audit confirmed that at March 1999, overall conditions had not significantly improved since the U. S. General Accounting Office's report in March 1998; some areas had worsened. KPMG's 1998 Financial Statement Audit Report, issued on March 12, 1999, had similar findings.

At the time of our testimony before your Committee on March 23, 1999, we stressed that we had not completed our audit of HUD's Single Family Property Management and Disposition Activities. The testimony was based on preliminary audit results and statistical data on various aspects of HUD's operations. Data used in the testimony was obtained primarily from HUD program officials. I would like to take this opportunity to respond to Assistant Secretary Apgar's letters of May 14, 1999, and June 9, 1999, to you in which he alleges false and misleading statements in the March 23, 1999, testimony of District Inspector General, Nancy H. Cooper, before your Committee.

Staffing Levels

FHA's Statement - In his May 14, 1999, letter, Mr. Apgar referred to a detailed list of FHA property disposition staff on board prior to the transition to the new Management and Marketing (M&M) contracts. He said FHA had 417 field staff and had maintained that level until the new M&M contracts were fully implemented. He said our testimony failed to correctly describe staffing levels.

OIG Response - We testified that HUD had about 300 field staff. This was based on information from FHA which showed 336 staff years assigned to the program as of November 17, 1998. Throughout our review, we were given conflicting information about staffing levels. At the time of our testimony, we were unable to obtain from FHA information on how many staff remained in the program. Many staff had obtained new positions in HUD, so we estimated that about 300 staff remained. Subsequently, we were provided documents which showed there were about 420 staff working in the program, including 20 Headquarters staff. We have used this number in our report. It does not, however, change the conclusions we drew in the testimony or in our final report.

Turnover Rate

FHA's Statement - In his May 14, 1999, letter, Mr. Apgar referred to a statement on page four of our testimony which states: "During the same period from October 1996 through February 1999, the turnover rate has increased 32 percent from over 5 months to over 7 months." Mr. Apgar claimed that according to HUD performance data, the average property turnover rate decreased during this period.

OIG Response - Our testimony was based on information obtained from an FHA report and explanations given to us by FHA staff. We subsequently realized that the data and explanations were incorrect. We now agree with Mr. Apgar's statement that the average number of days properties remained in inventory during that period was decreasing. More to the point, however, as our report shows, the average was still outside HUD's goal, and caused unnecessary loss to the insurance fund of $123 million for FY 1997 and 1998.

$2 Billion loss to the Mortgage Insurance Fund

FHA's Statement - In his May 14 letter, Mr. Apgar referred to page seven of our testimony which discusses average losses from sales. Mr. Apgar claimed our testimony was misleading and that FHA was not aware of where OIG obtained the data to support the average loss per property assertion.

OIG Response - The data was based on information obtained from FHA which showed that in FY 1996 FHA sold 53,025 properties at an average loss of $28,202. Based on this, we calculated a loss of about $1.5 billion for FY 1996. In FY 1998, FHA sold 64,038 properties at an average loss of $31,728 for a total loss of about $2 billion. We have found no evidence to indicate that the testimony was inaccurate. In fact, Mr. Apgar used this same data in Attachment A of his June 9, 1999, letter and calculated a loss for FY 1998 of just over $2 billion. He appears now to agree with us.

Santa Ana Homeownership Center Staff

FHA's Statement - Mr. Apgar's May 14 letter states that our testimony falsely asserted that FHA's Santa Ana Homeownership Center had 18 program staff in October 1998 with plans to be fully staffed at only 22. He stated there were 63 program staff working on the inventory of property. He also stated that following transition to the M&M environment, the Santa Ana HOC would have 22 full time program staff and 23 out stationed staff working part time to assist in contract monitoring activities.

OIG Response - Our testimony referred to program staff located at the Santa Ana HOC and those properties they were directly responsible for managing. This information was provided to us by the Santa Ana HOC officials. We correctly cited the number of staff as 18. We incorrectly cited the number of properties assigned to them as 16,000; the actual workload was 13,000. We believe the 63 staff Mr. Apgar referred to included staff located in the 16 various field offices under the Santa Ana HOC jurisdiction.

REAM contract reviews, rating, and enforcement actions

FHA's Statement - In his June 9, 1999, letter to you, Mr. Apgar provided data about REAM contract reviews, ratings, and enforcement actions and indicated copies of these reports would be provided to the Committee. He claimed that FHA conducted 241 on-site reviews in FY 1998.

OIG Response - This information differed from our audit evidence. So, at our July 7, 1999, exit conference, we requested to review a sample of the documents supporting his statement to you, and agreed to revise our audit report if we found the documents supported his claim. Instead, however, we found the documents included items such as rapid reply letters, memoranda, and other records that were not evidence of REAM reviews, ratings or enforcement actions. Upon further inquiry, the Director of Single Family Asset Management said he had not fully reviewed the documents and agreed that many did not appear to constitute reviews and risk rating analyses. We did not change our report.

Arthur Andersen Property Disposition Industry Benchmarking Study

FHA's Statement - In his May 14, 1999, letter Mr. Apgar referenced his testimony before your Committee in stating that the Andersen Consulting study indicated that FHA's performance, in terms of time properties were in inventory and the amount recovered upon their sale, were well within industry norms. When we cited the Anderson study, Mr. Apgar accused us of using "faulty methodological approaches."

OIG Response - To FHA officials, the Anderson study has become important when it supports them and unimportant when it does not. Our audit report contains an analysis showing how FHA incurred millions in unnecessary property holding costs and revenue losses. In his September 2, 1999, response to the report, Mr. Apgar states, "OIG appears to reach this conclusion by comparing FHA's REO sales performance for 1997 and 1998 to optimum industry standards identified in the 1996 Arthur Andersen study. The Department simply did not adopt the goals cited in the OIG audit." Although FHA may now wish to be selective in its use of the Anderson study, in fact, at the time the study was conducted, FHA officials did adopt the goals cited in our report.

I thank you for the opportunity to provide my clarifications on these issues. We will continue to provide additional analysis and recommendations of HUD's new M&M process.

Sincerely,

Susan Gaffney

Susan Gaffney
Inspector General

Enclosures

SINGLE FAMILY PROPERTY
DISPOSITION PROGRAM

99-A1-123-0001
SEPTEMBER 17, 1999

OFFICE OF AUDIT
SOUTHEAST/CARIBBEAN DISTRICT

audit report
OFFICE OF INSPECTOR GENERAL

Issue Date
September 17, 1999
Audit Case Number
99-AT-123-0001

TO: William C. Apgar, Assistant Secretary for Housing-Federal Housing Commissioner, H

N.H. Cooper

FROM: Nancy H. Cooper
District Inspector General for Audit-Southeast/Caribbean, 4AGA

SUBJECT: Single-Family Property Disposition Program

This report presents the results of our nationwide internal audit of Federal Housing Administration's (FHA) Single-Family Property Disposition Program. FHA's comments to the three findings and associated recommendations are included as Appendix D with excerpts and the Office of Inspector General's (OIG) response incorporated into the Findings and Recommendations section of the report.

Please furnish this office a reply within 60 days on each recommendation describing: (1) the corrective action taken; (2) the proposed corrective action and a planned implementation date; or (3) why action is not considered necessary. Also, please furnish us copies of any correspondence or directives issued as a result of the audit. Note that Handbook 2000.06 REV-3 requires management decisions to be reached on all recommendations within 6 months of report issuance. It also provides guidance regarding interim actions and the format and content of your reply.

We appreciate the cooperation of your staff during the audit. If you or your staff have any questions, please contact me at 404-331-3369 or Jerry Kirkland, Assistant District Inspector General for Audit, at 423-545-4368.

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Abbreviations

CFR	Code of Federal Regulations
FHA	Federal Housing Administration
FTE	Full Time Equivalent
FY	Fiscal Year
GAO	U.S. General Accounting Office
HOC	Homeownership Center
HUD	U.S. Department of Housing and Urban Development
M&M	Management and Marketing
MPS	Minimum Property Standards
NPR	National Performance Review
OIG	Office of Inspector General
REAM	Real Estate Asset Manager
REO	Real Estate Owned
SAMS	Single Family Acquired Asset Management System

Introduction

Background

FHA's Single Family Mortgage Insurance Program helps low and moderate income families become homeowners by reducing downpayments and limiting lender fees. FHA currently insures about 7 million loans valued at over $400 billion. Every year, thousands of borrowers default on their FHA-insured loans. When they default, FHA encourages lenders to work with them to bring their payments current. If they cannot do this, their homes may be sold to third parties, voluntarily conveyed to the lenders, or surrendered to lenders through foreclosure. Once lenders obtain the properties, they generally convey title to the Secretary of HUD in exchange for payment of their insurance claim. During FY 1998 FHA paid over 76,000 claims totaling about $5.8 billion. It also takes possession of abandoned properties secured by FHA-held mortgages, referred to as "custodial" properties, pending acquisition of title.

The National Housing Act (Act) of 1934 confers on the Secretary the authority to manage, rehabilitate, rent, and dispose of any property acquired under the program. Section 204(g) of the Act governs the management and disposition of single family properties acquired by FHA. Title 24, Code of Federal Regulations (CFR), part 291 implements this statutory authority. Handbook 4310.5 REV-2, dated May 17, 1994, *Property Disposition Handbook - One to Four Family Properties,* supplements the regulations.

FHA disposes of properties through its Property Disposition Program. Its mission is to reduce the property inventory in a manner that expands home ownership opportunities, strengthens neighborhoods and communities, and ensures a maximum return to the mortgage insurance fund. FHA's Office of Insured Single Family Housing, Asset Management Division, is responsible for administering the program.

FHA has the largest real estate portfolio and operation in the nation. It sold about 122,000 properties and generated revenues of about $7 billion for the mortgage insurance fund during the last 2 fiscal years. As of February 28, 1999, there were about 42,300 properties in FHA's inventory valued at about $3.5 billion. These properties are in inventory an average of about 6 months. In addition, FHA held about 1,200 custodial properties. These are properties secured by FHA-held mortgages but HUD does not have title to them. About 40 percent of the custodial properties have been in FHA's inventory for over 3 years; some for more than 10 years.

In 1993, the Commission on Reinventing Government produced the National Performance Review (NPR) which promotes principles to enable all federal agencies to redefine their missions. As a result of the NPR, Congress enacted the Government Performance and Results Act of 1993. The Act requires all federal agencies to set specific and measurable goals in performing their public missions. The NPR recommended that HUD outsource its property disposition function in order to create higher returns.

Introduction

In March 1997, Andersen Consulting prepared an Industry Benchmarking and Best Practices report to allow HUD to draw conclusions regarding its program performance. The report focused on best practices used in private industry Real Estate Owned (REO) operations. Based on the report, FHA developed goals for various critical success factors. The goals included: (1) selling properties at 98 percent of appraised value; (2) attaining a 150 day average property holding period; and reducing the percentage of properties in inventory more than 12 months to 5 percent.

In February 1993, HUD initiated a reinvention effort to streamline HUD operations and reduce costs. FHA also began reducing program staff and consolidating its mortgage insurance processing, claims, and property disposition activities from 81 field offices into Homeownership Centers (HOC). In August 1994, the first of four centers opened in Denver, Colorado. At that time about 580 staff worked on the program.

In March 1997, FHA issued its 2020 Field Consolidation Plan for Single Family Housing. The plan included opening three additional HOCs, in Philadelphia, Pennsylvania; Atlanta, Georgia; and Santa Ana, California, and outsourcing property disposition activities and selling nearly all assigned notes.

FHA contracted out a variety of its program functions including property appraisals and about 220 contracts with REAM contractors to secure and maintain program properties nationwide. The contractors were required to inspect and secure properties, report their condition to FHA, notify interested parties of HUD's ownership, perform needed exterior and interior maintenance, and ensure that properties were free of debris and hazardous conditions. Because of staff reductions, some field offices were unable to adequately perform their program functions. In 1998, four contracts in Birmingham, Alabama; Jacksonville, Florida; Coral Gables, Florida; and Chicago, Illinois were awarded to provide management and marketing services.

As of March 1999, there were about 420 Full Time Equivalent (FTE) staff working on the program at FHA Headquarters, 4 HOCs, and field offices; a staff reduction of 28 percent since 1994.

Pilot Program

In 1996, in order to test the feasibility of contracting out program functions, FHA awarded three pilot M&M contracts to Golden Feather Realty Services, Inc. The contracts covered the New Orleans, Louisiana; Sacramento, California; and Baltimore, Maryland areas. The contractor provided extensive services previously performed by program employees. During the period October 1996 through February 1999, contract staff managed about 10,400 properties. They also sold about 8,500 of these properties.

	Beginning Inventory	Acquired	Sold	Ending Inventory
New Orleans	379	1,365	1,535	209
Sacramento	408	3,682	3,470	620
Baltimore	673	3,857	3,506	1,024
Total	1,460	8,904	8,511	1,853

A 1998 performance report by FHA concluded that the pilot program was successful.[1] It stated that the contractor attained sales goals, reduced the time properties remained in inventory, and increased the return to the insurance fund. No final assessment of the pilot program had been performed as of April 1999.

The total cost of the contracts was $36,637,378.

New Orleans	$ 5,952,214
Sacramento	12,525,068
Baltimore	18,160,096
Total	$36,637,378

In early 1997, at FHA's request, the OIG performed a limited review of the pilot contracts to identify areas vulnerable to waste, fraud, and abuse, and recommend ways to improve a planned nationwide management and marketing contract.[2] The report identified several weaknesses in the contracts including (1) failure to place restrictions on the use of identity-of-interest companies, (2) inclusion of vague and nonspecific contract terminology, (3) not requiring the contractor to maintain written policies and procedures, and (4) failure to require compliance with changes in FHA legislation, regulations, or FHA policies and procedures. The report also stated that the contracts did not define the difference between repair costs covered by contractor fees, and repair costs reimbursed the contractor by FHA. It also cited FHA for not aggressively pursuing titles for custodial properties in the REO inventory, and having unreliable data in the Single Family Acquired Asset Management System (SAMS), FHA's primary management information system. FHA generally agreed with the recommendations and took action to correct the deficiencies. These actions included adding various provisions and clarifying language in the M&M contracts and consolidating staff to pursue custodial property titles. A subsequent OIG audit of SAMS showed problems with system data.

[1] HUD internal report titled, Golden Feather Realty Services, Inc., Evaluation of the Second Year of Operation, October 1, 1997 to September 30, 1998, dated 3/23/99.

[2] Audit of the Single Family Real Estate Owned Pilot Contracts, HUD Office of Inspector General (98-AO-123-0001, January 1998).

Nationwide M&M Contracts

On March 29, 1999, FHA put the final phase of its reorganization plan into effect. It awarded 7 companies a total of 16 contracts to manage and market its properties nationwide. For about $927 million over 5 years, these companies will handle nearly every aspect of the program including property management, marketing, and sales. Other property inspection and file review contracts will be awarded to help staff monitor the M&M contractors. The estimated cost for the first year of these contracts is about $3.5 million.

The duties of HOC and field office program staff are expected to change dramatically. They will no longer manage and market properties. Their primary function will be to monitor contractor performance and enforce compliance. Once the contracts are operational, FHA estimates that 143 FTE (135 field, 8 headquarters) staff will be needed to oversee activities.

Prior Audit Findings

FHA has had a history of problems with REAM contractors. Reviews by the OIG and other audit organizations have frequently cited FHA for ineffective program management and reported contractor noncompliance and systemic abuse. For example, an OIG audit of the Massachusetts State Office in 1996 concluded that management had not established and implemented adequate controls to monitor and assess performance of REAM contracts.[3] The report cited missing and/or untimely REAM property inspection reports, little monitoring of contractor performance by FHA staff, and unacceptable property conditions. An OIG review in 1997 of FHA's Phoenix, Arizona office cited similar deficiencies.

In 1997, at Congress' request, GAO conducted a review of FHA's management of REAM contractors in Boston, Chicago, and Fort Worth. In March 1998, GAO reported that FHA did not have an adequate system in place to monitor oversight of REAM contracts. None of the FHA offices visited adequately performed all functions needed to ensure contract compliance. GAO's inspections of inventoried properties revealed serious problems such as vandalism, maintenance deficiencies, and safety hazards. The report also discussed FHA's plans to continue making changes to its property disposition process. GAO made several recommendations to strengthen FHA controls over REAM contractors.[4]

[3] Controls Over Real Estate Asset Manager Contracts, Massachusetts State Office, HUD Office of Inspector General (96-BO-123-0001, June 1996).

[4] Improvements Needed in FHA's Oversight of Property Management Contractors (GAO/RCED-98-65, March 27, 1998).

A 1998 audit of FHA's financial statements performed by KPMG, LLP found similar control weaknesses.[5] The report stated that:

FHA has control weaknesses in its single family property acquisition, management and disposition functions which hindered FHA's objective to reduce inventory in a manner that maximizes the return to the mortgage insurance fund while preserving and protecting residential properties.

Deficiencies cited in the report included:

- Inadequate oversight of REAM services, including maintenance and repairs, real estate closing services, and other contract services.

- Deficient management, maintenance, and upkeep of program properties, including properties that were not secured and lacked signs identifying them as government properties available for sale, and properties where REAM employees appeared to be signing in for multiple visits.

- Delayed recognition and management of newly conveyed properties.

Audit Objectives

Our primary audit objective was to determine the effects of HUD's 2020 reorganization efforts on the mission of FHA's Property Disposition Program. This included assessing whether: (a) program operations were effective, efficient, and economical, and (b) management controls effectively identified and addressed operational deficiencies and contractor compliance.

Audit Scope and Methodology

The audit was conducted at FHA Headquarters in Washington, D.C. and at four HOCs located in Atlanta, Georgia; Denver, Colorado; Philadelphia, Pennsylvania; and Santa Ana, California and various field offices. We also visited six contractor offices. (See Appendix A.) We reviewed activities and management controls over FHA's critical case processing steps 1 through 6. These steps included the processes to acquire and secure properties, record appraisals, determine the disposition method, and repair, maintain and market properties. We focused on controls over property management contractors because recent audits had identified significant control weaknesses involving FHA's monitoring of its contractors, contract compliance, and the condition of program properties. We also assessed management controls in the M&M contracts and the contracts management manual. Our audit was performed from August 1998 through April 1999 and primarily covered program activities from October 1996 through March 1999.

[5] Federal Housing Administration Audit of Fiscal Year 1998 Federal Basis Financial Statements (HUD Office of Inspector General Report (Performed by KPMG, LLP), 99-FO-131-0002, March 12, 1999).

To meet our objectives, we:

- Obtained information on current program operations, responsibilities, policies and procedures. Analyzed planned changes in regulations and discussed their implementation with Single Family Housing officials at FHA Headquarters, HOCs, and field offices.

- Interviewed contractors responsible for managing the FHA-owned and custodial properties.

- Assessed the extent and adequacy of FHA's monitoring of HOC and field office operations through interviews with responsible officials and reviews of monitoring reports.

- Reviewed operating budgets and staffing plans to identify significant changes that might affect program operations.

- Analyzed required monitoring logs and 181 monitoring reports to determine whether contractor visits were timely and required property inspections were performed.

- Compiled the results of 7,440 FHA property inspections.

- Reviewed 52 enforcement actions taken against non-compliant contractors.

- Reviewed 38 property case files judgmentally selected from contractor inventory lists to determine whether these contractors complied with contract requirements.

- Followed up on prior audit findings to determine whether recommendations had been implemented.

We also conducted 48 FHA-owned and 5 custodial property inspections. Of these 53 properties, 33 properties were the same as those in our case file review. Another 20 properties were judgmentally selected from the Atlanta, Chicago, Los Angeles, and Santa Ana field offices' inventory lists.

We conducted our audit in accordance with generally accepted government auditing standards.

HUD's Reorganization Adversely Affected Its Program Mission

FHA did not effectively, efficiently, and economically manage its Property Disposition Program. HUD's reorganization efforts adversely affected staff resources and ability to adequately monitor the condition of program properties and enforce contractor compliance. Our review confirmed what FHA performance reports showed that property inventory increased, sales to homeowners declined, average losses from sales increased, and property conditions were deplorable. GAO and KPMG reported similar results. We found that performance worsened since their reviews were conducted. Consequently, FHA did not meet its basic program mission of reducing the inventory in a manner that expands homeownership, ensures a maximum return to the mortgage insurance fund, and strengthens neighborhoods and communities.

Criteria

Title 24 CFR part 291 requires that FHA issue policies and procedures to ensure the program's mission is met. It is responsible for the ongoing management, marketing, sales, and closing of acquired properties and management of custodial properties. FHA is also responsible for overseeing contractors and ensuring their compliance with contract terms. On-site reviews of contractor performance (including property inspections) and prompt enforcement action to correct deficiencies are important to the success of the program.

In its March 1998 report on the program, GAO stated that FHA did not have an adequate system in place to assess oversight of REAM contractors. GAO's property inspections identified serious problems including vandalism, maintenance deficiencies, and safety hazards. Similarly, in its March 1999 audit report on FHA's FY 1998 financial statements, KPMG cited various control weaknesses involving the property acquisition, management, and disposition functions, including inadequate oversight of REAM contractors. According to our audit results, these weaknesses continued through March 1999 to the detriment of HUD's mission.

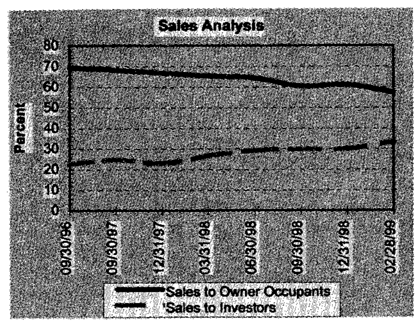
Finding 1

Inventory increased

The property inventory increased 71 percent from about 24,800 properties on September 30, 1996, to about 42,300 properties on February 28, 1999. The inventory has increased by 3,200 properties since September 30, 1998. In comparison, the volume of total sales has not kept pace, increasing only 9 percent from about 58,500 properties in FY 1997 to 64,000 properties in FY 1998. There were about 26,700 properties sold in the first 5 months of FY 1999. At this pace, FY 1999 sales will not increase beyond the FY 1998 level.

Sales to homeowners declined

Although total sales were up slightly, monthly sales to homeowners steadily declined from 68 percent in September 1997 to 57 percent in February 1999. In contrast, monthly sales to investors increased from 25 percent to about 34 percent for the same period. Sales to nonprofit organizations increased from 7 to 9 percent during the period.



Program losses increased

Processing delays caused properties to remain in inventory longer, increasing property holding costs and increasing the potential for vandalism and decline in property values. Associated losses adversely impacted the program's mission of maximizing the return to the fund. Losses to the fund totaled about $269 million for FY 1997 and 1998. (See Finding 2.)

Neighborhoods and communities deteriorated

We found the program failed to strengthen neighborhoods and communities. This occurred because REAM contractors did not always secure, repair and maintain properties according to contract terms. Properties also remained in inventory longer than necessary causing them to deteriorate. In some cases, the FHA homes were the eyesore of the neighborhood.

We analyzed the results of 7,440 property inspections conducted between October 1998 and March 1999. We also inspected 48 acquired properties. The results were similar (See Appendix B); they showed systemic contractor noncompliance and many of the same problems identified by GAO. We compared the results of our inspections to recent inspection reports prepared by REAM contractors. We found numerous instances where the contractors did not include deficiencies in their reports. This condition was also identified by GAO.

Recent OIG and FHA inspections of acquired and custodial properties found deplorable conditions (See Appendix C).

The condition of FHA's property inventory has contributed to the program's performance problems including decreased marketability; increased holding costs; possible decreased value of surrounding homes; and in some cases, conditions that threatened the health and safety of neighbors and potential buyers.

Insufficient staffing and inadequate travel funds

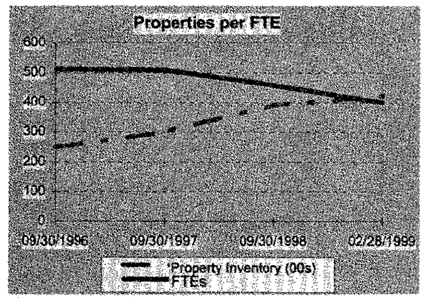
Staff shortages, inexperienced staff, increased workload, and limited travel funds prevented program employees from effectively overseeing program activities. As a result of HUD 2020 reforms, many experienced staff left HUD or took other HUD jobs. Buyouts and attrition depleted staff at a number of sites. Many of those remaining did not have program experience. FHA never intended that the remaining program staff would handle the full range of property management and disposition functions that we found them doing. FHA expected to award the M&M contracts by October 1998. However, the contracts were not awarded until January 1999 with March 1999 effective dates.

During our visit to the Santa Ana HOC in September 1998, we found that program staff could not handle the workload. Although the program was authorized 16 Housing Specialists, there were only 11 on duty. These 11 specialists were responsible for monitoring overall operations of 16 field offices located in 8 western states, including Alaska and Hawaii. In addition, because of staff shortages in the Los Angeles, Santa Ana, and San Diego field offices, the day to day property management, marketing, and contract monitoring duties for about 13,000 properties were transferred to the Santa Ana HOC. The staff's workload increased so much that staff from the Denver, Colorado and Tampa, Florida offices were sent to Santa Ana temporarily to help.

In Coral Gables, Florida, we found two employees working on the program. One of the employees had only been assigned for about a year. The other employee was in a clerical position prior to working for the program. Program officials confirmed that as a result of reorganization, many less knowledgeable and experienced staff were left in HOC's and field offices to handle the increased workload.

Staff shortages were also so severe in the Coral Gables, Florida; Jacksonville, Florida; Birmingham, Alabama; and Chicago, Illinois field offices that emergency contracts were awarded to handle most of their property disposition duties.

A long standing criticism of HUD's property disposition operation has been the unreasonable number of properties each FTE staff was expected to manage. According to the 1997 Andersen Consulting study, one FTE for 35 properties would be needed to effectively manage a portfolio similar to HUD's at the time of the study. We found that from September 30, 1996, to February 28, 1999, the number of properties per FTE increased from 48 to 106.



Planned staffing may not be adequate to manage the new M&M contracts. According to the Andersen study, if FHA's property disposition functions were completely outsourced, each field employee should be able to oversee the management and sale of 70 properties. It stated that a large number of properties per FTE could decrease FHA's ability to effectively monitor operations, and increase the possibility of fraud, waste, or abuse. FHA plans for 135 FTE in the HOCs and field offices to manage the contracts. At the current inventory level, this is about 300 properties per FTE. Each of the 28 program FTE under the Santa Ana HOC's jurisdiction will oversee about 580 properties.

In addition, many of the field staff assigned critical monitoring responsibilities only work for the program part-time. According to FHA's M&M Contract Monitoring Manual, these program support staff are responsible for performing sample property inspections and file reviews to assess the quality of contractor work. At the Santa Ana HOC's current inventory level, about 160 inspections and 160 file reviews are to be conducted monthly by staff. The Santa Ana HOC has 23 program support staff (7 FTE) assigned part time to perform this function in 8 states including Alaska and Hawaii.

Program officials in the field told us they did not have adequate travel funds in prior years to conduct reviews. HOC travel budgets and expenditures for FY 1999 (as of June 30, 1999) were:

	Budget	Expended
Atlanta	$209,943	$188,795
Denver	204,215	184,947
Philadelphia	222,842	196,032
Santa Ana	185,000	162,374
Undistributed	34,000	0
Total	$856,000	$732,148

In June 1999, the national program director said he did not have a breakdown of travel funds allocated HOCs property disposition activities for FY 1999. A Santa Ana program official told us that $17,000 had been allocated for property disposition activities in 8 western states including Alaska and Hawaii. An additional $54,000 was requested but had not been approved at the time of our review. These figures appear inadequate to protect the Government's interest; however, we were assured that adequate travel funds will be provided for program activities.

Inadequate contract monitoring

FHA Handbook 4310.5 REV-2 required FHA to perform an annual risk assessment of each REAM contract. Monthly on-site reviews were required for high risk contracts, quarterly for moderate risk contracts, and semi-annually for low risk contracts. The Handbook also required FHA staff to maintain control logs to record overall review results and target dates for correcting deficiencies. FHA was required to send written reports to the contractors, along with target dates for correcting deficiencies. All reports, including notes of oral guidance, were to be maintained in fully documented files to support contract extension decisions and act on inadequate performance.

In 1998, there were about 220 REAM contracts nationwide. If all REAMs were rated low risk, program staff were required to perform a minimum of 440 reviews annually or at least 880 during our 2-year review period. To assess whether program staff performed required reviews, we requested current control logs, all monitoring reports, and review checklists from January 1997. The HOCs provided evidence of 181 reviews, far short of the minimum required.

Our analysis also disclosed that staff did not perform monthly reviews on known high risk REAM contracts. For example, Atlanta's log showed that between July and December 1998, no reviews were conducted on any of the 10 contracts rated high risk. The Memphis, Tennessee office performed reviews of two contracts during April and May 1997. The staff rated one of the contracts low risk, and no rating was given for the second contract. Staff did not review these two contracts again until August 1998; by then they found both contracts to be high risk. Despite prescribed controls, no further reviews were done as of March 31, 1999.

There was also no standard reporting format. FHA staff often did not include risk ratings and target dates for correcting deficiencies in the reports. Most reports did not require contractor response. Many reports did not adequately describe the scope or the sample of properties or files reviewed.

We found that because of staff and travel fund shortages caused by HUD 2020 reforms, required property inspections were not always conducted by FHA staff. Even when inspections were conducted many were not reviewed or tracked to identify trends and systemic weaknesses. For example, although the Atlanta, Denver, and Santa Ana HOCs and field offices received thousands of inspection reports during this period, they did not compile and analyze the results. Occasionally some reports were reviewed and contractors contacted to correct problems on the individual properties. In Atlanta, we found hundreds of inspection reports in a desk drawer. In Santa Ana, we found hundreds more in a box. There was no evidence of any formal review or analysis of these reports.

Inadequate contract enforcement

Although contractor noncompliance was pervasive, FHA took few enforcement actions. Since January 1997, FHA did not assess any monetary penalties and only terminated four contracts for noncompliance.

For example, in July 1998, as a result of the OIG audit, the Philadelphia HOC began compiling inspection results. About 9,000 inspection reports were summarized and results reported quarterly to the HOC Director and to the Director of the Office of Insured Single Family Housing. The summaries showed 91 percent, 70 percent, and 78 percent of properties inspected during the 4th quarter of FY 1998 and the 1st and 2nd quarters of 1999, respectively, had one or more contract violations. Although the reports showed pervasive noncompliance, potential fraud, and deteriorated properties, little or no action was taken to enforce compliance. Several HOC officials told us that action was not taken against the contractors because the M&M contracts were expected to be awarded soon.

We requested correspondence from HOC officials and contracting officers to support any enforcement actions taken against REAM contractors since January 1997. We identified 52 contract actions during a 2-year period involving 39 contracts.

Letter of Concern	17
Cure Notice	26
Show Cause Notice	5
Termination	4
Total	52

Without timely on-site monitoring, management cannot assess contract performance and property conditions. In order for FHA to meet its mission, it is essential that adequate resources be committed at all management levels to monitor FHA staff and M&M contractor performance and enforce compliance as necessary.

FHA Comments

FHA generally agreed with our analysis of historical problems with its property disposition program. However, FHA disagreed with our concerns that planned staffing may not be adequate to manage the new M&M contracts. FHA stated that our conclusion was faulty because it was based on the Andersen Consulting study. FHA claimed the staffing estimates in the study were premised on the assumption that all REO work would be performed directly by HUD employees, not private sector contractors.

FHA also disagreed with our concerns regarding the adequacy of travel funds. It stated that allocation of travel funds at the HOC level empowers the HOC Directors to use travel funds to meet immediate work priorities, property disposition being the number one priority for the HOCs throughout this fiscal year. FHA also commented that under the new M&M initiative, FHA established an aggressive oversight program which included property inspections by a contractor and file reviews by third party auditors. Out-stationed HUD staff would also re-inspect 10 percent of the contractor's sample. FHA stated that these rigorous monitoring approaches would not tax current allocations.

OIG Response

Contrary to FHA's response, our citation of staffing estimates was based on the complete outsourcing of the property disposition function. The Andersen study states, "Industry also reports that if the PD function is completely outsourced, each employee should be able to oversee the management and sale of 70 properties." The study also recognized that based on an average inventory of 27,000 properties, the staffing level would need to be about 385 employees if the property disposition function was outsourced. A large number of properties per FTE could decrease FHA's ability to effectively monitor operations, and increase the possibility of fraud, waste, or abuse. As stated in the Finding, FHA plans for 135 FTE in the HOCs and field offices to manage the M&M contracts or about 300 properties per FTE. Also, each of the 28 program FTE under the Santa Ana HOC's jurisdiction will oversee about 580 properties. Thus, we remain concerned that the planned staffing will not be adequate to manage the M&M contracts.

FHA seems to contradict itself with the statement, ". . . these rigorous monitoring approaches would not tax current allocations." It would seem that travel allocations would be substantially affected if FHA intends to re-inspect 10 percent of the contractors' sample.

We remain concerned that if planned staffing and current travel allocations are not adequate, FHA will not be able to properly manage the M&M contracts. We will continue to assess FHA's ability to monitor contractor performance and enforce compliance.

Recommendation

We recommend that you:

1A. Ensure adequate resources are available (including staffing and travel funds at all organizational levels) to (a) monitor staff and contractor performance and enforce contract terms, and (b) take timely action when mission goals are not met.

FHA Incurred Millions in Unnecessary Property Holding Costs and Revenue Losses

Over the last 2½ years, FHA's ability to maximize return to the insurance fund was compromised. FHA was unable to meet its goals to sell properties within 5 months or at 98 percent of appraised value. In FY 1998, for example, almost half the inventory experienced processing delays when measured against industry standards. The delays occurred at various stages and were attributable to FHA staff, REAMs, and appraisers. As a result, properties remained in inventory longer and FHA incurred both an increase in its holding costs and a decline in revenue earnings from its program operations. Had FHA accomplished its goals, it would have contributed an additional $269 million to the fund in FY 1997 and 1998.

FHA seeks to minimize costs and maximize revenues. According to the Andersen study, FHA's goal is to sell properties within 5 months of acquisition and at 98 percent of appraised values. These goals are within industry standards. FHA measures performance using 10 standard processing steps, beginning with the acquisition and ending with the reconciliation of funds from the final sale or disposal of the property. SAMS tracks how many days properties are in a step and compares the actual time to a standard time. FHA also tracks various statistics, including the number of properties remaining in inventory over 6 months, the average number of days that sold properties are in inventory (holding period), appraisals, and sales prices.

Processing delays increased holding costs

The Andersen study showed that the processing time on 27 percent of FHA's inventory as of February 27, 1997, exceeded industry standards. On October 31, 1998, the number of properties exceeding standard processing time had increased to 44 percent. The following table shows where the delays occurred:

STEP	DESCRIPTION	STANDARD DAYS	% FAILING
1	Add property to inventory and assign REAM	17	64
2	Record appraisal of property	3	81
3	Determine method to dispose of property	3	16
4	Identify and approve repairs to property	20	34
5	Identify properties that are ready to list for sale	10	13
6	List property for sale	30	30
7	Accept preliminary offer for property	7	95
8	Accept sales offer/contract	60	31
9	Record sales or settlement of property	7	56
10	Close/archive property[8]		
	Total processing days	157	44

[8] Processing time for step 10 is not tracked.

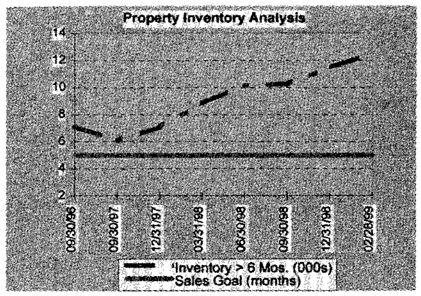
Our review of 38 case files showed similar results. All 38 cases showed delays attributable to one of the following areas:

- 31 percent of properties were not assigned to REAMs timely.
- 38 percent of properties were not assigned to appraisers or appraisals were not received timely.
- 29 percent of initial inspections were not performed or not received timely.
- No sales disposition programs were properly prepared or reviewed timely.

Total processing days are counted and averaged when properties are sold. In FY 1997 and 1998, average days from acquisition to sale was 182, or 32 days beyond the 5-month sales goal. These delays substantially increased FHA's holding costs. We calculated a daily holding cost per property using costs of staff, maintenance and operations, repairs, and lost interest and the average number of days sold properties were in inventory for FY 1997 and 1998. We determined that FHA's daily holding cost per property was $30.75 and $32.04[7], respectively. For the 2-year period, the delays increased losses to the insurance fund by about $123 million.

The first 5 months of FY 1999 showed no improvement - FHA missed its sales goal on average by 41 days. The average processing time on FHA sales will not improve quickly. This is because the overall age of the inventory has increased. The number of properties in inventory over 6 months increased 76 percent from 7,093 properties on September 30, 1996, to 12,503 properties on February 28, 1999.

[7] FHA's computation in November 1997 did not include applicable program costs such as property repair costs and all staff costs. Also, the calculation was improperly determined using average turnover rate (164 days) rather than average days in inventory (182 days), and ending property inventory rather than average inventory for the period.



FHA's inventory of properties over 12 months old is also in excess of industry standards. According to the Andersen study, the industry average for inventory over 12 months old is 2 to 3 percent of total inventory. FHA's monthly average was 7 percent in FY 1997 and 1998 and 9 percent for the first 5 months of FY 1999. Its goal is 5 percent.

FHA did not maximize return to the fund

FHA measures revenue losses based on the difference between average sales price and appraised value. It strives to sell properties at or near appraised value to maximize revenue to the mortgage insurance fund. The following schedule shows FHA's sales activity for FY 1997 and FY 1998. It reflects lost revenue totaling about $146 million because FHA did not meet its goal of selling properties, on average, at 98 percent of appraised value. It reflects a trend that continued into FY 1999.

		Average Sales Price				Sales	Revenue ($000,000)
FY	Appraisal	Actual	%	Goal	Difference	Volume	Gain/(Loss)
1996	$54,272	$ 53,449	98.5	$ 53,187	$ 262	53,000	$ 14
1997	$57,203	$ 55,589	97.2	$ 56,059	$ (470)	58,500	$ (28)
1998	$60,670	$ 57,606	94.9	$ 59,457	$ (1,851)	64,000	$ (118)
1999	$63,062	$ 59,700	94.7	$ 61,801	$ (2,101)	64,000	$ (134)*

* Annual projection based on sales through February 1999.

* * * * * * * * * * * * * *

During Congressional testimony in May 1999, the FHA Commissioner downplayed these statistics. Understandably, he preferred to focus on the fact that mortgage premiums offset property disposition losses by $1.5 billion in FY 1998. Considering FHA's inherent role in trying to bring homeownership to lower income families, it seems equally important, however, to find ways to reduce mortgage premiums. By maximizing revenue from sales and lowering costs, FHA could have returned $269 million more to the insurance fund in FY 1997 and 1998 than it did, a savings ultimately passed on to the borrowers. We recommend that the Commissioner stay equally focused on the program mission and performance goals.

FHA Comments

FHA disagreed with our conclusion that it incurred millions in unnecessary property holding costs and revenue losses. FHA stated the conclusion was blatantly false. FHA said that the performance goals cited in the report as the basis for our holding cost computation from the Andersen study were optimum REO performance measurements for the private sector. FHA claimed that it did not adopt these measurements as goals. Instead, it strives to sell properties in an average of 180 days rather than the 150 days. In reference to the losses, FHA stated that it recognized the importance of the statistics. It claimed that we misinterpreted the data and its goals and made erroneous conclusions.

FHA said it agreed with our recommendation to update performance goals based on current market conditions, program objectives, and the M&M contract structure; and to re-compute property holding cost factors.

OIG Response

The Andersen study was based largely on input from the Single Family Property Disposition Division. A FHA focus group known as the "Visioning Team" met to develop an "Operational Vision." The team compared its current property disposition process with that of industry. It redefined the property disposition mission, developed aggressive goals for the future, and identified key components of the future process, organization and technology that would enable attainment of future goals. It redefined the property disposition mission as follows:

> *"To reduce the inventory of acquired properties in a manner that ensures a maximum return to the Mutual Mortgage Insurance Fund (MMIF)."*

The team's Operational Vision states in part that,

> *"The Single Family Property Disposition Division will support the primary mission of the MMIF by maximizing the return from the sale of acquired properties, thereby making more and less costly FHA home loans available for those who are unserved or under-served by the private market."*

Using the results of the study, the team identified key performance indicators and target goals that would track program revenues and measure performance. One of the key performance indicators developed was "Sales Price as a Percentage of Market Value." The study states that, "The Team decided that 98% of a 30 day sale price is an appropriate target since industry generally prices for 30 day sale and industry's performance is 96-98% for unrepaired properties."

The team also identified Total Cycle Time (Average Holding Period) as a key performance indicator. The study had identified this as a primary indicator of cost efficiency since it directly impacts property holding costs. The study states that, "The Team set a Total Cycle Time target of 150 days by allocating 30 days for Evaluation, 60 days for Marketing (given a 30 to 60 day sale list price) and 60 days for Closing. This target is directly in the middle of the industry range of 120-180 days."

As stated in the study, the goals were developed in the spirit of the 1993 NPR and the requirements of the Government Performance and Results Act. The performance goals set out in the study were the only written goals we identified. Thus, we believe the audit report fairly reflects FHA's program goals and its inability to accomplish the goals it set and quantifies resulting losses to the insurance fund.

Interestingly, Andersen Consulting also recognized that FHA's failure to meet the goal of selling properties in 150 days could impact the insurance fund. Similar to our analysis, the study stated, "Attaining 150 days Average Holding Period may save the SFPD Division approximately $60.8 million annually in holding costs...".

Recommendations

We recommend that you:

2A. Develop and implement written procedures to routinely assess whether program mission goals are achieved and take corrective action when goals are not met.

2B. Recompute and track the per property holding costs based on industry-recognized program costs when the M&M contracts and monitoring contracts are fully implemented.

Controls Over M&M Contracts Need Strengthening

HUD's new M&M contracts and contract monitoring policies are comprehensive, but need some improvement. We found that contracts did not contain (1) sufficient information regarding FHA's reimbursement to contractors for property repair costs, or (2) monetary penalties for contractor noncompliance. In addition, the new contract monitoring manual did not provide comprehensive guidance to review and approve reimbursement of repair costs, conduct contract risk assessments, and document monitoring results. Clarity and consistency in applying policy is needed to prevent contractor noncompliance and abuse.

M&M Contracts

On March 29, 1999, 16 M&M contracts went into effect with a 5-year value of about $927 million. The seven companies that received these contracts will manage nearly every aspect of the property disposition process from property acquisition and maintenance to marketing and sales. In general, FHA pays contractors an initial fee when they list properties for sale. This fee is determined by multiplying a contract price factor by the list price. The result is multiplied by 30 percent. For example, $80,000 (list price) x 3.5 percent (price factor) x 30 percent = $840. A final payment is made when the property is sold. It is based on the net sales price. For example, $75,000 (net sales price) x 3.5 percent (price factor) less $840 (first payment) = $1,785. FHA also pays a fixed amount per month (e.g., $95 per property) for managing its custodial and unimproved properties.

Costs for most services between acquisition and sale are built into the fees and paid by the contractors. These include costs for such services as the appraisals, debris removal, and advertising. This system provides an incentive for contractors to sell properties quickly at prices that provide the most return for them and FHA. The lower the contractors' costs; the higher their profits.

In addition to fees, FHA also reimburses contractors for other costs incurred. These "pass-through" costs are primarily third-party charges such as for taxes and utilities. Under certain circumstances, some property repair costs are reimbursable with FHA's prior approval. These include costs of repairs for:

- natural disasters,
- extraordinary acts of vandalism,
- mortgagee neglect,
- remediation of environmental hazards,
- latent defects to properties not reasonably detectable, and
- major deficiencies not related to normal maintenance when properties are received by contractors (e.g., repairs for properties to meet Minimum Property Standards (MPS)).

We found the contracts provided little information to contractors regarding when and how these costs are to be reimbursed. Program officials told us that FHA staff will rarely approve payment for property repair costs under any circumstances. One official said that FHA will not reimburse contractors for MPS related repairs. Properties are generally sold "as is." The official stated that if properties are insured, funds to pay needed repairs will be included in an escrow account at closing or contractors will pay for the repairs.

Failure to provide contractors enough information about the reimbursement of repair costs may lead to confusion and abuse. For example, our review of one contractor's draft quality control plan found extensive steps devoted to assessing properties for needed MPS repairs, obtaining FHA authorization, and initiating action to make the repairs. An official in the Santa Ana HOC stated that depending on the circumstances, MPS related repairs will be authorized. Reimbursement of repair and maintenance costs has been subject to fraud and abuse in the past. FHA has tried to reduce the problem in these contracts by including most costs in contractors' fees and requiring prior approval for reimbursement of other costs.

The contracts contain no provision for monetary penalties if contractors fail to comply with contract terms. Program officials told us they did not believe monetary penalties are necessary because most property management and marketing costs are included in the fees. They believe that extensive noncompliance and abuse under the prior property disposition process should be significantly reduced. Officials said that there are provisions in the contracts for termination, if necessary.

Our review disclosed that during the last 2 years FHA rarely sanctioned REAM contractors although noncompliance was pervasive. No monetary penalties were imposed and only four contracts were terminated. We believe the M&M contracts should contain specific monetary penalties (e.g., liquidated damages clause) to help ensure compliance and to offset losses to the fund caused by the contractors.

M&M Management Control Manual

FHA designed an extensive manual entitled *Management Controls For The Single-Family REO M&M Contracts* covering contract management, financial, and monitoring controls. If FHA properly implements and consistently follows the manual, most of the contract management problems shown in Findings 1 and 2, should be eliminated. However, several areas of the manual need strengthening to ensure its effectiveness.

Except for the review and approval of repair of latent defects, the new manual has no policies or procedures to approve, justify, and document FHA payment of other repair costs. For example, there is no definition in the manual of what constitutes extraordinary vandalism and no requirements for contractors to justify reimbursement of the costs (e.g., police report). The contracts state that all repairs caused by ordinary vandalism (broken windows, graffiti) are not reimbursable.

The manual provides numerous standard review instruments for FHA staff to use in monitoring contract activities. For example, there are 94 pages of review documents for conducting risk assessments on each of 11 critical events (e.g., mortgagee claims, property inspections, appraisals, sale closings). A low risk rating requires that the contractor acknowledge any deficiencies and correct them. A medium rating requires a reprimand, suspension, or termination of key personnel or subcontractors. A high risk rating requires issuance of a cure notice placing the contractor on probation or contract termination. The manual also requires that an overall risk assessment be made on each contract. Contractors are to be given the assessments, required to respond, and take corrective action.

However, the manual is not clear on how often all documents should be completed and there is no standard document or procedures for conducting the overall assessment. Each critical event is weighted equally. Therefore, a high risk rating on a contractor's handling of property maintenance is weighted equally with a high risk rating on its handling of rental properties. A program official in FHA's national office told us that all forms must be completed and an overall risk rating made monthly on each contract. A Government Technical Representative responsible for oversight of one of the contracts said he did not know how often the assessments should be conducted.

The manual requires that a final assessment report must be prepared each month on each contract. The report must contain a performance/risk assessment, contractor's response, and FHA's determination of corrective action. This report is to be sent monthly to the HOC Director, the Deputy Assistant Secretary for Single Family Housing, and the FHA Commissioner. However, there is no standard format for the report and no requirement that it be sent to the contracting officer who is the only person who can sanction contractors. Also, the manual does not provide sufficient details regarding what documentation is needed and what specific actions to take when contractor sanctions are necessary. Although program officials told us that verbal procedures have been established for working with the contracting officers, we believe that written guidance is necessary.

FHA Comments

FHA generally agreed with the finding and recommendations. FHA stated that it should provide additional guidance to staff regarding reimbursements to M&M contractors for property repairs. It agreed to revisit the potential for incorporating monetary penalties for contractor noncompliance and to strengthen its monitoring approaches.

Recommendations

We recommend that you:

3A. Issue detailed written policies and procedures for approving reimbursement and documenting the need for repairs associated with natural disasters, extraordinary vandalism, mortgagee neglect, environmental hazard remediation, latent defects, and MPS.

3B. Modify the M&M contracts to require monetary penalties (e.g., liquidated damages) for specific recurring contract deficiencies.

3C. Revise the M&M management control manual and/or issue written policies and procedures:

(1) detailing how often risk assessments must be made for all critical events and providing a standard document for completing the overall risk assessment including risk rating weights for each event; and

(2) providing a standard document for completing the monthly final assessment report and requiring that copies be sent to applicable contracting officers.

3D. In conjunction with contracting staff, issue written policies and procedures specifying what actions to take and documents needed to enforce compliance and sanction deficient contractors.

3E. Develop a system to track and summarize monitoring results to identify trends and systemic weaknesses for corrective action.

Follow-up on Prior Audits

Several prior audit reports contain findings which impact the objectives of this audit.

- An OIG audit (Report Number 96-BO-123-0001, dated June 1996) of the Massachusetts State Office concluded that FHA had not established and implemented adequate management controls to monitor and assess performance of REAM contracts.

- An OIG audit (Report Number 97-SF-123-0802, dated July 23, 1997) of the Arizona State Office found that program staff did effectively monitor a REAM contractor's performance resulting in payments for work not performed.

- An OIG audit (Report Number 98-AO-123-0001, dated January 30, 1998) of the pilot contracts conducted soon after the contracts were awarded, identified several weaknesses. Except for an issue regarding SAMS data, adequate corrective actions were taken. A subsequent OIG audit of SAMS (Report number 98-DP-166-0004, dated September 30, 1998) found a similar problem. The findings of this report did not impact our audit objectives.

- A GAO audit (Report Number 98-65, dated March 27, 1998) of FHA's management of REAM contractors in Boston, Chicago, and Fort Worth concluded that FHA did not have an adequate system in place to monitor oversight of REAM contracts.

- An audit of FHA's 1998 financial statements, performed by KPMG, LLP (Report Number 99-FO-131-0002, dated March 12, 1999) concluded that, "FHA has control weaknesses in its single family property acquisition, management and disposition functions which hindered FHA's objective to reduce inventory in a manner that maximizes the return to the mortgage insurance funds while preserving and protecting residential properties."

As discussed in detail in the "Findings and Recommendations" section of this report, these conditions regarding contract monitoring continued to exist. HUD 2020 reforms inhibited proper implementation of effective corrective actions. This report stresses the importance of developing and implementing management controls to ensure that the conditions do not continue.

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Locations Visited

DESCRIPTION	**LOCATION**
Single Family Housing Division	**Washington, DC**
Homeownership Center	**Atlanta, Georgia**
Field Office	**Chicago, Illinois**
Field Office	**Coral Gables, Florida**
Homeownership Center	**Denver, Colorado**
Field Office	**New Orleans, Louisiana**
Homeownership Center	**Philadelphia, Pennsylvania**
Homeownership Center	**Santa Ana, California**
Contractors	
The Urban Group (REAM)	**Ft. Lauderdale, Florida and Miami, Florida**
Gibralter Realty, Inc. (REAM)	**Chicago, Illinois**
Golden Feather Realty Services, Inc. (Pilot M&M)	**New Orleans, Louisiana**
Citiwest Properties, Inc. (Emergency M&M)	**Coral Gables, Florida and Chicago, Illinois**

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Results of FHA Property Inspections

October 1998 through March 1999[8]

Field Office[9]	Inspections	Debris Outside	Debris Inside	Property Unsecured	Defective Paint	Vandalism	No FHA Sign	No Regular Inspections
		Percent Deficiencies						
Atlanta	32	19	41	0	23	16	4	31
Chicago	1,123	12	23	18	6	21	5	20
Coral Gables	105	38	22	9	89	22	15	14
Philadelphia[10]	5,977	24	20	16	27	0	14	16
Santa Ana	203	15	9	5	7	32	29	15
TOTAL	7,440	22	20	16	22	5	13	17

Results of OIG Property Inspections

August 1998 through March 1999

Field Office	Inspections	Debris Outside	Debris Inside	Property Unsecured	Defective Paint	Vandalism	No FHA Sign	No Regular Inspections
		Percent Deficiencies						
Atlanta	6	50	83	33	50	50	16	50
Chicago	11	45	64	9	88	45	45	0
Coral Gables	9	44	22	56	20	13	100	100
New Orleans	12	42	42	17	65	25	100	86
Los Angeles	5	40	20	0	11	40	100	25
Santa Ana	5	80	60	20	10	0	40	0
TOTAL	48	48	49	23	46	28	68	47

[8] Except for Philadelphia HOC summaries, we did not review all inspection reports or summaries prepared during the period by or for these offices.
[9] Although inspection reports were requested from the Denver HOC, none were provided.
[10] All field offices in the Philadelphia HOC's jurisdiction.

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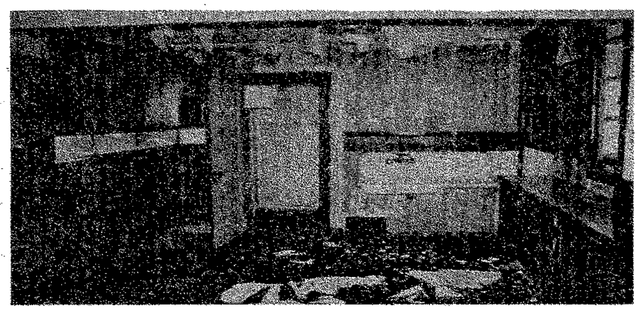
Examples of Acquired and Custodial Property Conditions

Acquired November 1998 FHA Case Number 221-127722 New Orleans, Louisiana
OIG Inspection March 16, 1999

This well was not secured by the REAM; a major safety hazard.



Acquired March 1998 FHA Case Number 131-799500 Rockford, Illinois

The REAM did not repair the roof causing the ceiling to fall.

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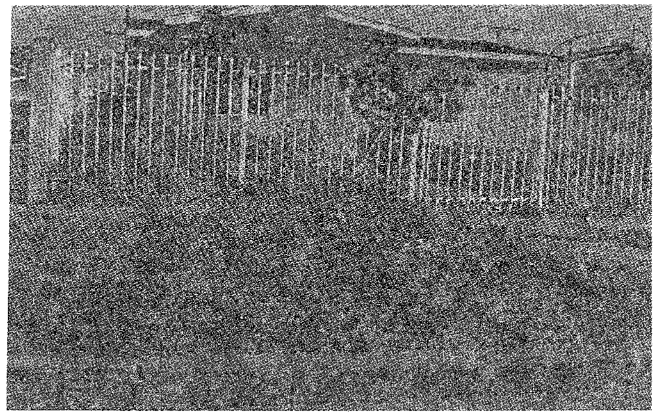

Acquired June 1998 FHA Case Number 041-856326 Los Angeles, California
OIG Inspection March 13, 1999

The REAM did not maintain the yard.

Acquired January 1999 FHA Case Number 221-272693 New Orleans, Louisiana
OIG Inspection March 16, 1999

Exterior not free of debris; a REAM responsibility.

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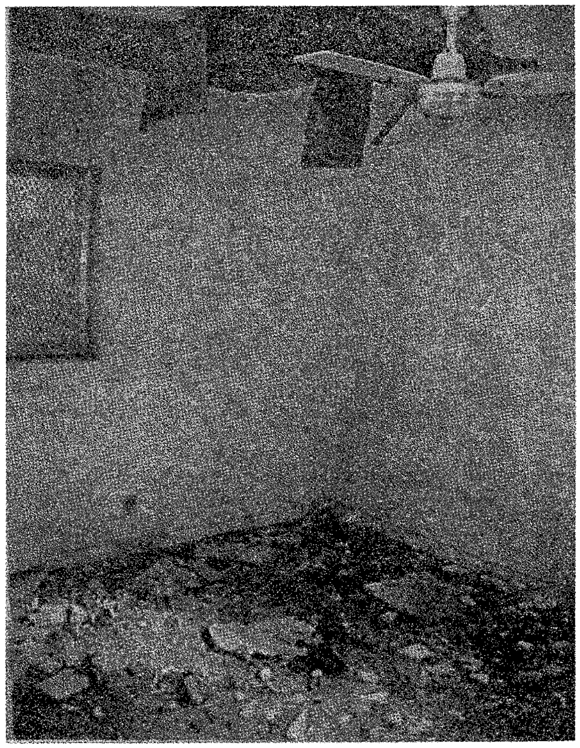

Acquired July 1996 FHA Case Number 092-446893 Ft. Lauderdale, Florida
OIG Inspection January 19, 1999

Ceiling has fallen from water damage caused by a roof leak. No repairs were made by the REAM.

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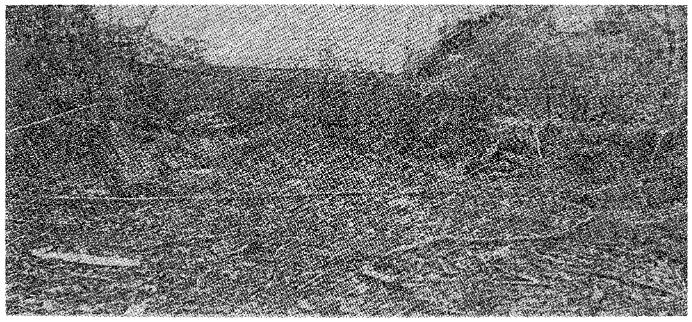
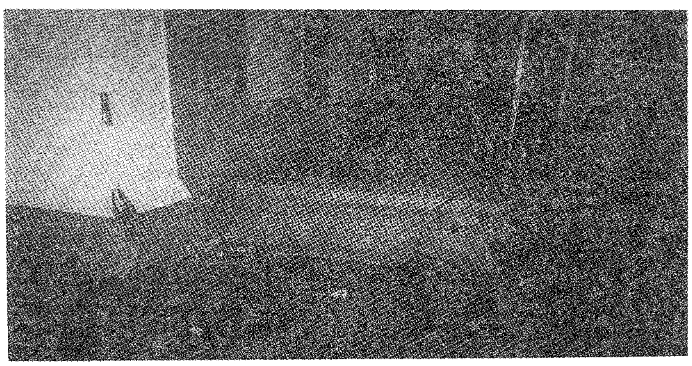


Custodial Property | FHA Case Number 221-154121 | New Orleans, Louisiana
Assigned November 1996 | | OIG Inspection March 17, 1999

Yard full of debris. Grounds were not maintained by the REAM. This condition adversely impacts the neighborhood and is a potential safety hazard.



Custodial Property | FHA Case Number 132-070682 | Petersburg, Illinois
Assigned June 1996 | | FHA Inspection December 15, 1998

Trash and other debris not removed by the REAM. The condition adversely impacts the neighborhood, and it is a potential safety hazard.

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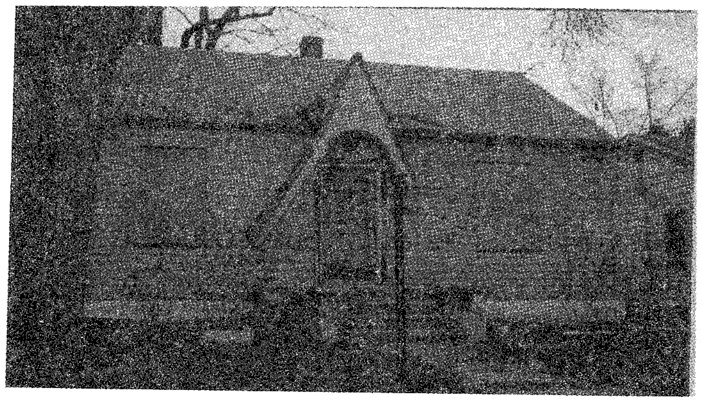

Custodial Property
Assigned May 1995

FHA CASE Number 132-069554

Alton, Illinois
FHA Inspection December 10, 1998

The condition of this property adversely impacts the neighborhood.

Same property as above.
The REAM contractor did not properly secure the property; a potential safety hazard.

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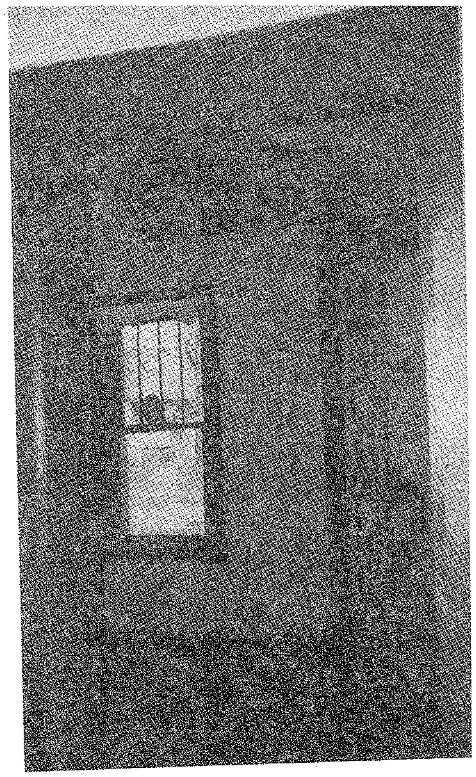

Custodial Property FHA Case Number 132-054460 East St. Louis, Illinois
Assigned November 1993 FHA Inspection December 10, 1998

Water damage caused by the REAM not repairing the roof.

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FHA Comments

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

SEP 2 1999

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

MEMORANDUM FOR: Nancy H. Cooper, District Inspector General for Audit, 4AGA

FROM: William C. Apgar, Assistant Secretary for Housing-Federal Housing Commissioner, H

SUBJECT: FHA Response to OIG Nationwide Internal Audit of FHA Single Family Property Disposition Program

Thank you for the opportunity to review and comment on your audit report on the Single Family Property Disposition program. The audit assesses program activities from October, 1996 through March 1999 and was performed by OIG staff from August, 1998 through April 1999 – a period of time when FHA was in transition from directly administering FHA's property disposition program, to outsourcing with private sector professionals. On March 29, 1999, FHA implemented the cornerstone of the HUD 2020 reform plan for single family property disposition, the Management and Marketing (M&M) contract initiative. Therefore, this audit is primarily focused on assessing program performance prior to the implementation of HUD 2020 reform, though it also includes a review of new contract management and control procedures developed by FHA in consultation with Booz-Allen & Hamilton for the new M&M environment.

The audit accurately notes a history of problems with FHA's property disposition program, citing a series of OIG and GAO reports conducted over the last several years, prior to the implementation of HUD 2020 reforms. The audit also accurately indicates that the pilot contracts for the new Management and Marketing approach were the subject of another prior OIG audit. In fact, FHA and OIG staff met nearly every week during the M&M pilot and worked together to construct a revised, model contract to address deficiencies in the pilot. This model, which incorporates every one of the recommendations of the previous OIG audit, is the basis for the new M&M contracts. Too often in the past, responses to prior OIG audits have resulted in short-term solutions which did not address inherent program weaknesses. Here, I believe the new M&M contracts developed with significant input from the OIG, has enabled the Department to finally free itself from the burden of an inefficient organizational structure.

While I am concerned that the report contains several false and misleading statements and relies in several instances on faulty methodological approaches to assess prior performance, I am pleased that the Office of the HUD Inspector General (OIG) shares my belief that the new Management and Marketing approach to FHA's single family property disposition will address many of HUD's long-standing program deficiencies. I agree with the conclusion of the audit which states that, "if FHA properly implements and consistently follows its manual [*Management Controls For The Single Family REO M&M Contracts*], most of the contract management problems shown in Findings 1 and 2 should be eliminated". As the audit notes, FHA has developed a comprehensive set of program management and control procedures to ensure effective monitoring of the new M&M contractors. We are aggressively implementing the procedures and controls identified in that manual and it is paying dividends. Contrary to concerns expressed in the audit that FHA will not act promptly to enforce sanctions when contractor performance is inadequate, we are aggressively monitoring M&M contractors' performance. The strongest evidence of this is that FHA terminated contract services under one of the 16 M&M contracts, ***30 days into performance under the contract***, due to performance issues. Moreover, FHA also issued six "cure" notices for other contract areas within the first ninety days of the new initiative.

FHA also disagrees with OIG's claim that current REO staffing levels under the M&M environment are not sufficient. FHA commissioned Booz-Allen & Hamilton to conduct detailed work flow and staffing analysis to address FHA's staffing needs under the M&M environment. FHA has ***exceeded*** the staffing levels recommended in Booz-Allen & Hamilton's January 22, 1999 report, recognizing the unique demands of the transition and initial implementation periods.

The draft audit report states "planned staffing may not be adequate to manage the new M&M contracts". The basis for OIG's faulty conclusion here appears to be drawn from 1996 study by Andersen Consulting, commissioned by FHA to review private industry practices and identify means by the Department could best improve its internal operations. Ultimately FHA determined that it could not match the skills and flexibility of the private sector, and as noted above, that ***outsourcing*** property maintenance and sales is the best approach for FHA. The Anderson study was a valuable tool in gathering information about private sector capacities, but its staffing estimates were premised on the assumption that all REO ***work would be performed directly by HUD employees***, not private sector contractors. Booz-Allen & Hamilton used information from the Anderson study for its analysis, but identified staffing requirements for the ***outsourcing*** approach, and emphasizes contract administration and oversight.

FHA also appreciates OIG's sound recommendation that management should provide additional guidance to FHA contract monitoring staff regarding reimbursements to M&M contractors for property repairs. As the audit notes, FHA solicited input from OIG in developing the M&M contracts and incorporated every one of OIG's recommendations into the final contract, including a dramatic reduction in the number of eligible pass through expenses.

Furthermore, FHA will follow OIG's new recommendation to revisit the potential for incorporating monetary penalties for contractor non-compliance with HUD requirements. FHA staff previously discussed the potential value of monetary penalties with HUD contracting staff prior to implementing the M&M contracts, and were advised that such provisions were not necessary since the M&M contracts are performance-based contracts, where non-performance on critical services adversely impact the contractors themselves. However, FHA will discuss options for inclusion of non-performance penalties, including liquidating penalties, with Departmental experts on contract approaches. FHA also agrees that our monitoring approaches will be strengthened by standardizing a reporting format, clarifying risk assessments, and identifying performance trends.

2

OIG's Assessment of Prior Performance

I am pleased that the OIG abandoned the ill-conceived analysis contained in the preliminary audit report to Congress that suggested that the Department was wasting a "million dollars a day" in taxpayers money on its REO sales operation. As you know, that unfounded accusation was the centerpiece of a Congressional hearing and a national television news broadcast. Even though the final audit backs away from this erroneous claim, the preliminary report nevertheless did substantial harm to the reputation of the FHA, and may have contributed to a loss of revenue as private entities lost confidence in our products. I am therefore pleased that the final audit does not include this erroneous claim.

The final OIG audit does however state that FHA incurred millions in unnecessary property holding costs and revenue losses. This conclusion too is patently false. OIG appears to reach this conclusion by comparing FHA's REO sales performance for 1997 and 1998 to optimum industry standards identified in the 1996 Arthur Andersen study. The Department simply did not adopt the goals cited in the OIG audit. These measurements are included in the Anderson study as optimum performance measures for the private sector REO industry, based on the 1996 real estate market. They do not reflect the Department's social mission, including sales to owner-occupants, nonprofit organizations and local governments. Furthermore, it is not realistic to expect a public agency encumbered with the regulatory constraints and stringent civil service restrictions to perform at the optimal level for private industry.

Instead, FHA strives to sell HUD-help properties in an average of 180 days, within range of the private industry standard which Andersen Consulting identified as between 150 and 180 days in inventory, but not equal to the optimal or peak private sector performance. As noted in the draft audit, FHA average sales in FY 1987 and 1988 was 182 days, only slightly above expectations. The 150 days in inventory goal identified by OIG in the audit is not FHA's internal goal, nor is it a realistic expectation under the old method of REO property disposition which is the subject of this audit. Therefore, OIG's entire basis for asserting that FHA's REO operation is losing revenue is faulty.

OIG also seems to have misinterpreted the intent behind edits imbedded in FHA's primary computer system for REO property inventory control, SAMS. SAMS tracks the status of properties from conveyance through sale and closing, using 10 distinct "steps" in the disposition process. When properties remain in a step past a selected time period, disposition specialists must review the account to determine if additional action is required. The OIG audit erroneously identifies the total days in step (157) as a standard. The "tickler" at the end of each step time period is not a goal, as OIG appears to assume, but rather it is a process flow management tool intended to highlight properties in need of focused attention.

Furthermore, the audit states that "During Congressional testimony in May, 1999, the FHA Commissioner downplayed these statistics" . Quite to the contrary, I recognize both their importance and complexity. Although misinterpretations of the data by OIG staff lacking program or industry knowledge are understandable, misrepresentations of performance goals and erroneous conclusions on

Appendix D

this issue are both misleading, and detract from genuine efforts to improve program performance. However, I do embrace the practical recommendation offered in the draft audit, that FHA update performance goals based on current market conditions, program objectives, and the M&M contract structure; and that property holding cost factors be re-computed.

The OIG audit also inaccurately cites as the cause of a growing portfolio insufficient staffing, inadequate travel funds, inadequate contract monitoring, and inadequate contract enforcement. Again, inherent deficiencies in the former disposition approaches did contribute to the problems listed above. However, the audit fails to recognize that economic and market conditions drove both an increase in property acquisitions and a sluggish resale market. Furthermore, a key advantage to FHA's new outsourcing approach is the ability of the private sector to swiftly expand and contract its workforce based on market conditions, and to foster expertise in skills not readily found in the federal workforce. Our recent experience with successful private sector contractors reveals that a relatively small, centralized disposition workforce relying on a strong network of local service providers can be *extremely effective. Conversely, contractors who most closely mimic FHA's prior disposition* approaches but utilize a significantly larger staff have been far less successful.

The adequacy of travel funds is a recurring concern in the draft audit. The draft identifies FY 1999 travel budget and expenditures for the Single family Home Ownership Centers. The allocation at the HOC level empowers the HOC Directors to use travel funds to meet immediate work priorities, property disposition being the number one priority for the HOCs throughout this fiscal year. The draft report states that "These figures appear woefully inadequate to protect the Government's interest". The draft contains no analysis to support this conclusion.

Under the new M&M initiative, FHA has established an aggressive oversight program which includes on-site property inspections of 10 percent of its portfolio each month by "special property inspectors" – private firms with property maintenance and inspection expertise, and review of 10 percent of all property files using third-party auditors. Out-stationed HUD staff re-inspect 10 percent of this sample as a primary control over HUD-held property and file conditions. Through this approach FHA once again maximizes the use of a private industry network of service specialists, and ensures contract compliance using on-the-ground FHA staff. None of these rigorous monitoring approaches tax current travel allocations.

As a final clarification, the Management and Marketing contracts do represent FHA's primary current means of disposing of properties. However, recent legislation has provided FHA with two new authorities representing alternative disposition strategies. FHA is negotiating pilot agreements with local communities to sell properties in "Asset Control Areas" to local governments and non-profits on a future flow, or "pipeline" basis. FHA has also initiated efforts to acquire and sell FHA-insured mortgages in default, in lieu of acquiring properties.

4

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Public Affairs Officer, G (Room 8256)
Director, Housing and Community Development Issue Area, U.S. GAO, 441 G Street N.W., Room 2474, Washington DC 20548 ATTN: Judy England-Joseph
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The Honorable Joseph Lieberman, Ranking Member, Committee on Governmental Affairs, United States Senate, Washington DC 20510-6250
The Honorable Dan Burton, Chairman, Committee on Government Reform, United States House of Representatives, Washington DC 20515-6143
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Department of Veterans Affairs, Office of Inspector General (52A), 810 Vermont Avenue, NW, Washington, DC, 20410

Mr. GILMAN. Thank you, Mr. Chairman.

Do you have requirements or guidelines for how much time HUD employees should spend actually looking at HUD-held properties, and how many site visits they should conduct? Do you understand my question?

Ms. COOPER. I do understand your question, but it's not an easy answer, so I'm trying to decide how to answer it.

HUD staff right now are contract monitors. They're not going to be property inspectors any more. The guidelines for the time that we've been looking at the REO operations——

Mr. GILMAN. You keep saying REO. What is REO?

Ms. COOPER. Real estate owned. The property disposition program.

Mr. GILMAN. What does REO stand for?

Ms. COOPER. Real estate owned. It's my southern accent. I'm saying real estate owned [REO]. I'm sorry, I was told not to use acronyms here.

I'll try to say property disposition program. Now I've lost track of what it was you asked me.

Mr. GILMAN. Let me repeat what I'm asking. Do you have any requirements or guidelines for how much time HUD employees should spend in actually looking at HUD-held properties and how many site visits they should conduct? I think that's a basic question to see whether or not they are able to do the job.

Ms. COOPER. For the last 1½ years, the contract monitors, the contractors who have been doing the property inspection, have had a requirement to do an initial inspection of every property that comes in under their responsibility. After that, they are required to do 10 percent of their portfolio every month.

I'm assuming that was probably the same criteria that HUD used when HUD did property inspection and had the staff to do it. They imposed that same requirement on the contractors.

Mr. GILMAN. Have you reviewed this to see if that's an adequate performance by HUD employees?

Ms. COOPER. Actually, the problems that we are going to be addressing are not with the number of inspections, necessarily. It would be more with the action that's taken once that inspection is done. They can inspect all day long, all week long, all year long. But if nothing is done with the results of the inspection, then it doesn't do much good, which is why I was hoping to get across the point that there needs to be some enforcement, if a contractor is operating properly.

Mr. GILMAN. I think we would agree on enforcement, but we also want to know, are there sufficient number of inspections before you get to enforcement? Do you feel there are a sufficient number of inspections by these number of employees who will be doing the inspection to make a proper determination as to whether or not HUD is performing properly?

Ms. COOPER. No. The answer is no.

Mr. BURTON. Thank you, Mr. Gilman.

The gentlelady from Hawaii.

Mrs. MINK. Thank you, Mr. Chairman.

I want to continue in the discussion that was started by our ranking minority member. I'm very much confused with the title of the hearing today, HUD losing $1 million per day.

I think that from your testimony and the chairman's opening remarks, one of the important responsibilities that HUD has or indeed any homeowner has is to maintain the property, to preserve the value of the asset. That has to be a major requirement.

So on the sad occasion of a foreclosure, where the Federal Government resumes ownership of the property because of failure of the previous owner to make payments, then it is a very important responsibility that the Federal Government assume the cost of maintenance and repair and general upkeep. Would you not concur that that's a major obligation that HUD assumes when it takes over a foreclosure?

Ms. COOPER. I agree.

Mrs. MINK. If that is a responsibility of the new owner, in this case HUD, then it would seem to me that the expenditures to maintain the value of the property is a legitimate expenditure, wouldn't you say that?

Ms. COOPER. I would agree.

Mrs. MINK. Then really, in line with the videos that we saw, perhaps the Department can be accused for not spending enough rather than spending too little. Because indeed, what we saw, and I have no idea what the rest of the properties are, but if they're typical, then what needs to happen is that HUD should have authority to hire more employees, and have greater sums of money accessible to it for maintenance and upkeep.

Isn't that a fairly logical conclusion?

Ms. COOPER. That could certainly be a valid point.

Mrs. MINK. Well, then, let me go to the point of the very large, substantial increase in properties in the HUD inventory, from 24,000 in October 1996 to almost double, 42,000, as you testified, the last of February of this year. Given their own goal of 6 months disposition, and their efforts to dispose resulted in 12,000 plus properties remaining in their inventory in excess of 6 months, I believe that's what you said?

Ms. COOPER. Yes, ma'am.

Mrs. MINK. Then if we're going to criticize that HUD has not energized itself to dispose of properties within a short period of time, its own target of 6 months, then isn't it more appropriate to say that the $29 you assess as being "wasted" because they fail to dispose of the property to be legitimately charged to the 12,000 properties and not the 42,000? In which case then, it could be said that HUD unwisely spent $300,000 per day because of its failure to dispose of properties in a timely fashion?

Ms. COOPER. At the time the IG made that statement, HUD had also promised that it would pipeline all the properties that were in its, that came into its portfolio. In effect, HUD was already behind in removing all properties from the inventory, as it has promised it would do.

Mrs. MINK. But you see, the whole discussion is absolutely faulty. Because on the one hand you admit that it is a legitimate expense on the part of the Government to maintain the value of these assets, and therefore, moneys have to be expended. Second, you talk about the disposal of the properties on the market, and making sure that the Government gets value for the properties that it has now obtained ownership for.

If it is true that only 12,000 properties remained after 6 months, and if we're going to talk about excess expenditures, it seems to me it's absurd to talk about $1 million a day. We ought to talk about 12,000 properties costing the Government $29 a day, when those properties could have been sold.

One final comment I want to say, that in my jurisdiction, which is having a terrible time in its economy, thousands of properties are being foreclosed, not necessarily to HUD, but to the banks and so forth. These properties were acquired at a time when the values of the properties were extremely high. Their failure to pay up their mortgages resulted in a foreclosure.

So there is a huge windfall for the institutions as well as the Federal Government for assets they are now acquiring that are extremely valuable. Those are asset values. But the other side of that coin is that our economy is so bad out there, there are very few people who can afford to buy these properties. So they are held extraordinarily long.

I was just talking to someone in my office a moment ago who had to leave for a new job opportunity. His house has remained unsold on the market for 18 months. Now, that private owner, I am sure, has been doing everything he can do, standing on the sidewalks trying to dispose of his property and not being able to do so.

So in some cases, I'm sure that HUD has found the community and State circumstances such that it is impossible to move these properties. So I think it's unfair to load upon HUD all of these situations without critical evidence to point specifically to the areas and properties and concerns that might generate legitimate oversight responsibilities on their part.

Otherwise, I think this is an enormous waste of time. I yield back the balance of my time.

Mr. WAXMAN. Will you yield to me?

Mrs. MINK. I yield to my ranking member.

Mr. WAXMAN. It just strikes me, your point was so well taken, that we're talking about 12,000, which is out of 41,000, less than a third of the properties under foreclosure. That's because they haven't met a self-imposed 6 month deadline.

But isn't it accurate that at least 2 of those 6 months are by statute time when HUD can't dispose of the properties, because they have to give the owner a chance to come back and cure it or have some public interest group come in? Isn't that accurate, Ms. Cooper? Isn't that the policy they have at HUD?

Ms. COOPER. I need to consult with my staff, please.

Mr. WAXMAN. I understand that's their current policy, but they're talking about changing that policy.

Ms. COOPER. My staff is telling me that when HUD forecloses, or when the lender forecloses, that the owner of that property does not have an opportunity to buy back.

Mr. WAXMAN. As I understood it, they have a policy where they give them time, they hold off for a couple of months. So they have this built-in restraint that they've built in. But also, these are hard to sell properties in inner city neighborhoods. I would think anybody would have a hard time selling some of those properties.

That's not to justify it, it's just to give some balance to the fact that we're talking about less than a third of their inventory and the difficulty in selling it.

I thank the gentlelady for yielding.

Mr. BURTON. The gentlelady's time has expired.

Mrs. Morella.

Mrs. MORELLA. Thanks, Mr. Chairman. I think this is a very interesting hearing.

I note that one of the witnesses coming up, I think in the third panel, is going to state that HUD has become less and not more responsive to HUD related neighborhood issues. I just wonder if you would walk me through the process. I am a homeowner. Next door to me is a neglected HUD property. What do I do? Do I report it? How do I go through this process in order to get some resolution?

Ms. COOPER. You'd have to be able to identify the asset manager who is overseeing that property. All of these properties are doled out to local real estate companies to maintain them and to secure them and to preserve them and to ready them for market. Then to market those products as well.

You would have to know who that real estate company was.

Mrs. MORELLA. Could I find that out easily?

Ms. COOPER. You should be able to find out if there is a HUD sign posted.

Mrs. MORELLA. And if there isn't?

Ms. COOPER. You call HUD, I suppose.

Mrs. MORELLA. So I can find this out, I call HUD and get that information. Then do I call that entity, that real estate firm?

Ms. COOPER. I'm assuming you're asking, if there was a problem at the house, or if you wanted to inquire about buying it?

Mrs. MORELLA. No, I just want to eradicate the problem.

Ms. COOPER. You would find out who that asset manager was, and you would complain to them, or you would complain to HUD. If you complained to HUD, it would be HUD staff responsibility to contact that asset manager to tell them they've had a complaint and to have them go out and correct whatever the problem is.

They're getting paid good money to maintain those properties.

Mrs. MORELLA. That's what I was also going to ask, is how long does it take, too, for this process?

Ms. COOPER. That's why we look at the average. There are extremes, there are some properties that get out of inventory in 30 days. There are some properties that do stay in inventory for a year or a year and a half.

So the measure of how efficient things are operating is the average. The average is 6 months. It takes 6 months to get them out of inventory.

Mrs. MORELLA. Have you heard of problems, of the fact that HUD is not responsive to neighborhood issues, or is becoming less responsive to neighborhood issues?

Ms. COOPER. We didn't look at that.

Mrs. MORELLA. It might be something to look at, too, as one of the criteria that you evaluate. And how they are rectified or resolved.

Let me ask you a very parochial question. Do you have any kind of a listing of properties that HUD owns that have not yet been sold in my area, or in any congressional district? Do you have an inventory of that?

Ms. COOPER. HUD maintains a computer system that lists all properties in its inventory. I can't imagine that couldn't sort that by neighborhood. I would say yes.

Mrs. MORELLA. By congressional district?

Ms. COOPER. Right. In fact, I know they do, because we did it to select our samples.

Mrs. MORELLA. What information would it give me?

Ms. COOPER. I haven't personally looked at the list. I can ask.

Mrs. MORELLA. I would be interested whether it tells me how long it's been on the market, whether there are inspections made.

Ms. COOPER. Apparently there are several reports that can be generated through this system. It will not tell you information about inspections. HUD doesn't record that.

But it will tell you when the property came into inventory, how much it currently lists, how much HUD has, how much it has cost HUD in payments to the asset manager or perhaps payoff of the lender's claim. It will tell you information like that.

Mrs. MORELLA. The reason I ask that is, I feel as a good legislator this would be an important thing for me to find out more about if I want to make sure that HUD is making money, that the neighborhoods are looking good, that we have things in order so there is personal oversight. Wouldn't you agree that is a good idea for a Member of Congress? It helps you out as Inspector General.

Ms. COOPER. I would agree.

Mrs. MORELLA. Thank you, Mr. Chairman. I yield back.

Mr. BURTON. The gentlelady yields back the balance of her time. Is there further discussion?

Mr. Kucinich.

Mr. KUCINICH. Thank you, Mr. Chairman. I want to thank you for calling this hearing.

My questions and remarks will be more germane to the next panel, so I'm going to yield my time to Mr. Waxman.

Mr. WAXMAN. I thank you very much for yielding.

It just strikes me as perplexing why we're holding this hearing today. You're in the middle of an audit, you haven't completed it. HUD has proposed some changes, isn't that correct?

Ms. COOPER. Yes.

Mr. WAXMAN. That's supposed to go into effect on March 29th.

I just don't know how constructive this is. The chairman says we want to show how they're not doing their job, losing $1 million a day of taxpayers' money so he can go to the Appropriations Committee and cut their budget. Do you think that would be helpful, if we had smaller appropriations for HUD?

Ms. COOPER. That's a decision for all of you, not me.

Mr. WAXMAN. Well, it seems to me some of the problems you were indicating were that there is not enough personnel to supervise some of these buildings.

Ms. COOPER. At the moment, there are not. That's correct.

Mr. WAXMAN. Well, your office in September 1997 made several recommendations concerning real estate management contracts. I want to go through some of them so we can see whether HUD has taken measures to implement those recommendations.

The IG recommended that HUD establish specialized positions for personnel responsible for contract oversight and monitoring to make them full time jobs with performance standards and training requirements. Has this been done?

Ms. COOPER. That I don't know. That will be a part of what we have left to do, to see what positions HUD has for contract oversight.

Mr. WAXMAN. Well, the IG previously testified that it has been done. So they haven't let you know in the office that your boss told us that it has been done.

Ms. COOPER. Perhaps I should have asked my staff.

Mr. WAXMAN. Well, the IG also recommended, your agency, that HUD integrate data systems and payment systems so that contract performance and contract payments will relate and be systemically monitored. Has this been done?

Ms. COOPER. One moment.

Mr. WAXMAN. Well, let me just tell you, the IG has already told us it has been done.

Ms. COOPER. My staff is telling me that they don't recognize those recommendations, it wasn't part of the scope of the work we're doing. If it's something we should——

Mr. WAXMAN. Let's see if they recognize this one. The IG recommended that HUD establish a threshold dollar amount for review of contract proposals by the Chief Financial Officer prior to contract awards.

Ms. COOPER. You're reading from——

Mr. WAXMAN. This is September 1997.

Ms. COOPER [continuing]. Our audit of contracting, is that correct?

Mr. WAXMAN. That's right.

Ms. COOPER. OK. This is work we have yet to do. This is what I was trying to explain. We have not yet looked at what HUD has proposed to do. We've been looking at what HUD's been doing over the last year and a half.

Mr. WAXMAN. Well, shouldn't you look to see whether they're improving?

Ms. COOPER. Yes, sir. That's exactly where we're headed next. We're looking at how those contracts read and how those contracts will be monitored to see whether or not there are strategies in the Department to properly oversee those contracts.

So if you ask me that question again in 3 months, I should be able to answer it.

Mr. WAXMAN. Let me point out that these are recommendations, your staff doesn't even remember it, but these are recommendations made in September 1997 by the Office of Inspector General. And as I understand it, these recommendations have been followed by HUD, including the next recommendation that HUD take steps to integrate and update its information technology systems. And there are others I want to go through.

But you and your staff don't even seem to be familiar with your own recommendations. Second, you haven't completed your audit to see whether the recommendations have been followed, if you could remember what they were. And third, you're here to be critical of HUD for not doing things in the past and you don't know whether they've changed.

So I just don't know how helpful this hearing is for us as policymakers to evaluate whether things are getting better.

For example, I'll just tell you, GAO was very critical of HUD's management problems in its high risk series major management challenges and program risks. But GAO also gave credit where credit was due, concluding that "HUD continues to make credible progress in overhauling its operations to correct its management deficiencies."

Do you agree with that HUD statement? If you do, how could you when you don't even know what they're doing, whether they made changes or not? Do you agree with GAO?

Ms. COOPER. The report you're referring to was an audit, nationwide audit overall of HUD's——

Mr. WAXMAN. Which report is that?

Ms. COOPER. The report with the recommendations you're referring to.

Mr. WAXMAN. But I'm asking about GAO's statement, which I just quoted. GAO did a written, what they call high risk series, they looked at HUD. They said, HUD continues to make credible progress in overhauling its operations to correct its management deficiencies. Do you agree with GAO?

Ms. COOPER. We have looked at the property disposition activities since January 1997 to today. My answer in that perspective would be no, they have not.

Mr. WAXMAN. Let me point out for the record and for your information, I read to you recommendations that were made by the IG office in September 1997. The IG testified in a subcommittee of this committee in a hearing in June 1998. So in June 1998, the IG testified that some of these reforms had in fact been accomplished, because she had made the recommendations and they were being followed.

You don't seem to know about that.

Ms. COOPER. With respect to the property disposition activity?

Mr. WAXMAN. With respect to the way they're contracted.

Ms. COOPER. The contracting issue has been outside of the scope of this audit. The contracting issue is HUD's ability to, as an organization, nationwide, to implement contract activities. It didn't simply apply to the property disposition activities, it applied to everything. It applied to automation of the Department, it applied to contracts for closing agents, it applied to numerous things.

Mr. WAXMAN. Did it apply to contracting people to manage the properties?

Ms. COOPER. It would, yes.

Mr. BURTON. The gentleman's time has expired.

Mr. WAXMAN. Isn't that what we're talking about here?

Mr. BURTON. The gentleman's time has expired.

Mr. WAXMAN. You might want to let her finish.

Mr. BURTON. Did you have something you want to add?

Ms. COOPER. I simply wanted to say once again, this is an area that we intend to look at, but we have not yet looked at it. It is a part of the scope of our audit. So we will address that contracting oversight ability by the time we finish the work and issue our audit report.

Mr. BURTON. Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman.

Ms. Cooper, I don't have the institutional memory that a lot of our members have, since I haven't been here until this year. But just so I can have the information, right now, HUD is in the transition, is that correct?

Ms. COOPER. That's correct.

Mrs. BIGGERT. Was this at the recommendation of the GAO, or was this something that they just decided to cut down on the numbers, and go to fewer offices, or to have the four major offices, rather than smaller offices across the country?

Ms. COOPER. I believe it actually started with recommendations from the NPR. HUD hired consultants to help them design a system that would work more like private industry works. The conclusion of the study was that they would go to these four centralized home ownership centers to process their property disposition and all other aspects of FHA.

Mrs. BIGGERT. So in the middle of this, then, you're doing an audit. Were they to be finished with that transition prior to this time, or is this just the time that it takes?

Ms. COOPER. They were to have been finished with this. One of the reasons that we're doing, that we've undertaken the review we have is that GAO reported problems. We didn't want to wait. And after GAO reported those problems, we didn't see the transition coming, we didn't see HUD making much progress toward what it was ultimately going for, which was the private contracts.

We were afraid we would get caught, as the IG, when Congress called and said, HUD hasn't accomplished what it intended to accomplish, where have you been. We wanted to be in a position when you asked to be able to tell you the state of HUD's activities.

Mrs. BIGGERT. Was there any definite date, then, for when this was to be accomplished, or not?

Ms. COOPER. There was. Let me see if my staff remembers the date.

Originally, it was August or September 1998.

Mrs. BIGGERT. So do you expect that you'll complete your audit by July of this year?

Ms. COOPER. Yes.

Mrs. BIGGERT. Do you expect that they will be then having finished the transition and be privatized, so to speak, or having the private contractors take over?

Ms. COOPER. They will. Those contracts have already been signed. As of March 29th, all properties will be turned over to those new contractors. So they are now transitioning, as we speak.

Mrs. BIGGERT. So you would expect that your audit will also include the results from March 29th to July and how that's operating? Or will you end just as of March 29th?

Ms. COOPER. What we'll try to do, it's going to be a little difficult for us to assess new contracts that have started up over that short a period of time. So what we will do is study the monitoring procedures by HUD, and we will review very carefully those contract terms.

We will try to make some recommendations to HUD where we see risks. If for example, the contracts don't have any provision for monetary penalties or HUD does not have contingency plans, we will make recommendations such as those. If HUD's monitoring has holes in it from our reading and our perspective, based on our historical knowledge, we'll make recommendations about that.

We will probably wait for about 6 months to a year to look at, and we'll go back and look at those contracts.

Mrs. BIGGERT. So will your specific recommendations include reducing the holding times, or the costs, as well as specifics for the contract, such as penalties?

Ms. COOPER. I expect our recommendations will address that. One of the things we think would be important for HUD to do is to be able to measure the cost of the new contracts and compare it, compare that with alterative ways of handling the property disposition.

Mrs. BIGGERT. Thank you very much. Thank you, Mr. Chairman.

Mr. BURTON. The gentleman from Massachusetts.

Mr. TIERNEY. Thank you, Mr. Chairman.

Ms. Cooper, is it your practice, or do you generally testify prior to completion of an audit, or before you've issued your recommendations?

Ms. COOPER. Not mine. No, sir.

Mr. TIERNEY. So you're telling me it wasn't your initiative to come here and testify prematurely today?

Ms. COOPER. Part of the mission of the Inspector General is to keep Congress fully informed. When Congress asks for information, far be it from me to deny them that information.

Normally, we like to finish an audit before we make the results of the audit public. It's not so much to Members of Congress, but it is to the press. We don't do that.

The reason we don't do that is because as an organization, we're held to well recognized standards which means that when we come forward with an audit report, by gosh, everything in it, all the T's have been crossed and the I's have been dotted. So we like to go through that full process before we issue an audit report.

We also like to give the auditee, in this case, HUD, an opportunity to respond to the results of our work, in all fairness. So we get those comments, we allow those comments to be in our report, and then the report gets issued.

So generally we do.

Mr. TIERNEY. So you didn't initiate this visit here today, I take it?

Ms. COOPER. No, sir, I did not.

Mr. TIERNEY. I think your visit is premature, for all the reasons you've stated. I can't for the life of me imagine, other than for the press or some other motive what we're doing here today.

I'll give Mr. Waxman the balance of my time.

Mr. WAXMAN. Thank you for yielding.

I appreciate that it's the policy of your office to give Members of Congress information, so that we'll have it available to us. I wrote to Ms. Gaffney, who's the Inspector General, and asked her to respond to a report that was prepared by Mr. Donald Bucklin, who used to be the staff for Senator Thompson on campaign finance investigation. He was very critical of the Inspector General, he said things like that tensions exist between Ms. Gaffney and other HUD officials, and she has not provided credible evidence supporting many of her challenges to HUD actions.

In fact, he went on and said many of Ms. Gaffney's statements "[reveal] petty, nitpicking arguments based upon misrepresentations, distortion of events, remarks taken out of context and arguments that defy logic and reason."

Now, that's pretty troubling, when someone makes that statement who was hired by HUD to do an independent evaluation of the IG. But I didn't get a response from Ms. Gaffney. I'm not critical of you. But if it's your policy to give Members of Congress information, which I thought would have been helpful for me to have prior to this hearing, I just want to put on the record, I never got a response from her prior to this hearing. I was informed a few minutes ago that she's been out of the country, that she'll try and get me an answer by March 26th. But that's after this hearing.

Ms. COOPER. May I respond?

Mr. WAXMAN. Sure.

Ms. COOPER. It's not the office policy to give information to Congress, it's the law.

Mr. WAXMAN. Well, tell Ms. Gaffney she may be breaking the law if she doesn't get this information to me, although I doubt she'll be prosecuted.

Ms. COOPER. That's why we're here.

Mr. WAXMAN. She's your boss, isn't she?

Ms. COOPER. Yes, she is.

Mr. WAXMAN. I hope she'll give me the answers to my questions, because those charges are pretty damning.

Now, I want to examine this HUD issue in comparison to the private sector. You would think that based on the criticisms that HUD was performing leagues below private firms that dispose of foreclosed property. But I don't know that that's the case at all.

Are you familiar with an industry benchmarking and best practices report by Andersen Consulting in March 1997?

Ms. COOPER. I'm not. No, we are not.

Mr. WAXMAN. Well, one critical success factor considered by the Andersen firm was HUD's ability to maximize return on sales. I don't know if you're aware that sales revenue for private industry averaged 96 to 105 percent or more of value. HUD's single family property disposition performance was comparable at 98 percent.

Another critical success factor recognized by Andersen Consulting was minimizing the cost of sale. Chairman Burton apparently believes that HUD is losing $1 million a day. But Andersen thinks HUD is doing as well as the private sector.

Are you aware that the industry standard for cost of sale was 12 to 18 percent of market value and that HUD's costs averaged 17 percent?

Ms. COOPER. I was aware that HUD's costs—no, that HUD's loss per property based on its acquisition costs, had increased from $28,202 in fiscal year 1996 to $31,728 in fiscal year 1998. I was aware of that. I'm not sure I was aware of the statistics that you——

Mr. WAXMAN. You weren't aware of the Andersen Consulting report?

Ms. COOPER. No.

Mr. WAXMAN. What is your job at the Inspector General's office?

Ms. COOPER. Pardon me?

Mr. WAXMAN. What do you do at the IG office?

Ms. COOPER. I'm the District Inspector General for the Southeast/Caribbean District. I am the audit manager in charge of the eight southeastern States and Puerto Rico. Overseeing internal and external audits of the Department.

Mr. WAXMAN. In that region?

Ms. COOPER. Or nationwide, which is what this is. But yes, sir, in that region, too, the external audits in that region.

Mr. WAXMAN. Thank you, Mr. Chairman.

Mr. BURTON. Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman.

I share the chairman's background in real estate, and I have some personal direct experience in acquiring HUD properties that have been foreclosed upon. I want to make sure that my memory is accurate in terms of what I recall from the transactions I've done.

The point of your visit here is to brief us on your progress, if you will, an interim report. And you've referenced the KPMG report of March 12, 1999, and suggested that your preliminary results mirror those conclusions.

I think the point I'd like to make, and I want to hear feedback from you very briefly, is in terms of property, REO property that HUD ends up owning, in terms of the REO stuff that HUD has, typically HUD takes possession after a number of months. In California, for instance, I think it's 3 months, 92 days or something, in terms of filing the notice of default and getting to a foreclosure and taking possession.

Oftentimes in that period of time, the person in whom title is vested will vacate the property. You end up with a property that has disconnected utilities, no maintenance, no occupant, no insurance. In some areas you'll get people who move into the property, then you have a squatters problem, et cetera.

I appreciate how you have pointed out here the cost of that delay that is incumbent to HUD when that delay takes place. You have talked about an average disposition time of around 6 months, suggesting there are some that go 12 months. But that ignores that first 45 days before you ever even have possession, if I understand correctly.

Ms. COOPER. That's correct.

Mr. OSE. In California, with the temperature variations we get, and the condensation we get, if we have an unoccupied property without heating or air conditioning, we'll get significant deterioration, as you showed in these pictures. For instance, in drywall, paint, what have you, flooring. We'll have people come in and steal the equipment, microwaves, utility, garbage disposal and the like.

Is it your point that we are failing in disposing of these properties in a timely manner?

Ms. COOPER. HUD's statistics support that we are failing in disposing of them in a timely manner, yes.

Mr. OSE. Is it your purpose in coming here today to suggest that your interim audit confirms that?

Ms. COOPER. That's correct.

Mr. OSE. As does the KPMG audit of last week?

Ms. COOPER. Yes.

Mr. OSE. I want to shift to this chart over here. Mr. Chairman, has that been entered into the official record?

Mr. BURTON. I think Mr. Waxman asked that it be entered into the record. I presume it was.

We'll put it in the record, without objection.

[The chart follows:]

MUTUAL MORTGAGE INSURANCE FUND

Financial Results

($ in millions)

	1998 Act.	1999 Est.	2000 Est.
Receipts			
Sales of Acquired Property	1,063	2,367	1,971
Recoveries from Defaulted Mortgage	16	15	0
Fee and Premiums	2,421	2,488	2,114
Sale of Mortgage Notes		244	
Interest on US Securities	921	1,031	1,125
Miscellaneous Income	4	(10)	(3)
Subtotal Receipts	4,425	6,135	5,207
Total Expenditures	(2,872)	(3,997)	(2,729)
Net Receipts	**1,552**	**2,138**	**2,478**

Mr. OSE. Thank you, sir.

I have a question on the fees and premiums, the $2.4 billion, I sat on the board of an insurance company. It's my recollection from our operations that we tried to cover operating costs off fees and premiums and generated our profit on the basis of our portfolio growth. If I look at those numbers over there, these premiums of $2.4 billion are less than total expenditures or $2.87 billion, generating about a $450 million deficit, which is close to the million dollars a day costs that we're otherwise concerned about.

I would appreciate having some further explanation as to what falls into that category that's described as total expenditures over there. I don't understand what's within the $2.87 billion. As a practitioner, and someone who has purchased HUD property, a year after HUD has taken possession under the REO, can you tell me or quantify for me roughly on a time line the loss in value that HUD suffers as you go from 6 to 9 to 12 months? Is it 10 to 20 to 30 percent?

Ms. COOPER. I wouldn't have information to give it to you like that. I certainly can't tell you. What will go up, the lender's claim will be the same. What will go up is the cost to maintain the property by the asset manager, the repairs that are needed based on vandalism, weather, those kinds of things.

The longer it sits without utilities, the more it deteriorates.

Mr. OSE. My point in bringing these things up is that the money we spend on that kind of activity, of correcting those deficiencies, we cannot spend to take care of new housing demand.

Mr. Chairman, I yield my time to you.

Mr. BURTON. I think I'll let the gentleman keep his time, if he likes. I'll bring up my comments and questions at the next panel.

Mr. WAXMAN. Would the gentleman yield so I can ask a factual question?

Mr. OSE. I would yield to my distinguished colleague.

Mr. WAXMAN. Thank you. I misunderstood, I thought you made a statement to her and she didn't dispute it. You said the average time for disposition is 6 to 8 months. Is that your testimony? Because I understood your testimony was that you were focusing on and criticizing that property which turned out to be a third, less than a third of the 41,000 that took more than 6 months.

But is it on average 6 months? Or are you critical or singling out for us those that took longer than 6 months?

Ms. COOPER. We're actually trying to show the trends in the whole portfolio. We're doing several things. We have taken statistics from HUD's own data base to try to compare to what HUD's property disposition mission is. We're looking at whether or not——

Mr. WAXMAN. Just specifically the 6 month figure. Is it inaccurate to say you're talking about an average, that it takes an average of 6 months or longer to sell property? Or did you single out that part of their portfolio that took longer than 6 months for which you were critical of the amount of money HUD had to spend?

Ms. COOPER. We didn't single out. HUD's goal is 6 months. We looked to see whether properties were being turned over to the market within 6 months. We saw that in fact HUD was not maintaining that 6 months.

Mr. OSE. May I reclaim, please?

Mr. WAXMAN. Yes.

Mr. OSE. I think the gentleman's point is well made about the houses that we hold in portfolio past 6 months. That is the area I'm concerned with, because that is the area we suffer the greatest declination in value. So I would like to reinforce your point, whether that 6 months is an average or not, my concern is focused on those houses that exceed that 6 months.

Mr. WAXMAN. I share your concern.

Mr. OSE. It's a legitimate area for concern.

Mr. BURTON. I thank Ms. Cooper very much. Unless we have further members wanting to speak, we'll have the next panel come up.

Mr. Apgar.

[Witness sworn.]

Mr. BURTON. Mr. Apgar is the Assistant Secretary for Housing and also the Federal Housing Commissioner at the Department of Housing and Urban Development. He's in charge of the Federal Housing Authority. Mr. Apgar, you are recognized for 5 minutes.

STATEMENT OF WILLIAM APGAR, ASSISTANT SECRETARY FOR HOUSING, FEDERAL HOUSING COMMISSIONER, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. APGAR. Good afternoon. On behalf of HUD Secretary Andrew Cuomo, I want to thank you for this opportunity to testify on behalf of the FHA.

FHA is a real success story. By insuring low down payment loans for people with less than perfect credit, FHA has helped more than 27 million American families to become homeowners. Last year, FHA assisted over a million families.

Perhaps more importantly, FHA does this at no cost to the taxpayers as the charts illustrate. Last year, we contributed $1.5 billion to the national deficit reduction effort.

Building on this record of achievement, Secretary Cuomo has created new and effective ways for FHA to conduct business. Today's hearing focuses on just one area of that reform, our FHA property disposition efforts.

As a mortgage insurer, FHA does take ownership of some properties. Last year, FHA took 70,000 properties, or approximately 1 percent of the more than 7 million loans outstanding. We are constantly looking for new ways of doing business. Over the last 2 years, we have developed, tested and now are implementing a new property disposition method, predicated on the belief that private sector real estate professionals can more efficiently manage and sell REO properties than HUD staff.

Before I go farther, to describe this new approach, I'd like to make a brief comment on the testimony provided by the HUD Office of Inspector General.

As the NBC situation pointed out, it's really important to get the facts straight in this review. And I will submit a detailed accounting of the factual errors contained in the testimony you just heard from the IG.

I'd like to briefly comment, though, on one prominent example of IG misstatement. This is the million dollar issue. The statement is provocative as you've heard here. In many ways it's misleading. What the Inspector General fails to recognize is that a vast majority of the costs discussed here today are not incremental costs associated with delay, but rather the basic costs of a sales operation.

Contrary to the statement by the IG, there has been no slowdown in recent years in the time it takes to sell FHA property. Moreover, as we noted from the Andersen Consulting study, FHA's average property holding and sales costs are squarely in line with industry standards.

Finally, it's noteworthy to reiterate that FHA does not cost taxpayers 1 penny, since the overall operation actually generates more than $1½ billion of net revenues.

Unfortunately, many HUD critics continue to focus on the past, rather than work with us to forge the new initiatives that are coming on line at HUD. By any objective standard, the new management and marketing approach is praiseworthy. First, we know this new contracting approach works. During more than 2 years of pilot testing at three sites, private contractors have proved able to sell properties faster and at a higher rate of return than HUD's own efforts.

Next, we are well on the way to deploying this successful model nationwide. Last fall, we received more than 170 proposals in response to a national RFP. This was one of the most competitive HUD procurements in history.

And finally, the contract is incentive based, with the entire fee set as a percentage of the net return to FHA. And at the suggestion of HUD's Inspector General, the contract minimizes pass-through expenses to HUD, creating a strong incentive for the contractor to sell HUD properties fast.

Our confidence in this report was bolstered by the recent assessment of the Office of the Comptroller General at the General Accounting Office. They concluded that the new approach would likely yield substantial benefits of cost savings and quality improvements. Over the last 8 months, we have worked with the management consulting company of Booz, Allen and Hamilton to develop a comprehensive set of management and financial systems controls. In combination with the new incentive based contract, this monitoring system will ensure the national program works as well as the pilots.

Finally, I'd like to take a brief moment to comment on the testimony you'll hear from Gale Cincotta. While I disagree with many of Ms. Cincotta's solutions, I agree with her focus on foreclosure avoidance. That's why I urge Gale Cincotta and others to take a careful look at the steps that FHA has taken over the past year to reduce foreclosures.

These strategies include our initiatives to foster greater use of FHA home buyer retention tools, to enhance FHA lender monitoring enforcement, and to create new appraisal monitoring systems that will provide consumers with the information they need to help them make good home buying decisions, and will enable FHA to better identify and sanction those lenders and appraisers who would abuse the system.

Before concluding my remarks, I'd like to thank Congressman Kucinich for alerting the Department to his concerns about the impact of the HUD Reform Act on grant application review process. The HUD Reform Act is designed "to preclude giving an unfair advantage to applicants who would receive information not available to other applicants."

However, as the Congressman has pointed out, applications sometimes are rejected for narrow technical errors, such as checking the wrong box on the form, which may seem to defy common sense. Mr. Kucinich has proposed an amendment to the Federal grants process, which would clarify the ability of applicants to correct these kinds of ministerial omissions or errors.

The Department will also take administrative action to provide clear guidance to applicants and HUD staff regarding notification of technical errors and applications for HUD grants. We believe these actions will address the concerns raised by Congressman Kucinich and others, and we are pledged to continue to work with the committee on this issue.

So in conclusion, Mr. Chairman, I'd like to thank you for this opportunity to testify. I believe an honest and objective assessment of these and other HUD reform initiatives will demonstrate that under the leadership of Secretary Andrew Cuomo, HUD is moving in the right direction. And I'd be happy to take any questions you may have.

[The prepared statement of Mr. Apgar follows:]

TESTIMONY OF ASSISTANT SECRETARY FOR HOUSING-FEDERAL HOUSING COMMISSIONER WILLIAM C. APGAR COMMITTEE ON GOVERNMENT REFORM U.S. HOUSE OF REPRESENTATIVES

March 23, 1999

**TESTIMONY OF ASSISTANT SECRETARY FOR HOUSING/
FEDERAL HOUSING COMMISSIONER WILLIAM APGAR
COMMITTEE ON GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES**

Good morning Mr. Chairman and members of the Committee. My name is William Apgar, and I am the Assistant Secretary for Housing/Federal Housing Administration Commissioner at the United States Department of Housing and Urban Development (HUD). On behalf of HUD Secretary Andrew Cuomo, I want to thank you for the opportunity to testify on the Federal Housing Administration (FHA), and specifically FHA's single family property disposition program, the focus of today's hearing.

FHA is one of the federal government's real success stories. Since 1934, FHA has helped more than 27 million American families become homeowners. We do this by insuring home mortgages, providing valuable credit enhancement that encourages private lenders to make home loans they otherwise would deem too risky. With the ability to take more risk by insuring low-down payment loans for families with less than perfect credit records, the FHA of today insures an additional than 1 million loans each year, the vast majority going to first-time home buyers, racial and ethnic minorities, urban dwellers and other American families who would not otherwise have been able to buy a home. We currently have nearly 7 million loans with an unpaid principle balance of $420 billion in our portfolio – that's approximately one out of every eight American home owners today who bought their home using FHA insurance.

Perhaps most importantly, FHA provides this valuable service to the American homebuying public at no cost to the taxpayer. The insurance premiums we collect plus recoveries on properties sold from the real estate owned (REO) inventory exceed the cost of all insurance claims and operations. In fact, last year FHA contributed more than $1.5 billion toward balancing the national budget.

And the financial condition of the Fund is strong. A recent actuarial review performed by Price Waterhouse (PW) indicated:

- **FHA's Mutual Mortgage Insurance (MMI) Fund, which backs single family mortgages, exceeded statutory capital requirements in FY 1998 for the fourth year in a row.** The capital ratio, a measure of the fund's cushion against unexpected insurance losses, was 2.71 percent, exceeding the Congressional target of 2.00 percent before the year 2000. This represents tremendous improvement in the capital ratio, which stood at **negative** 0.88 percent in 1990.

- **The projected economic value of the MMI Fund stood at $11.36 billion at the end of Fiscal Year 1998.** This represents a more than $14 billion increase in the value of the Fund since 1990, when it was **negative** $2.7 billion.

Furthermore, Price Waterhouse reports that the FHA fund is well positioned to become even stronger. PW estimates that the MMI Fund capital ratio will increase to 3.4 and the economic value of the fund will grow to more than $14.635 billion in FY2000.

HUD IS REFORMING FHA TO PREPARE FOR THE 21ST CENTURY

Under the leadership of Secretary Andrew Cuomo, FHA is implementing an aggressive set of Management 2020 Reforms. HUD is creating new and more effective ways for FHA to conduct is business. Instead of working out of 81 small and inefficient field offices, FHA now does business through four state-of-the-art Home Ownership Centers (HOCs). Working with Freddie Mac and Fannie Mae, FHA lenders and borrowers now have access to state-of-the-art automated underwriting system, reducing from days to a matter of minutes, the time needed to approve an FHA borrower for a loan. And we have reformed and rationalized dozens of FHA loan origination requirements and procedures to make FHA more customer friendly and bring our operations more in line with private market practices.

FHA also is aggressively working with lenders to implement our new loan loss mitigation program, a Congressionally mandated program that offers borrowers in default five different options to avoid foreclosure. Finally, we are reforming our REO property disposition to take advantage of private sector expertise. On February 1 of this year, we contracted with seven private real estate professionals to provide comprehensive property management and marketing services for our portfolio of approximately 40,000 REO properties.

In short, FHA is streamlining operations, centralizing back-office functions and staff, investing in advanced technology and drawing on private sector expertise wherever possible. Secretary Cuomo is leading FHA into the 21st Century, and turning it into a state-of-the-art mortgage insurance company.

FHA SINGLE FAMILY PROPERTY DISPOSITION

In the course of doing business as a mortgage insurer, FHA takes ownership of some properties due to borrower default. When a default occurs, FHA lenders first try to keep the borrower in their home by pursuing loan loss mitigation. If these efforts are not successful, the lender forecloses on the home and conveys the property to FHA in exchange for payment of an insurance claim. Last year FHA took in some 70,000 properties, on our base of nearly 7 million loans, or approximately 1 percent of all loans.

FHA foreclosed (or Real Estate Owned) properties tend to be located in distressed communities, and they tend to be in relatively poor physical condition. The challenge for FHA is to sell these properties in a manner that protects the government's financial interest and has a positive impact on neighborhoods where our properties are located. In the past we have attempted to do this by contracting with private firms to manage our properties, and using HUD staff to perform all marketing and sales activities. Using this approach, we sold more than 64,500 properties last year.

Over the last few years, FHA has explored new and innovative methods to improve its property disposition efforts. In 1997 we commissioned a comprehensive study of our property disposition operation by the management consulting firm, Andersen Consulting. The study noted that even though FHA has a number of competitive disadvantages relative to private sector REO operations, including the location and condition of our properties and cumbersome government regulations, FHA's performance compares favorably to industry norms. For example, Andersen reported that:

- The industry norm for sales revenue is between 96 percent and 105 percent of appraised value, and FHA sells properties at an average of 95 percent of market value;
- The industry norm for time in inventory according to Andersen is 120 to 180 days, compared to the current FHA average of 187 days; and,
- The industry norm for cost of selling properties ranges between 12 percent and 18 percent of market value, while FHA averages 15 percent.

So, while there clearly is room for improvement, the Anderson study confirms that FHA's operations already meet or closely approximate private industry benchmarks.

This study also refutes the HUD Inspector General's assertion that HUD delays in disposition are costing taxpayers $1 million a day on costs associated with property disposition. In their semi-annual report to Congress in September 1998 the HUD Inspector General stated:

> "With HUD's estimated holding cost at about $29 per day and with more than 41,000 properties in inventory, management delays in disposing of these properties are costing HUD over $1 million per day."

This statement is false and misleading. What the Inspector General fails to recognize is that these costs are not incremental costs due to delay, but rather are simply costs associated with any REO operation – whether a public agency or a private company. Last year the FHA REO property disposition operation grossed nearly $4 billion in sales, and the holding and sales costs were simply the cost of doing business. Moreover, according to Andersen Consulting, FHA's average property holding and sales costs (approximately $9,000 on an average appraised value of approximately $60,000), represent just 15 percent of appraised value, well within the industry standard of between 12 percent and 18 percent. FHA, like any organization with an REO property disposition operation encounters property holding and sales costs in the normal course of doing business. This is not noteworthy. The more relevant fact is that FHA's costs are squarely in line with private industry standards. Finally, it is worth reiterating that these costs, like all FHA expenses, do not cost taxpayers one penny, since the overall FHA operation actually generates net revenues. In fact, FHA generated more than $1.5 billion in revenue for the United States Treasury last year.

FHA is Reforming Property Disposition to Take Advantage of Private Sector Expertise

Building off the Anderson study, FHA moved to further improve operations. Over the last two years we have conducted a pilot demonstration to test an entirely new property disposition method that relies on private sector real estate professionals to perform all property management, marketing and sales activities. Rather than using private contractors to manage the properties and HUD staff to market properties, this approach utilizes private contractors to perform all management and marketing activities (or M & M activities), freeing HUD staff to focus exclusively on monitoring contractor activities.

This new approach is predicated on the believe that private sector real estate professionals can more efficiently manage and sell REO properties than HUD staff. The National Performance Review report on HUD completed in 1994, first suggested that FHA consider privatizing its REO operation. In that report, the NPR recommended that HUD:

> "Outsource its property disposition function in order to create higher returns. Private companies operating in a competitive market can normally provide a business service more efficiently than a government staff, which is protected from the rigors of competition. The management and disposition of problem assets is an essentially business, not government function....This is a suitable task for a business organization with its own money at risk and a clear profit motive tied to maximizing the net return on assets. This is not a suitable task for salaried government staff working from government rules and handbooks"

Mr. Chairman, we know this new contracting approach works. During more than two years of pilot testing in three locations – Baltimore, Maryland, New Orleans, Louisiana and Sacramento, California -- private contractors proved able to sell REO properties more quickly and at a higher rate of return than HUD. Under the pilot the average time in inventory was reduced dramatically in all three locations, and the average property sales price and the net return to FHA increased dramatically in two sites and remained constant in the third (Sacramento, California), despite a downturn in the regional real estate market. Pilot results included the following:

- **The average time a property was in inventory was reduced** from 211 days to 139 days in Baltimore; from 236 days to 132 days in New Orleans; and, from 162 days to 122 days in Sacramento; and,

- **The average sales price per property increased** by $17,108 in Baltimore and by $6,011 in New Orleans;

- **The net return to FHA per property increased** by $13,695 in Baltimore and by $5,105 in New Orleans.

These results not only represent a dramatic improvement over FHA current operations, in most dimensions they meet or exceed the results obtained by other private sector REO sales efforts.

Implementing Management and Marketing Contracting Model Nationwide

Now, we are taking this successful model nationwide. Last August we issued a Request for Proposals (RFP) for sixteen contracts covering the entire country, that was met with tremendous enthusiasm from the real estate community and government watchdog agencies, alike. In what HUD's Chief Procurement Officer called one of the most highly competitive procurements HUD has every conducted, we received more than 170 proposals from a number of highly-qualified private sector real estate professionals.

The HUD Technical Evaluation Panel, Chaired by the Director of our Denver Home Ownership Center (HOC), and staffed with a mix of senior field and headquarters REO staff, selected seven highly qualified contractors in January of this year, and FHA entered into contracts with these firms on February 1, 1999. Over the last several weeks we've been working with the contractors on a daily basis to ensure they will be ready to begin providing services on Monday, March 29, when they are scheduled to take over approximately 25,000 properties that are not currently under a sales contract.

Mr. Chairman, we also are confident that these well-qualified contractors will have strong of incentive to perform. The M&M contract is incentive-based with the entire contractor fee set as a percentage of the net return on sale to FHA, creating the incentive to sell the properties at a fair market price. And at the suggestion of the HUD Inspector General, the contract minimizes pass through expenses to HUD by requiring the contractors to bear the bulk of the costs associated with maintaining the properties, creating a strong incentive to sell properties quickly.

To further improve the property disposition process, we also have added contract provisions that require contractors:

- **To use the Multiple Listing Service (MLS)** to market properties, a requirement that should greatly enhance our marketing reach, create more demand for our properties and generate a higher return on sale;

- **To use electronic bidding** to replace our previous sealed bid method that caused substantial delay in our process and was prone to human error;

- **To inspect every property within 24 hours** of conveyance into our inventory;

- **To complete property appraisals** within ten days of conveyance, to ensure properties are brought to market quickly.

M&M Performance Goals

Mr. Chairman, I believe this contracting model will greatly enhance our operations. By contracting with the best private sector real estate professionals and modifying our procedures to take advantage of the latest advancements in real estate industry practices, I believe we can dramatically improve our REO property disposition performance. Specifically, in the first year of operating under the M&M model nationwide, we aim to:

- **Reduce the average time we hold properties in inventory** from our current average of 187 days, to between 150 and 160 days; and

- **Improve our net return on sale,** the percent of property market value we net after paying all costs associated with managing and selling the property, from our current level of 79.40 percent to 81.40 percent of property market value, an improvement that would generate additional revenues of more than $80 million annually for FHA.

However, these improvements will not just create dollar savings and boost the financial return to HUD, they will also mitigate any adverse impact our properties may have on neighborhoods.

The Comptroller General of the United States agrees that our transition to the M&M contracting model nationwide is likely to generate positive results. In assessing the contract model during the procurement process the Office of the Comptroller General at the General Accounting Office (GAO) said:

> "We conclude that the record supports finding that substantial benefits of cost savings and quality improvements will likely result from the consolidation of the previously contracted-out requirements with HUD's new requirements into contracts covering relatively large areas, and that these benefits go beyond reducing administrative and personnel costs alone. The expected improved program efficiency and quality, as well as the substantial potential cost savings, support the finding that the consolidation of the requirements under the M&M RFP approach was necessary and justified."

FHA Has Developed a Comprehensive Contract Management and Control System

With the transition to the M&M model, FHA staff will focus exclusively on monitoring contractor activities. Over last eight months an interdisciplinary team of staff from FHA Headquarters and field REO divisions, the Office of the FHA Comptroller, the Office of Procurement and Contracts, and the Office of General Counsel have been working with the management consultant Booze-Allen & Hamilton to develop a new comprehensive system of management, financial and systems controls for the M&M contract environment. Our new monitoring and control system calls for FHA to:

- **Inspect the physical condition of 10 percent of all properties in the inventory on a monthly basis,** using a combination of third-party contract monitors and FHA staff;
- **Audit 10 percent of all M&M contractor files on a monthly basis**, employing a combination of third-party due diligence contractors and FHA staff. These audits will capture information related to the property inspection, appraisal, maintenance, listing, marketing, bids, sales contract and closing activities;
- **Complete on-site process observations at the M&M contractor's offices** on a monthly basis, to ensure contractor staff are properly following specific contract requirements;
- **Conduct on-going analysis of results of all property inspection, file audit, and performance measure reports,** including data on time in inventory and net return on sale;
- **Hold monthly performance reviews with the contractors,** to assess critical performance measures, identify deficiencies and discuss corrective actions;
- **Prepare comprehensive contractor performance assessment reports** for each contract area on a monthly basis.

FHA Headquarters staff also will support the system by conducting quarterly reviews of each HOC's REO operation. The objectives of these reviews are to confirm adherence to prescribed monitoring procedures, provide additional training to HOC REO staff as needed and share lessons learned from "best practices" of other HOC REO operations.

FHA is Creating New Partnerships with Local Governments and Nonprofit Organizations

In reforming our property disposition program, HUD also intends to maintain its long-standing commitment to working with local governments and nonprofit organizations wishing to purchase HUD-owned single family housing as part of a broader local strategy to provide and promote affordable housing in cities across the country. Last fall HUD worked with Congress to create a new approach to transfer FHA foreclosed homes located in revitalization areas to local government and nonprofit organizations.

This new approach, which was included in the FY99 HUD Appropriations Act, will include deep discounts on properties in revitalization areas to defer some of the cost of rehabilitation, and it will offer local government and nonprofit organizations unprecedented control over the neighborhoods they work in. Rather than simply offering properties for sale on a property-by-property basis, HUD plans to enter into broad agreements with local governments which will agree to purchase all FHA foreclosed properties within a specifically defined revitalization area, to be selected by both the local government and HUD. This will further focus federal and local resources on those neighborhoods most in need of public investment.

The FY1999 HUD Appropriations Act also gave HUD critical new statutory authority to pay insurance claims in exchange for a note, a modification to our statutes that will pave the way for FHA to pursue a note sales approach to disposition on a broader scale. This alternative approach to property disposition could lead to even further savings once fully implemented. While implementing the M&M model nationwide, HUD/FHA are actively working with a number of external financial consultants to asses alternative program designs using these new authorities.

FHA IS ENHANCING ITS FORECLOSURE AVOIDANCE CAPACITY

Finally, FHA recognizes the importance of helping FHA insured borrowers avoid foreclosure. Foreclosure avoidance not only helps keep families in their homes, it also benefits the FHA Fund in avoiding the costly process of selling REO properties. Over the last several months, FHA has taken a number of steps to reduce foreclosures. These strategies include:

(1) Facilitating greater use of FHA's loan loss mitigation program designed to provide troubled borrowers effective options to foreclosure, and thereby reduce the number of FHA defaults and claims;

(2) Enhancing FHA lender monitoring and enforcement activities;

(3) Developing automated systems to monitor insured loan performance and Specific enhancements in these areas include:

Facilitating Greater Use of FHA's Loan Loss Mitigation Program

FHA's new National Loss Mitigation Center located in Oklahoma City with thirty-seven staff dedicated to facilitating greater use of the loan loss mitigation program, opened the Summer of 1997 and became fully operational in February, 1998. Staff in this new functional center focus solely on providing foreclosure avoidance counseling to FHA homeowners in default, performing on-site training and monitoring of high volume servicing lenders, and conducting large group training seminars for smaller loan servicers across the country.

The Center's work already is showing results. FHA is seeing a dramatic increase in the number of homeowners in default who are gaining access to one or more foreclosure avoidance options offered by FHA. In FY 1998, FHA helped nearly 11,000 homeowners take advantage of foreclosure avoidance options, with the number of assisted families increasing each month. During the first quarter of FY 1999 this new program has continued to gain momentum, as FHA lenders put more than 4,800 borrowers into one of the loan loss mitigation options. If this rate of use continues throughout the year, as FHA expects it will, then the program should serve approximately 20,000 borrowers this year, a remarkable increase over activity levels in previous years.

FHA also is beginning to see a marked increase in use of loan loss mitigation program options that keep borrowers in their homes. Of the more than 4,800 program cases during the first quarter of FY 1999, more than 3,600 cases, or approximately 75 percent of all cases, were options that keep the borrower in their home (options such as mortgage modifications, special forbearance or partial claims).

Moreover, HUD officials worked closely with Congress last fall to craft legislation creating new authority for FHA to impose financial penalties in an amount up to treble the amount of the outstanding insurance claim on lenders who do not follow FHA's loan loss mitigation requirements. This powerful new enforcement tool, which was included in the FY 1999 HUD/VA Appropriations Act, will greatly enhance FHA's ability to enforce existing program requirements and also should encourage even greater use of the loan loss mitigation program.

Enhancing FHA Lender Monitoring and Enforcement Activities

FHA has taken several steps to enhance its lender monitoring and quality assurance activities to ensure lenders are conducting quality underwriting of insured-loans, and servicers are thoroughly evaluating every candidate for the loan loss mitigation program. Since FY 1997, the Department has increased the number of lender monitors from approximately 23 to154 monitors, and nearly doubled the number of annual on-site monitoring reviews from 256 to 440. For FY99, FHA has established a goal of performing 900 on-site reviews. This increase in activity, naturally, increases lender awareness of FHA program requirements, and is designed to improve lender performance and mitigate losses due to defaults and claims.

Developing Automated Systems to Monitor Insured Loan Performance

FHA has developed a new automated system for monitoring loan performance data by lender and geographic area. The Neighborhood Watch system, which was designed to track FHA insured loan performance by several different characteristics including the originating lender, the FHA loan program, specific loan characteristics, and geographic areas, was implemented nationwide in May, 1998. This new automated system gives FHA staff a powerful automated tool for monitoring defaults and making relative comparisons of lender performance.

Furthermore, FHA also is preparing to launch a new performance-based lender enforcement program. The Quality Assurance Division in HUD Headquarters is on schedule to restart the Credit Watch/Termination initiative in FY 1999. This initiative is designed to improve lender origination performance by regularly reviewing mortgagees' early payment default and claim rates by branch office within regional markets, and alerting mortgagees of deficient performance.

Finally, as part of the new Home Buyer Protection Plan announced by Secretary Cuomo in 1998, FHA is now piloting a new automated appraisal monitoring system. This new system will provide consumers the information needed to help them make a good home buying decision, and enhance FHA's capacity to identify and sanction those lenders or appraisers who would abuse the public trust by submitting inflated, incomplete, or misleading appraisal information to the potential home buyer or the FHA.

HUD HOMELESS PROGRAMS

Finally, on another topic, I would like to thank Congressman Kucinich for alerting the Department to his concerns about the impact of the HUD Reform Act on the grant application review process. The HUD Reform Act is designed to "preclude giving an unfair advantage to applicants who would receive information not available to other applicants." However, as the Congressman pointed out, applications are sometimes rejected for narrow technical errors – such as checking the wrong box on a form - which seem to defy common sense.

Mr. Kucinich has proposed an amendment to the federal grants process which would clarify the ability of applicants to correct these kind of ministerial omissions or errors. The Department will also take administrative action to provide clearer guidance to applicants and HUD staff regarding notification of technical errors in applications for HUD grants. We believe that these actions will address the concerns raised by Congressman Kucinich and other members of the Committee, and we are pledged to continuing to work with the Committee on this issue.

CONCLUSION

Mr. Chairman, I would like to thank you for this opportunity to testify today. I would like to conclude by reiterating that I believe HUD and FHA reform is headed in the right direction. I am excited by the prospect of launching the M&M model nationwide, and I look forward to reporting back to this committee and other members of Congress on the program results. Thank you, and I look forward to answering your questions.

Mr. BURTON. When a person buys a house on FHA, they buy the FHA mortgage insurance?

Mr. APGAR. That's correct.

Mr. BURTON. And the premiums that they pay go into the mortgage insurance fund?

Mr. APGAR. That's correct.

Mr. BURTON. If they default on their mortgage, the money comes out of that fund to pay for any loss that the mortgage fund incurs, it comes out of that fund?

Mr. APGAR. That's correct.

Mr. BURTON. And when the property is then sold, the money that's received from the sale of that property then goes back into the fund?

Mr. APGAR. That's correct.

Mr. BURTON. According to the previous panel, based upon the acquisition costs, they increased from $28,000 in fiscal year 1996 to $31,728 in fiscal year 1998. They say as a result, the loss to the mortgage insurance fund increased from about $1.5 billion in fiscal year 1996 to slightly over $2 billion in fiscal year 1998.

That money is not a direct loss to the taxpayer, but it is a direct loss to the fund. Now, when the fund loses money, that means that the people who are paying into the fund, the people who are buying that mortgage insurance, do not benefit from a profit in the fund, they lose because there's a loss in the fund.

So the premiums that could go down to the millions of people who have FHA loans do not go down because of the loss in the fund, is that not correct?

Mr. APGAR. First of all, the data you just cited are some of the factual errors that are contained in this report. We have no idea where they got the 7 percent increase in cost per sale. Our own estimates suggest that it hasn't increased, just as our own estimates suggest that there's no increase in the length of holding time.

But you are correct to the extent to which we incur costs in selling homes, that results in a loss in money to the fund.

Mr. BURTON. If a property, let's say a person moves out, and they have a mortgage of $50,000 on a property, and the property is worth $70,000, you've got a $20,000 profit there that's going to go back into the fund. But if the house sits there and deteriorates, as we've seen these other houses deteriorate, for 6 or 7 months, and then it's only sold for $55,000, instead of the $70,000 it would have gotten, that's a loss of $15,000 that could have gone into that fund, because it had to be held for that extra period of time, isn't that correct?

Mr. APGAR. Typically, sir, if a property is worth more than the value of the outstanding mortgage insurance——

Mr. BURTON. No, you're missing the point. My point is——

Mr. APGAR. That property will never come to us, sir. If the market value of the property is more than the outstanding mortgage balance, the lender would repossess the home and sell it through their own mechanisms.

Mr. BURTON. Let's just say it's $45,000 and the property is worth $50,000. The lender is going to lose money. And it sits there. There's a $5,000 loss. If it sits there for 6 months and it deteriorates, it goes down to $25,000.

So now you have, instead of a $5,000 loss, a $20,000 loss, and that is absorbed by the fund, right?

Mr. APGAR. While the properties aren't being sold, the fund incurs costs, correct.

Mr. BURTON. So the fund loses money. Now, who pays into that fund?

Mr. APGAR. Who pays into the fund?

Mr. BURTON. Yes.

Mr. APGAR. The receipts come from the mortgage insurance premiums.

Mr. BURTON. Which is paid by?

Mr. APGAR. By the home buyers in the FHA system.

Mr. BURTON. That's right. So if the people who are in the fund, who are buying a home, I want to buy an FHA home, and I have to pay a certain percentage into the mortgage fund for mortgage insurance in case I default on a loan.

If the fund continues to go down by $1 billion or $1½ billion or $1 million a day or whatever we're talking about, then what that means is the costs are going to be passed on to the consumer in the form of an increase in the premiums, or at the very least, not a decrease in the premiums that they could realize if the fund was making money.

Mr. APGAR. Well, if that were the case, that would be true. But of course, the fund is strong, it's the most financially secure position we've been in over a decade. As a result of that, in the last several years, we've cut premiums in several significant ways. We've had a special first time buyer program cut, which for counseled buyers, we give them a discount off their property insurance as well as an inner city discount.

So in fact, we have been able to cut insurance premiums, because the scenario you described just isn't true.

Mr. BURTON. If the IG is correct, and you're saying that it isn't correct, but if the IG is correct and it's losing $1 million a day, or $365 million a year, then that money is coming out of the fund, if they're correct. You're disputing that. But if they're correct, that money is coming out of the fund.

And if there has been a reduction in premiums, as you've said, to the consumer when they get a loan, it could be greater if that figure is correct, the $365 million a year. I know that's a hypothetical figure to you and you don't agree with it. The fact is if money's coming in, I was an insurance man, too, as well as a real estate man.

There is what's called the law of profit and loss in the law of large numbers. If you're losing money, what the insurance carrier does is they either increase the premium or they eliminate the risk by reducing that class of business so they don't have to insure it any more. But in any event, they're going to operate at a profit.

Now, you don't have to operate at a profit, but you have to at least maintain some funds in that insurance fund. So the bottom line is, if you're losing money each year, because of excess properties being on the market, because maintenance of those properties is high, then that money comes out of the fund, and that money cannot be passed back onto the persons buying the insurance in the form of lower rates.

That is correct, isn't it?

Mr. APGAR. Right. If all the scenarios you say are true, then your final conclusion is true.

Mr. BURTON. So the big difference we have, then, is whether or not you're correct or whether or not the IG is correct. If you're correct, there's no problem. If the IG is correct, we're losing $1 million a day out of the fund.

Granted, according to Mr. Waxman, this is not taxpayers' money. But it is the money of millions of people who have loans through the FHA mortgage loan program. So it might not be taxpayers' money, but it's the money of millions of people who have homes through the FHA plan that could realize a lower premium, therefore more money in their pockets, if there wasn't a problem. That's the premise that we're talking about.

Mr. Waxman.

Mr. WAXMAN. Before I begin my questions, I want to yield to Mr. Kucinich.

Mr. KUCINICH. Thank you very much, Mr. Waxman, Mr. Chairman.

I want to thank the Chair for holding this hearing, because one of the outcomes that we've seen, as demonstrated by the testimony of Mr. Apgar, is that HUD did recognize problems and demonstrated a willingness to take action and reevaluate their policies. I want to tell the Chair how much I appreciate your support, and I appreciate Mr. Waxman's support.

All I'm saying is that the response that Mr. Apgar gave is in response to a recognition by HUD that there are problems. And they demonstrated a willingness to take action. That came about, I might add, because of the support of the Chair and also Mr. Waxman. So these hearings can be productive in some way. Thank you.

I yield back to Mr. Waxman.

Mr. WAXMAN. I thank you for pointing that out, because it does show that there is a responsiveness at HUD to a genuine criticism that all of us have. I thank you for being responsive.

Let me go to the points that are before us today, that the chairman seemed to try to argue that when money is paid out of this fund that it raises premiums for others. So it's not taxpayers' money, but other people are going to pay more for their premiums.

Are your premiums based exclusively on the loss, meaning money that was spent to maintain the property?

Mr. APGAR. No, they're based on the overall financial health of the fund. Which as I said is the strongest it's been in over a decade.

In the 1980's, of course, the fund was very much mismanaged. We had a serious situation where the fund was net underwater. Since that time, we've rebuilt the capital base of the fund through prudent management to its highest level in over a decade.

We just had the new audit by our Price Waterhouse. This audit again makes this point.

Mr. WAXMAN. So it's not like if you have insurance and you pay off a loss—that's what insurance is all about—it doesn't mean your insurance companies have to immediately turn around and ask everybody to pay more for that loss.

Mr. APGAR. We expect to take certain loss. That's part of our whole risk management strategy.

Mr. WAXMAN. That's why you have the insurance.

Mr. APGAR. That's right. We lend to people who, quite frankly, could not get a loan other ways. They are riskier borrowers. We anticipate a certain amount of losses as part of the calculation that goes into making those mortgages.

And as was mentioned earlier, 93 out of every 100 of our borrowers go on to be homeowners, successful homeowners for life. When there are issues, and the property is foreclosed upon, that's what we're talking about today, the small number of cases, not the large number of successful cases.

Mr. WAXMAN. I want to question you about how HUD is performing with these foreclosed properties compared to the private sector, because I think that's really the issue that's before us. But I want to just take a moment to point out to everybody what FHA means to people. FHA insured 585,000 people, or one-fourth of all first-time home buyers' in 1997. FHA is the primary insurer in urban areas and insures more mortgages of African-Americans and Latinos than any other insurer.

In fact, the 1996 Federal Reserve report concluded FHA bears approximately 66 percent of the aggregate credit risk for minority and low income borrowers and their neighborhoods, while private mortgage insurers bear only 6 to 8 percent. Of FHA insured home purchase loans, 15.4 percent were to Latinos, compared to 6.8 percent for home loans insured by private insurers in 1996.

Of FHA insured loans, 13.2 percent went to African-Americans, compared to 5.3 percent of home loans in the private insurance market. Of FHA insured home purchase loans, 31 percent were to low income borrowers, compared to 14 percent for home loans insured by private insurers in 1996. In fact, almost 85 percent of FHA's loans to low income borrowers in 1995 would not have qualified within private insurance market guidelines to loan to value ratios. Which means these poor people wouldn't have been able to buy homes.

Even serving all these needs, FHA performs generally on par with private mortgage insurers, isn't that right?

Mr. APGAR. Yes. We did the Andersen benchmarking study because we wanted to know how we compared, where our areas of weakness might be as we began this new process of changing our property disposition activity.

Mr. WAXMAN. Let me just ask you, regarding the Andersen benchmark study, are there a lot of different studies out about how well you and the private sector would be doing in this area of dealing with foreclosures and homes?

Mr. APGAR. We wanted one that focused on our details. So this is the one we have. There are other studies that compare FHA activities. For example, in terms of our sales price information, there's a national study that says that our sales price relative to an estimate of market value is on a par with other private entities.

Mr. WAXMAN. Can you imagine anybody in your field not having heard of the Andersen study?

Mr. APGAR. It was pretty widely discussed, it was a very important study for us, and it was a key to our restructuring our FHA operations.

Mr. WAXMAN. I was shocked that the representative of the Inspector General seemed to never have heard of this, even though she was here commenting on this very area.

Mr. APGAR. In our testimony before another committee last year, of course, we provided information on the Andersen study. This is no secret on our part. We've been using this information to try to refute these claims that FHA is a poor performer.

Mr. WAXMAN. My time is up, and I'm hopeful I'll get more time, because Mr. Kucinich said he'd come back and yield me more time. I want to go into precisely how the private sector matches up to HUD in this very area for which HUD is being criticized.

Thank you, Mr. Chairman.

Mr. BURTON. Mr. Kanjorski is next.

Mr. KANJORSKI. Thank you, Mr. Chairman.

Mr. Chairman, I come a little bit armed, because I not only have the opportunity to sit on this committee, but I have spent the last 14 years of my career on the Banking Committee. We're well aware of the history of HUD and the housing problems that have existed in the United States.

I think the records show that in the second term of the Reagan administration and in the first and only term of the Bush administration, there was always great consternation in the Banking Committee about FHA. We thought there was some hidden vault down there in the Department building where all these records and all these properties were located, and no one really had a handle on it.

Over the last 6 years, the Department has undertaken a massive approach to handling inventory, studying these problems and getting a handle on these problems. Consistent with any criticism of HUD or any other Federal agency, for that matter, there is always room for criticism and always room for tightening. It's evident that there are things here that we would like to have operate in a more effective manner.

To the Commissioner, I'd like to say that every report I'm getting back is that you have taken on a Herculean task and have significantly changed the processes and procedures. I'm wondering whether you could tell the committee for the record some of the things you've done on Internet with the advertisement of properties to make them readily available to average people, and also to the brokers, and private sales community.

Mr. APGAR. Yes. Mrs. Morella asked the question about whether you can find out about HUD-held properties. Of course, all our properties are listed on the Internet. In fact, many of our home buyers come to us via that new technology. Certainly a lot of our broker partners use the Internet to learn about HUD properties for sale.

As part of the new management and marketing contract, we're going to move more aggressively into the multiple listing services around the country. This should both widen our market and hopefully further shorten our sales time. But we've been aggressive users of new technology, both in terms of the operations of the program and also our outreach to consumers.

Mr. KANJORSKI. Have you found that as a result of the use of the Internet and these new methodologies, the process of turnover of properties has increased and has decreased in cost of holding and handling?

Mr. APGAR. Right. Unlike the IG, we see no degradation in our time of holding properties. It has remained constant at about 180 days. The reality here is, most of our properties sell quite quickly. It's difficult to sell properties that are a problem. And the example discussed earlier where a private homeowner couldn't sell their home in 18 months, we see that all the time.

In Syracuse, for example, the estimate is it takes anywhere from 16 months to 20 months to sell a privately owned home. So in those instances, some of our homes quite frankly don't sell as quickly. We aggressively cut the price, we work with community based nonprofits to sell the homes. So we do have efforts. But that's where our issues are.

Mr. KANJORSKI. If I could characterize your testimony, as I understand it, the premise of the hearing today was, HUD is wasting $1 million a day. But in reality, so that the taxpayers understand, the program that you administer and as administered by this administration under HUD is not only not costing $1 million a day, but something significantly less than that, and overall, FHA is returning to the Treasury $1.5 billion.

So, this is one department or one branch of HUD and the Federal Government that's making a profit for the U.S. Government, is that correct?

Mr. APGAR. Yes, we are a profit center with respect to deficit reduction efforts and overall health of the general funds.

Mr. BURTON. Would the gentleman yield?

Mr. KANJORSKI. Yes.

Mr. BURTON. You're returning $1.5 billion to the general fund?

Mr. APGAR. Actually, we have net returns of $1.5 billion. The funds actually stay in the FHA accounts.

Mr. BURTON. They stay in the mortgage——

Mr. APGAR. The mortgage insurance company, that's correct.

Mr. BURTON. But it's not going back into the general Treasury.

Mr. APGAR. But for purposes of calculating the deficit and expenditure estimates, they are listed that way, yes, sir.

Mr. BURTON. Because of the unified budget?

Mr. APGAR. That's correct, because of the unified budget.

Mr. BURTON. But it's not going back into the general fund, in actuality.

Mr. KANJORSKI. Reclaiming my time, so that the chairman understands, if he's not involved in accounting, it's a reserve fund that is showing a surplus of $1.5 billion. Any time we were to finalize the accounts and dissolve the U.S. Government, in fact, the Treasury would receive the surplus funds which amount to $1.5 billion a year.

Mr. APGAR. Right.

Mr. KANJORSKI. So to attempt to mislead and say it's not going back to the Government would be a mistake. It's accounted for in the overall deficit as a plus. It is in fact a plus and the funds exist there presently to be re-used and to support the fund. Nevertheless, it operates at a profit to the U.S. Government, is that correct?

Mr. APGAR. That's my understanding, sir.

Mr. KANJORSKI. Thank you, Mr. Chairman.

Mr. BURTON. Thank you. The gentleman's time has expired. The gentlelady from Washington.

Ms. NORTON. Mr. Chairman, I regret I was not able to be here for most of this hearing. I do want to say that the subject matter of this witness is of enormous interest to me. The District had a $5,000 home buyer credit that has had an enormously positive effect on home buying in the city.

While our concern was particularly with middle income taxpayers who have bought in great numbers, what has been wonderful to see is the coming alive of home owning in the poorer sections of the District of Columbia, in wards 7 and 8. None of that could have occurred without HUD's help with these particular home buyers.

I'd like to yield the balance of my time to the ranking member, who has been here.

Mr. WAXMAN. Thank you very much for yielding.

We, through technology, have seen pictures today of really dilapidated houses in what appear to be very bad shape. I could imagine, when we hear from people who live near these houses, they must be horrified at what it's doing to their neighborhoods.

I want to know what HUD's responsibility is. First of all, was HUD responsible for the deterioration of the house immediately, or do they sometimes pick up these houses when the borrower has walked away from it?

Mr. APGAR. As was suggested earlier, the foreclosure process in many States can be lengthy, ranging from a couple of months up to 18 months or more. In many instances, by the time we get control of the properties, they are in very serious disrepair.

That's why we requested and got authority from Congress just this last October to extend our reach in those difficult situations. So where there is a property languishing on the market during a foreclosure process, we can take control of that property through taking the note prior to foreclosure.

This was the approach that we had proposed using in our April testimony. We awaited confirmation of Congress through the 1999 Appropriation Act that we had the legal authority to do that. So that will give us an additional capacity to attack that portion of the problem that we don't have control over now, which is what happens to the property after the homebuyer moves out and before HUD gets legal possession of the property through a foreclosure action.

Mr. WAXMAN. So you have a buyer. The buyer is an irresponsible person who doesn't pay his or her debts and abuses the property, maybe just in the most horrible way. There are properties like that, aren't there?

Mr. APGAR. Yes, occasionally there are borrowers like that. Even if the borrower is a responsible party, an unoccupied home in many of the neighborhoods that are in serious decline will depreciate quite rapidly.

Mr. WAXMAN. So you get a property that's deteriorated in value, it's peeling, it falls apart, it smells, if a Congressman walked in with his brother, he would notice it, that it smelled. It could happen. It could also happen to private foreclosures, couldn't it?

Mr. APGAR. Oh, for sure.

Mr. WAXMAN. Now the question is, what do you do? Now you've foreclosed, you're trying to figure out how to get these properties foreclosed faster. Now you foreclose on them and the question is, what do you do to get rid of these properties? Resell them. Tell us about your activities there.

Mr. APGAR. We have a number of initiatives. In the District, for example, the Officer Next Door program is quite popular, where we give HUD homes at a discount to police officers to encourage them to live within the District. In fact, the 2,000th beneficiary of this program was a District police officer.

We also work with community based non-profits. Under the new legislation that was passed in 1999, we have a program which will target hard to sell areas, working in cooperation with neighborhood groups and cities, again to put a focus on our efforts to secure, maintain and dispose of those properties in the difficult to sell areas.

Mr. WAXMAN. Is it true that HUD takes a longer time, holds onto those properties longer than the private sector before they turn around and sell them?

Mr. APGAR. According to the Andersen benchmarking study, the industry ranges between 120 and 180 days. HUD is now at 182 days, right within that bound. Under our new management and marketing contracts, we think the incentives that we've given the new contractors will bring our average down to 150 days or less.

Mr. WAXMAN. Is it a fair statement that you have an average of 6 months before you dispose of these properties?

Mr. APGAR. That's our overall average right now.

Mr. WAXMAN. So it is 6 months on average?

Mr. APGAR. The range is between 4 months and 6 months. We're at the high end of the range now.

Mr. WAXMAN. You're at the high end of the range? Part of the reason for that is that you have a policy to promote owner occupants and other public policy interests?

Mr. APGAR. That's correct. Early on, we have a period in which from 30 days to 45 days in which community based non-profits have right of first refusal to purchase our properties, as do governments.

Mr. WAXMAN. Is that by statute or by policy?

Mr. APGAR. That's been our policy. Our new approach is going to continue to have that policy in effect, but streamline it so we're able to move quickly to make sure that if folks want to buy it through those special options, they can. But then we move it more quickly to the general market if they choose not to.

Mr. WAXMAN. Could it be that the Inspector General for HUD doesn't know about this policy?

Mr. APGAR. I don't know. It's in all our documents, it's in all our contracts. A key element of the new approach is to work out the handling of those setaside periods, to make sure it operates effectively.

Mr. BURTON. The gentleman's time has expired. Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman.

Mr. Apgar, on your testimony there is a comment in here about the industry norm for sales revenue between 96 and 105 percent of appraised value. And FHA sells properties at an average of 95 percent of market value. Is appraised value the same as market value in this lexicon?

Mr. APGAR. No, the appraised value should be a best faith estimate of market value.

Mr. OSE. How do you reconcile the 96 and 105 percent of appraised value with 95 percent of market value? It's apples and oranges.

Mr. APGAR. It's the same thing. The estimate that is the 105 percent figure, many private sector companies do cosmetic repairs to boost the sales price a bit. So they're able to sell higher than the initial appraised value.

We sell our properties generally as-is. So that's why we're on the low end of that spectrum.

Mr. OSE. Mr. Chairman, I need to jump shift here for a minute. I'm under the impression that the Chief Financial Officer for HUD resigned 2 weeks ago, is that correct?

Mr. APGAR. Mr. Keevey did leave HUD, maybe a week ago, 2 weeks probably.

Mr. OSE. What is the status of having a replacement named?

Mr. APGAR. They have an active search underway for a new Chief Financial Officer. I don't know the details of that, but I know they're looking.

Mr. OSE. Any idea on the timeframe for completion of the search?

Mr. APGAR. My expectation is, given the importance of the job that's going to be moved forward quickly.

Mr. OSE. I have a related concern. Deputy Assistant Secretary Smith fills a slot——

Mr. APGAR. He's actually the Acting Assistant Secretary for Administration. Joseph Smith, that's correct.

Mr. OSE. He has served in that capacity for more than a year without an appointment, consistent with current Federal statute?

Mr. APGAR. Joseph Smith is a career HUD employee. He's been with the Department for close to 25 years. He's in the process of being nominated, a very unusual move, to nominate a long-time career staff person to such a critical political position. But Joe Smith has more than earned the respect of the leadership at HUD, and he's in the process of being nominated.

Mr. OSE. I'm not questioning his degree of respect, I'm questioning whether or not he has served a year in a spot that is otherwise subject to the Federal Vacancies Act, that says you cannot serve in a temporary capacity for more than a year.

Mr. APGAR. You're going to have ask others about these matters in more detail. I know Mr. Smith's general role in the Department, I work with him every day. But in terms of the details of his appointment status, you'll have to get other information. I'd be happy to provide that for the record or get someone who could provide that for the record for you.

Mr. OSE. Mr. Chairman, I'd appreciate an opportunity to enter that question into the record for further response. I yield my time to the chairman.

Mr. BURTON. Thank you. Without objection, it will be so ordered.

[The information referred to follows:]

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

OFFICE OF THE ASSISTANT SECRETARY FOR
CONGRESSIONAL AND INTERGOVERNMENTAL RELATIONS

SEP 9 1999

Ms. Carla Martin
Chief Clerk
Committee on Governmental Reform
U.S. House of Representatives
Washington, DC 20515-6143

Dear Ms. Martin:

Thank you for your letter of August 20, 1999, requesting information on HUD employee Joseph Smith.

Mr. Smith is the Deputy Assistant Secretary for Operations, Office of Housing, and has been since August 3, 1997. He is currently on detail to the Office of Administration as General Deputy Assistant Secretary.

I hope this information is helpful. Please let us know if the Department can be of further assistance.

Sincerely,

Hal C. DeCell III

Hal C. DeCell III
Assistant Secretary

Mr. BURTON. First of all, 40 percent of the foreclosures or repossessions, where they leave the house, exceeds 6 months, 40 percent is what the IG said. Is that correct?

Mr. APGAR. Forty percent? I'm sorry?

Mr. BURTON. The vacancies, 40 percent exceed 6 months, is that correct?

Mr. APGAR. No, I believe it's closer to 19, 20 percent.

Mr. BURTON. Well, we need to once again check the IG.

Mr. APGAR. Yes, and even their calculation was 7,000 over.

Mr. BURTON. We'll check that. We did some calculating, and if the $1.5 billion per year is accurate—and the IG says $1.5 billion to $2 billion is accurate—if that money was returned in reduced premiums to the 7 million homeowners who pay mortgage insurance, it would amount to a $215 a year reduction in their insurance premiums. If you cut that in half, it would still be over $100.

So if those moneys were returned because the $1.5 billion to $2 billion wasn't wasted as the IG says, you would have a reduction in insurance premiums for those people of about $215 a year. Whether it's a tax reduction or a reduction in the insurance premiums, it's still quite a bit of money.

Now, the Inspector General told us that contractors are not being overseen or watched correctly, is that correct?

Mr. APGAR. No, I don't believe that's a correct statement. They identified some instances where they found that to be true, but that's not the general practice.

Mr. BURTON. They said that one contractor was not visited by a HUD employee in over 3 years. Are you familiar with that case?

Mr. APGAR. No. As we suggested, we only got their testimony yesterday. In a typical IG audit, we'd have a chance to read the testimony and review it.

Mr. BURTON. Would you correct that for me and let me know?

Mr. APGAR. I certainly will.

Mr. BURTON. And we've been told that another contractor was auditing his own work and approving his own payments. Are you familiar with that?

Mr. APGAR. That would be very unusual, and I'm not familiar with that particular case, other than having read it yesterday in the IG's testimony.

Mr. BURTON. But you will check that for me as well?

Mr. APGAR. I sure will.

Mr. BURTON. And do you dispute that supervision of contractors was poor and the condition of HUD properties was deteriorating because the contractors were not being supervised properly?

Mr. APGAR. I do not believe it's a fair statement that contractors weren't being supervised correctly. Again, there's no evidence that we're suffering any delay in sales of our homes. Our data suggests the opposite.

Mr. BURTON. If you would, after you review the report, give us a comment in writing, I'd really appreciate it.

Mr. APGAR. And we wish to submit for the record a list of what we've identified already as being factual errors, clearly misstatements of fact that just spring right out at you when you read that testimony.

[The information referred to follows:]

SETTING THE RECORD STRAIGHT

False and Misleading Statements Made By HUD's Inspector General
HUD's Response to Set the Record Straight

IG False Statement: In providing materials to the House Government Reform and Oversight Committee in preparation for this hearing and again in its semi-annual report to Congress, the Inspector General asserts that HUD delays in disposition are generating $1 million a day in costs associated with property disposition. The IG semi-annual report stated:

> "With HUD's estimated holding cost at about $29 per day and with more than 41,000 properties in inventory, management delays in disposing of these properties are costing HUD over $1 million per day."

HUD's Response: This statement is false and misleading. What the Inspector General fails to recognize is that these costs are not incremental costs due to delay, but rather are simply costs associated with any REO operation – whether a public agency or a private company. Last year the FHA REO property disposition operation grossed nearly $4 billion in sales, and the holding and sales costs were simply the cost of doing business.

Moreover, according to Andersen Consulting, FHA's average property holding and sales costs (approximately $9,000 on an average appraised value of approximately $60,000), represent just 15 percent of appraised value, well within the industry standard of between 12 percent and 18 percent. FHA, like any organization with an REO property disposition operation encounters property holding and sales costs in the normal course of doing business. This is not noteworthy. The more relevant fact is that FHA's costs are squarely in line with private industry standards. Finally, it is important to note that these costs, like all FHA expenses, do not cost taxpayers one penny, since the FHA Fund actually generates net revenues. In fact, FHA generated more than $1.5 billion in revenue for the United States Treasury last year.

IG False Statement: On page two of the HUD IG's testimony for today's hearing, the IG asserts that, "There are currently about 300 REO field staff working under the following structure."

HUD's Response: This statement is false. Today, FHA has 417 REO field staff. Despite the fact that FHA has provided this information to the IG on several occasions over the last several weeks, the HUD IG fails to recognize that FHA managers have maintained REO field staffing levels until the new M&M contracting approach is fully implemented. Although approximately three hundred field staff have new assignments within HUD in anticipation of contracting with private sector professionals to perform

FHA's REO property disposition, the vast majority of REO staff have not yet been released to their new positions, and will not be until after the M&M contractors start providing services.

IG False Statement: On page four of their testimony today the HUD IG states: "During the same period from October 1996 through February 1999, the turnover rate (for REO properties) has increased 32 percent from over 5 months to over 7 months."

HUD's Response: This statement is not factually accurate. According to HUD performance data, the average property turnover rate actually has decreased from October, 1996 to February, 1999. HUD data indicate that the average time turnover rate in October, 1996 was 195 days, and the average turnover rate in February, 1999 was 187 days, an improvement of 4 percent, rather than a 32 percent slippage in performance as asserted by the IG.

Furthermore, results of a comprehensive benchmark study performed by Andersen Consulting in early 1997 supports HUD's data. In January, 1997, just four months after October, 1996, Andersen found that HUD's average turnover was 213 days, indicating that HUD performance has improved even more dramatically since that time.

IG False and Misleading Statement: On page 7 of their testimony, the IG states that HUD did not meet its mission of ensuring a maximum return to the mortgage insurance fund... based on acquisition costs (income from sales less all related expenses), increased from $28,202 in fiscal year 1996 to $31,728 in fiscal year 1998. As a result, the loss to the mortgage insurance fund increased from $1.5 billion in fiscal year 1996 to slightly over $2 billion in fiscal year 1998.

HUD Response: This statement is misleading. Independent of the fact that FHA is not aware of where the IG obtained its data to support the average loss per property assertion (which is not consistent with HUD data), it is not possible that a 13 percent increase in the average loss per property (the stated increase from $28,202 to $31,728) could lead to a 33 percent increase in the loss to the insurance fund (the stated increase from $1.5 billion to $2 billion). HUD's data suggests that the REO costs per property have remained constant over this period, and the bulk of additional costs to the FHA insurance fund are due to an increase the number of claims, not the additional cost per property acquired via claim.

IG False Statement: On page 7 of today's testimony the IG falsely asserts that FHA's Santa Ana Home Ownership Center had a total REO staff of 18 in October, 1998 with plans to be fully staffed at only 22.

HUD's Response: This statement is blatantly false. In October, 1998 and to this day, the Santa Ana Home Ownership Center has 63 REO staff working on its inventory of property. Following the transition to the M&M environment, when private sector professionals will begin to perform all property management and marketing services, the Santa Ana Home Ownership Center will have 22 REO staff working full time monitoring contractor activities, and another 23 out-stationed staff who will work between 25 percent and 50 percent time to assist in contract monitoring activities.

Mr. BURTON. One other thing. I believe Mr. Kanjorski, I believe he was still here, said that you were returning $1.5 billion or thereabouts to the Treasury. The fact of the matter is, that money does not go back to the Treasury. Under the unified budget, as far as paper is concerned, just like the Social Security Trust Fund, Highway Trust Fund and so forth, that's included as an asset. But the fact is, you don't put any money out of the insurance fund back into the Treasury, do you?

Mr. APGAR. I asked our budget people to explain this to me. They said the practical effect was that this was contributing to the overall balanced budget, and it was effectively the same as putting money in the Treasury. Technically, the money stays in the FHA fund, as was noted by Mr. Kanjorski.

Mr. BURTON. The reason I bring that up is because if in fact the IG is correct, that there's a $1.5 billion to $2 billion shortfall in the fund because of these issues, and I know you disagree with that, but if that's the case, rather than saying that that money is in effect going back to the Treasury, when it isn't, because it really isn't, it's staying in the fund, wouldn't it be better to reduce the insurance rates to these 7 million policy holders who are mortgage holders, who have mortgages with the FHA, and save them $215 a year?

Mr. APGAR. Now that the fund is as strong as it's ever been, I think it's fair to look at the rate structure and decide whether or not we can prudently have a reduction.

Mr. BURTON. Mr. Cuomo I've talked to a number of times. He seems to want to be cooperative. I've been very impressed with him. All I would say is I wish you would suggest that to him when you talk to him about these other issues.

Mr. APGAR. Fair enough.

Mr. BURTON. Thank you. Mr. Kucinich.

Mr. KUCINICH. Thank you, Mr. Chairman.

I yield my 5 minutes to Mr. Waxman.

Mr. WAXMAN. Thank you very much, Mr. Kucinich, for yielding to me.

The Arthur Andersen Consulting firm is not a fly by night operation, it's a very highly regarded organization, isn't that accurate?

Mr. APGAR. Yes, they do very good work for us and many other Government agencies.

Mr. WAXMAN. In fact, the new head of the General Accounting Office was a partner at Arthur Andersen. That was, I think, one of the reasons that many people thought he would do a good job. He had the credentials for assuming the GAO position.

Mr. APGAR. That's true. They have good knowledge of Government practice, it makes an ideal person to move into Government service.

Mr. WAXMAN. I'm concerned, and Mr. Ose expressed a concern, if properties stay too long before they're sold, that that's costing us money. It's costing HUD money, whatever this fund is.

Mr. APGAR. Yes.

Mr. WAXMAN. Yet the Arthur Andersen Consulting firm said that the industry average standard, in terms of return on the appraised value, is 96 percent to 105 percent of the appraisal when they do sell property, whatever period of time it takes.

Mr. APGAR. Yes.

Mr. WAXMAN. And the performance, according to this study, is that HUD has achieved a 98 percent return on the appraised values. Sounds to me like that would indicate you're doing a reasonable job making sure we get the money back from these properties no matter how long it might take you to foreclose it and then turn around and sell it.

Mr. APGAR. I think that's fair. The Government Performance Act, of course, focuses on results. That's why we look to these benchmarking studies. We think that measured in terms of results, our work stands up in terms of best practices, a comparison with industry benchmark standards.

Mr. WAXMAN. That's the information we're getting from Andersen Consulting. I want to get more information about this issue to be sure it's true. I know that everybody would have a concern, especially people in the neighborhood, if there's a house that's not being cared for, and not being foreclosed on, not being turned around and sold, so that it can be maintained. So we don't want properties sitting out there for any length of time.

Mr. APGAR. Fair statement. Nor do we.

Mr. WAXMAN. In order to deal with these properties, however, you contract with people to maintain them, in the interim before you sell them, isn't that right?

Mr. APGAR. That's correct.

Mr. WAXMAN. Now, what I want to know is, are you taking all the appropriate actions to be sure that the contractors are doing their job? Do we have non-performing contractors? I understand you have contractors who are hired so to speak on an incentive based contract. Do you have any penalties against them if they're not doing their job?

Mr. APGAR. Well, of course the biggest penalty is that under the management and marketing contract, people only get paid for results. They get paid a fee relative to the sale price of the home. So there's a powerful incentive for them to perform, maintain the properties, and sell them for the best price.

Mr. WAXMAN. I want to be sure that we're getting these people who have this responsibility under contract with HUD, to be sure they're doing their job.

Mr. APGAR. So do we.

Mr. WAXMAN. We ought to explore that even further. But I don't think the case has been made credibly, charges have been leveled, but I don't think the case has been made in any credible way, that you have failed miserably to get the money back for these properties when people default, or that you have large numbers of properties that are substandard and eyesore and often constitute hazards.

The statement by the representative from the Inspector General was that they found 12,000 properties, I think she said that took too long to sell. Was that the testimony?

Mr. APGAR. I believe that's correct, that was the number they used.

Mr. WAXMAN. Is that an accurate statement?

Mr. APGAR. We were checking that number, because it led her to make an inaccurate conclusion, which the time on the market of our properties has grown over the last 2 years. Our statistics suggest that's not true. So we're trying to figure out ourselves how she could make that statement, given her own data to suggest that the conclusion she came to was correct.

Mr. WAXMAN. If it were true, what do 12,000 properties represent of your total portfolio?

Mr. APGAR. We have 40,000 properties in inventory. So it's about 30 percent. We sold about 65,000 properties last year, that was the number of properties we sold.

Mr. WAXMAN. I appreciate the testimony you've given. I have somewhat defended HUD, because I think you've been unfairly criticized. But I do want to point out to you that I want to be sure you're doing the job that the American people expect of you.

I thought it was ironic that you were criticized for not taking the money that you make and not giving it back to the taxpayers. But you would think from the title of the hearing today, "HUD Losing $1 Million Per Day," it sounds like the Government is losing $1 million a day. They're funds that shouldn't be lost, whether they're Government funds or the premium payers.

Mr. Chairman, let me ask unanimous consent for all Members' statements to be entered into the record. We didn't get to that earlier.

Mr. OSE [presiding]. Without objection.

Mr. WAXMAN. And I thank you for your forbearance.

Mr. OSE. Our distinguished colleague from Illinois.

Ms. SCHAKOWSKY. Thank you, Mr. Chairman.

As a new Member of Congress, I come here with having been involved with community organizations in my district for many, many years. In particular, I want to ask you a process question. I want to be sure that you will make a commitment to me now, because Chicago has been particularly hard hit by FHA foreclosures, because we have many abandoned HUD buildings in Chicago, that you will meet with me when I ask, but also with me and representatives of organizations who have lots of experience and lots of data, to try and reconcile some of those differences on a regular basis, if I ask for those meetings.

Mr. APGAR. We'd be happy to do that.

Ms. SCHAKOWSKY. We're about to hear some testimony from these community organizations, who true to form are always sort of at the tail end of hearings. I know that there is the issue of inspections of FHA properties. I recently purchased a home, and the notion of purchasing a home without having an inspection first is absolutely unthinkable. Just unthinkable to me, and to my lender as well.

So I'd like you to comment on that. Let me get my other question in, too, and you can answer. The other issue is going to be on a particular piece of legislation, H.R. 595, which, if we really are seeking to decrease the number of foreclosures, it seems to me that we ought to be looking at ways to provide emergency assistance to people who, for no fault of their own, are finding it hard to meet payments.

It seems like it may also be economically a wise thing to do, in the long run, to keep people who have an investment in those homes in those homes over a hump. So if you could comment on both those things, on the inspections and on the legislation, I would appreciate it.

Mr. APGAR. Fair enough. You're exactly right, a home inspection is a very important element in the home buying process. The overwhelming large share of buyers get a home inspection.

FHA prominently encourages, through its housing counseling system, people getting inspections. The issue where we differ with various proposed legislation is whether we should make that step mandatory. We're worried about whether or not a mandatory inspection at this time, given the fact that the home inspection industry is largely unregulated by the Federal and State governments, would in fact provide less benefit than meets the eye.

What we are doing though, is that we're expanding our efforts to try to encourage folks to get a home inspection and to take note of the fact that that's a very important part of the home buying process.

Relative to the legislation that you referenced, we agree, foreclosure avoidance is the most effective way of addressing this set of issues. We wouldn't be here today if we weren't moving ahead in our foreclosure efforts. My concern is that the particular form of legislation will make the same mistake that got us into part of this problem in the beginning. We had this activity in the past called the assignment program. That program has led to a mass of foreclosures and building up of debt that led to many of the problems with the FHA earlier in the decade.

We have foreclosure tools that were legislated and guided through legislation enacted in 1996. Those foreclosure avoidance tools are hitting their stride. We're doing more foreclosure avoidance work now than we ever did under the previous regime, and we think we're making significant progress in that arena. I think it's something like 1,500 foreclosures a month are being avoided, and over 1,200 of those are homeowners who are getting exactly the kind of benefit you're suggesting, of being able to have forgiveness on their loans or some extra benefit to keep them in their home and avoid the costly foreclosure process.

Mr. OSE. Would the gentlelady yield for a moment?

With respect to Ms. Schakowsky's question about home inspection, are there not States in the United States that actually already require that? For instance, in California. Do we have any evidence as to the differential default rate that might follow on accordingly? I'd be happy to take it in writing.

Mr. APGAR. We could look at the State law as to whether they require inspections. Again, most States are silent on that matter. As a matter of fact, most States do almost no regulation of the home inspection industry. Our concern is whether you should mandate this, not whether it's a highly desirable activity.

Again, the Banking Committee took this matter up last time. This proposal appeared in the Lazio Home Ownership bill, and it was removed, because again, the conclusion, at least of that committee at that time, was this was not an effective way to address the problem.

Mr. OSE. The Chair would provide the distinguished gentlelady from Illinois a couple more minutes, having taken your time. I yield back.

Ms. SCHAKOWSKY. I just have one comment, thank you, Mr. Chairman. It seems to me that the data does not bear out that there have been effective foreclosure avoidance measures. If we look at the foreclosure rate increase in 1997, for example, 15 percent, and in 1998, an additional 7 percent increase in FHA foreclosures. So it seems to me we certainly have some distance to go.

Mr. APGAR. Fair enough.

Mr. OSE. The Chair recognizes the distinguished Member from Florida, Mr. Mica.

Mr. MICA. Thank you, Mr. Chairman.

I have a couple of questions. First of all, we're in a very good economy, I believe, last I checked. Dispute as to who gets credit for it. I think that as part of those that help come and balance the budget, make people work instead of being on the public dole.

But in any event, I think most of us agree we're in a pretty good economy, right, sir?

Mr. APGAR. Overall, the economy is doing very well, yes.

Mr. MICA. In 1996, there were just under 61,000 foreclosures of your properties. In 1997, that grew by 10,000 to 71,000. In 1998, it was up another 5,000. It's gone up 15,000 in 2 years.

To what do you attribute the dramatic rise in foreclosures in 2 years of basic prosperity?

Mr. APGAR. As was suggested earlier, the foreclosures that are occurring today are often among properties that, despite the good economy, their current value isn't what the prices were when they were originally purchased. The largest increase in our foreclosures is coming out of California, which even though the California economy is beginning to improve, it hasn't improved enough to move houses out of this foreclosure problem.

In addition, most of those foreclosures are coming out a particular HUD program, the adjustable rate mortgage program. There we have made significant changes to improve the overall quality of our underwriting of the adjustable rate mortgage program.

Mr. MICA. Even with adjustable rate mortgages, the payments actually would have been going down in this economy, because the interest rates have been dropping. They've dropped to historic lows in that pattern, so people's payments, I know it takes a while for it to kick in.

Mr. APGAR. Yes. The point I was making there is, there was a significant increase in foreclosures in California, mostly linked to this ARMS program. We've made adjustments to improve the overall underwriting in that program. Again, the California economy was slow to recover.

I'd just like to say one thing about the overall economy, because of course, in other budget discussions we've talked about this. This is really a two-tiered economy, in which many are doing very well, but the inner cities and our core areas are not all benefiting. We have the highest worst case needs housing situation in the Nation's history. We have significant under-utilized resources in terms of high unemployment in our inner cities.

So while the economy is working for most, in the neighborhoods that we serve, the economic recovery is not nearly as strong as your question suggests.

Mr. MICA. If you're having a fairly dramatic increase in the number of people who are being foreclosed upon, and you said you had pinpointed it to some of these California properties, is there anything, have you done anything, any kind of review or profile of the individuals who are defaulting?

Mr. APGAR. We have statistics on the characteristics of our defaults, the characteristics of default rates by program type, by characteristics of the borrower and the like, yes.

Mr. MICA. Is anything done to implement changes in lending practices? Have you instituted things to try to mitigate the number of folks who get into that situation?

Mr. APGAR. Actually, in respect to the ARMS program, we did significantly change the underwriting of that program in February of last year. We're already seeing a substantial reduction in our ARMS business. We think that's good, we think some lenders may have been abusing that program. That's why we took that action.

Mr. MICA. Is that your loss mitigation program?

Mr. APGAR. No, in terms of the loss mitigation program——

Mr. MICA. Could you explain what loss mitigation is?

Mr. APGAR. Essentially, loss mitigation is a term that says that trying to avoid the losses to a mortgage lender, it's a little cold and impersonal term. What we're really talking about is how we keep homeowners in their homes. That's the key. In many instances, it costs more money to everybody, certainly the homeowner and often the FDA, to foreclose.

We had a series of legislation guided policies that we put in the books in 1996. In 1997, we did 5,000 cases of loss mitigation under that guidance. We did 10,000 last year. We're projecting we're doing 20,000 this year. Again, the vast majority of those cases are places where we're able to intercede with the property owner and the mortgage lender, restructure the mortgage, extend the term, write down the note rate, do any one of those things to make it so that that homeowner can stay put.

Even though that costs the fund money, it saves us money by avoiding these costly foreclosure efforts.

Mr. MICA. You said in California that there was a change in property values or you attributed some of the problems to the changes in property values. Is that also something that you've allowed for under any of these problems for adjustment, so that, again, the goal I think is to keep people in their property, avoid the cost of foreclosure, which is tremendous.

Mr. APGAR. For sure.

Mr. MICA. Plus the dislocation of the individuals.

Mr. APGAR. There are many mortgages that are underwater in this sense, meaning that the value of the home is less than the outstanding mortgage balance. In those situations precisely is when you want to keep the homeowner there, because they can continue to use that home and benefit from it. As the economy and the prices improve in that area, they work their way out of this deficit situation.

Mr. MICA. I can't understand exactly how you get into a situation when the property is worth a little bit less, the payments are less and the people are being foreclosed upon.

Mr. APGAR. Because they can't meet the payments. And they can't sell the home.

Mr. MICA. Then the problem is they can't sell the home, and recover any of the equity, or, well, there's no equity. But actually a net loss.

Mr. APGAR. That's what I'm saying. It's underwater. The outstanding mortgage balance is higher than what they can sell the home for.

Mr. MICA. And do you have any way to again, specifically, to deal with that problem?

Mr. APGAR. Yes, we can write the mortgage balance down. That's called a partial payment of claim, in which we pay off the lender for a share of the mortgage balance.

Mr. MICA. Do you take a hit?

Mr. APGAR. We take a hit on the fund to do that. We can restructure the mortgage by extending the term, changing the interest rate, or if there is mortgage debt owed, I mean, payments owed, we can forbear, i.e., we can forgive those payments and let the owner pick up fresh with where they are.

Mr. MICA. Do you have any recourse if the property is sold later at an additional profit?

Mr. APGAR. No. It's a transaction that benefits the home buyer, so we don't have any recovery mechanisms against the lender.

Mr. MICA. Thank you.

Mr. APGAR. We do? I'm sorry. We do place a second lien for that amount to secure our interests there. But it's not with the original lender, not related to the original lender, but an obligation of the homeowner to pay.

Mr. OSE. The Chair will entertain a second round of questions if the Members wish.

Mr. KUCINICH. Again, Mr. Chairman, as I indicated earlier to Mr. Burton, HUD is demonstrating willingness to try to work to solve problems when they're given a definitive challenge. And I'm hopeful that the other areas that have been identified here, you'll also be given the opportunity to rise to the occasion, as you did on the homeless program.

Mr. APGAR. Thank you. Our new management and marketing contract approach goes on line next week. We perceive that it will in fact improve on the record substantially.

Again, we have evidence from the pilots that we ran that we can substantially reduce our time of holding the inventory and raise our yield. So we're very optimistic that this new approach will yield great benefits.

Mr. OSE. The gentlelady is recognized.

Ms. SCHAKOWSKY. Thank you. I have just one more quick question, Mr. Chairman.

That is, I have been told that Secretary Cuomo has said to housing advocates that there are no inspectors, housing inspectors, in the United States. What could he possibly have meant by that?

Mr. APGAR. I'm not sure, since he's so knowledgeable about the housing industry, that must be a misstatement. Because we meet with various groups, including various associations that represent home inspectors, all the time. So we understand that there are home inspectors working in our properties and elsewhere.

Ms. SCHAKOWSKY. So your assumption is that was a misstatement?

Mr. APGAR. Yes. It certainly is not factually correct. It would be hard to imagine that he would make that error.

Mr. MICA [presiding]. Mr. Apgar, just a quick question. Maybe you can refresh me, and you may have already given this information to the committee.

You have 76,000 foreclosures. What percentage of foreclosures is that out of your total?

Mr. APGAR. We have close to 7 million loans outstanding. So that's approximately 1 percent of all the loans that are outstanding in the FHA insured portfolio.

Mr. MICA. How does that compare to conventional lenders?

Mr. APGAR. In terms of our outstanding foreclosures?

Mr. MICA. Yes.

Mr. APGAR. We anticipate that our foreclosures are going to be a higher share. That's how the program was designed. We take risks on borrowers that the private sector wouldn't touch. If they are the kind of safe, less risky borrower, then they would in fact go to the private sector, they wouldn't foreclose as often and they're well served by the private sector.

Mr. MICA. One of the problems that has arisen in the past is that you've had some serious difficulties with contractors. I'm interested in how HUD will ensure that contractors who performed poorly in the past, have poor performance records, will not be working as subcontractors under the M&M contracts.

Mr. APGAR. First of all, the competitive bidding process that we had for the national contract had over 170 bidders. People that had poor records with us in the past, that was taken into account. And the largest share of the work will be done by these firms themselves. They already have opened 56 offices around the country, hired over 600 people. So the direct contractor will do much of the work. Subcontractor relationships will exist in some of the outlying areas. We will monitor those closely.

With respect to contractor monitoring, again, this contract is a new vehicle that was created out of the pilots. The contracting mechanism of the pilot was carefully reviewed by the Inspector General. They gave us a list of recommended changes to the contract, and we embedded many of them in the new structure.

For example, the issue of pass-through costs, which is a very difficult monitoring area, where we had to decide whether costs coming through from the contractor was a legitimate cost. Under the new contracting mechanism, these costs are paid for out of the contractor's pocket. They only get paid, not for incurring costs of maintaining the properties, but only get paid to the extent to which they are able to sell the properties and return funds to the FHA.

We think this will encourage them to sell the homes quickly and to maintain them to preserve the market value.

Mr. MICA. Do you have contractors that are monitoring contractors?

Mr. APGAR. Under the new setup, we will monitor through a variety of ways. Of all the records that the contractor retains, 10 percent will be reviewed, 10 percent of all the properties they have under inventory will be inspected. Those functions will be handled by a contractor.

Again, these are not highly judgmental functions. We're asking people to go out and, relative to a standard checklist, identify whether the property meets certain standards or whether the files are in place.

It's our job as HUD to review those monitoring reports and then take the action. So all the action steps will be taken by our HUD staff.

Mr. MICA. And your HUD staff and your professional staff is monitoring monitors, so to speak, they're conducting the top level of oversight?

Mr. APGAR. We do quality assurance on all levels of our contracting. There was a question made earlier about whether or not our HUD staff is adequate for the task, and where our staffing numbers came from. Again, this was the place where the IG's testimony was misleading. We estimate we will have in effect 143 people, full time equivalents, doing our monitoring work.

The estimate of how many we needed was the result of a careful workload assessment done by Booz, Allen and Hamilton. If anything, their early report suggests that we have too many people doing this job now. But because we want to be cautious, we've kept the fuller level of oversight.

Recognize that the numbers that we have in the field today are doing a lot of functions which will be shifted to contractors under the new system.

Mr. MICA. Your system to monitor the work of the contractors is important. And you've discussed how that would be in place. What's the progress for having those monitors in place as far as contracts? Are all of those positions filled, or those slots filled?

Mr. APGAR. Yes, they are. That work will be done out of the home ownership centers.

Mr. MICA. All the monitors and contractors?

Mr. APGAR. They'll be supported by field staff which are located in field offices around the country, and again, those people are working today for us, but they'll be working in a new role starting Monday.

Mr. MICA. It's my understanding that you testified to Mr. Burton or told him that in your previous testimony here that you weren't lax in overseeing contractors and contractor problems were very limited. However, you just told me that poor performing contractors were being precluded from new bids.

Mr. APGAR. That's correct. There are some. We've taken sanctions against them in the past and will continue to take actions against them in the future.

Mr. MICA. What percentage are we looking at of those that fall into that poor performing category?

Mr. APGAR. I think last year we took action against 8 or 10 contracts, terminated their contracts. A larger number of them, we put them on notice for poor performance. I think last year we may have had as many as 150 contractors. The essence of the new approach is to have fewer folks to monitor. Again, we have a higher quality, I believe, of contracting agent now, because we're able to be more selective.

Mr. MICA. I have no additional questions at this time. Do any of the other Members?

We want to thank you for your testimony and for working with our committee today. We have no further questions and excuse you at this time.

[Additional questions for the record follow:]

HELEN CHENOWETH
1st District, Idaho

AGRICULTURE COMMITTEE
RESOURCES COMMITTEE
CHAIRMAN, SUBCOMMITTEE ON
FORESTS AND FOREST HEALTH
VETERANS' AFFAIRS COMMITTEE

1727 LONGWORTH HOUSE OFFICE
BUILDING
WASHINGTON, DC 20515
(202) 225-6611
E-mail Address:
ask.helen@mail.house.gov

265980

Congress of the United States
House of Representatives
Washington, DC 20515–1201

DISTRICT OFFICES
304 N. 8TH ST., ROOM 454
BOISE, ID 83702
(208) 336-9831

111 MAIN, SUITE 191
LEWISTON, ID 83501
(208) 746-4613

118 N. 2ND ST., SUITE 2
COEUR D'ALENE, ID 83814
(208) 667-0127

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May 14, 1999

The Honorable William C. Apgar
Assistant Secretary for Housing-
Federal Housing Commissioner
U.S. Department of Housing and Urban Development
451 7th Street SW
Washington, DC 20410

Dear Assistant Secretary Apgar,

I was interested to hear your testimony recently before the Government reform committee, but I have some follow-up questions regarding Housing and Urban Development's changeover from Real Estate Asset Management contractors to so-called "M&Ms." Particularly, I want to know how these changes will affect Idaho. I have some serious concerns that the new programs will be detrimental to my constituents and to neighborhoods in Idaho.

First, I'm sure you'll agree that eliminating the REAM program and instituting instead the M&M program in Idaho is a huge change in policy. I am concerned that this change was initiated by problems in other states, and isn't the best thing for Idaho. What data do you have that proves that eliminating repair work, and eliminating the current program actually benefits our communities in Idaho?

Specifically, do you have evidence that the money put into repair work does not increase the sale price of the home an equivalent amount? Secondly, almost always the American taxpayer losses during repossessions, but do you have evidence that the money put into repair work doesn't cut the losses the taxpayer is already suffering on the defaulted HUD loan, both generally and specifically in Idaho?

I've read about fraud and abuse among the REAMs. I've heard a lot about problems, but I'm wondering if this is in Idaho, or just in large urban areas. Do rural areas have the same quantity and type of problems as the urban areas? Do Northwestern states have the same ratio of problems? Does Idaho? If Idaho and the Northwest don't have the same level and types of problems, then why was our area reorganized into M&M's, rather than maintaining the old REAM program?

Is there any incentive for repair work in the new M&M contracts?

Can M&M marketers "bulk-up" sales? For example, can they sell a whole block or area of houses to one buyer? If so, doesn't this cater to slum lords, but not to the first-time American home buyer that HUD was designed to help?

Lastly, will you consider modifying the M&M program to better address small rural states like Idaho?

I look forward to your prompt reply to my questions. As well as informing my constituents in Idaho of your response, I will also submit your response to the Government Reform Committee for inclusion in your testimony at the hearing. If you have any question, please do not hesitate to contact my assistant, Elizabeth Schwarzer at (202)225-6611.

Very sincerely,

Helen Chenoweth

Helen Chenoweth
Member of Congress

enclosure
HPC\ess

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-1000

OFFICE OF THE ASSISTANT SECRETARY FOR
CONGRESSIONAL AND INTERGOVERNMENTAL RELATIONS

The Honorable Helen Chenoweth
U.S. House of Representatives
Washington, DC 20515

Dear Representative Chenoweth:

Thank you for your letter of May 14, 1999, concerning the decision by the Department of Housing and Urban Development to use Management and Marketing (M&M) contractors to secure and protect properties which HUD has acquired through foreclosures and payments of claims on FHA-insured mortgages to lenders.

When HUD takes ownership of a property, an inspection is conducted within 24 hours to determine occupancy status. If the property is vacant, it is immediately secured, cleaned, and listed for sale. In the past, Real Estate Asset Management (REAM) contractors performed the securing and cleaning process for the Department. HUD staff then marketed and sold the property by maintaining and producing periodic lists of properties in its inventory, publishing newspaper advertisements, posting for-sale signs, and other such marketing methods to sell the property. Also, HUD staff evaluated, approved, and accepted the contract when a prospective buyer made an offer on a HUD-held property. The process of marketing and selling the Department's inventory of properties, and the monitoring of over 200 REAM contracts nationwide required a significant number of HUD staff.

Because of recent staff reductions and centralization of operations, the Department needed a better method to manage and market its nationwide inventory of properties. HUD chose to award nationwide contracts that would cover both the property management and marketing functions, rather than continue the local contracting of the property management function. This would limit the responsibilities of the reduced HUD staff to monitoring the performance of the M&M contractors. In March 1999, after the Department evaluated many proposals from private-sector companies experienced in real estate asset management and marketing, HUD awarded 16 contracts in 16 regions of the nation. The Department awarded seven of these M&M contracts to the In-Town Management Group (ITMG). ITMG is a joint venture whose three primary partners had extensive experience in real estate asset management and marketing for both the government and the private sector. The president of ITMG is a former Regional

Director of Property Disposition for Freddie Mac. The state of Idaho is one of several states covered by the ITMG contract. HUD staff will diligently monitor ITMG's performance and the Department will take immediate action if sub-performance occurs in any state.

The Department is committed to protecting and preserving all properties in its inventory. The procedures HUD uses, through the M&M contractors, to accomplish this are common industry practices. Several of the M&M contractors perform similar functions for private mortgage companies. There is no incentive for repair work in the M&M contracts unless the property will be purchased using an FHA-insured mortgage (in which case the property must meet certain standards), because it is the Department's position that the marketplace should answer the question of the value of property repairs, rather than the Federal Government. Further, encouraging contractors to repair HUD-held properties would prolong the management and marketing process, resulting in higher costs. Instead, HUD places a higher priority on securing and selling its properties quickly in order to mitigate losses to the FHA insurance fund.

I hope this information is helpful. Please let me know if I can be of further assistance.

Sincerely,

Hal C. DeCell III

Hal C. DeCell III
Assistant Secretary

Mr. MICA. I'd like to call now the third and final panel. If I may, I'd like to introduce witnesses as they come froward.

On our third panel, we have Ms. Gale Cincotta, co-founder and executive director of the National Training and Information Center, also known as NTIC, in Chicago. The NTIC is a national resource center on urban issues. Over the past 20 years, Ms. Cincotta has received numerous achievement awards for outstanding work on such issues as human rights, poverty and community revitalization.

Accompanying her on the panel is Grace Jackson, who is from the Chicago area. She is a board member and past president of the Roseland Home Ownership Center of Roseland Neighborhood Housing Services. Throughout the 1970's and 1980's, Ms. Jackson was a neighborhood leader for the Greater Roseland organization, and played an important role in the fight against insurance redlining and FHA lending abuses. We welcome you to the panel and look forward to your testimony.

We also are pleased to have Mr. Carl Edwards, a fellow Hoosier of the chairman's, with us today. Mr. Edwards was born in Indianapolis, where he's lived for the past 26 years. He volunteers his time as president of the Fletcher-Lipincott Neighborhood organization. He's also a member of the Brookside Park advisory committee and serves on the board of the Near Eastside community organization. I'd like to thank you, Mr. Edwards, for coming, and our other panelists for being with us today. We look forward to your testimony.

These particular witnesses testified 1 year ago on April 1st, 1998, before the Banking Subcommittee on Housing chaired by Mr. Lazio. It's my understanding that you came before this panel a year ago. In essence, this group testified that FHA property disposition problems were contributing to, rather than alleviating, urban blight and deterioration. They have been asked to provide our committee with an update today on the status of issues that they raised at that time, almost 1 year ago.

We also have Mr. Stanley Czerwinski from the General Accounting Office who is going to join us for the panel in testimony. He is the Associate Director of the Division on Resources, Community and Economic Development at the General Accounting Office. I'd like to welcome him and thank him for his participation.

It's part of the responsibility of this committee of Congress to swear in our witnesses, which I'll do in a moment. I understand we have one additional witness, who has been involved in homeless area programs. We have Mr. Brian Davis, director of the Northeast Ohio Coalition for the Homeless. He's going to testify about problems that he's experienced in dealing with that problem.

I think that completes this third and final panel. I'd like to welcome each of you. This is an investigative committee of Congress, and it is our custom and practice and also requirement that we swear in our witnesses.

[Witnesses sworn.]

Mr. MICA. Welcome to our panel today. I'm pleased to recognize Ms. Gale Cincotta, co-founder and executive director of the National Training and Information Center from Chicago for your testimony and opening statement.

Also I might tell all of the panelists, if you have a lengthy statement that is written or prepared, and you'd like it submitted as part of the record, we will do so at request by unanimous consent of the committee.

Ms. Cincotta, you are recognized now, and you will see the little light go on here for 5 minutes. You'll get a little warning there in red.

Thank you.

STATEMENTS OF GALE CINCOTTA, EXECUTIVE DIRECTOR, NATIONAL TRAINING AND INFORMATION CENTER, CHICAGO; GRACE JACKSON, VOLUNTEER, ROSELAND NEIGHBORHOOD HOUSING SERVICES, CHICAGO; CARL EDWARDS, PRESIDENT, ORGANIZATION FOR A NEW EASTSIDE, INDIANAPOLIS; BRIAN DAVIS, DIRECTOR, NORTHEAST OHIO COALITION FOR THE HOMELESS; AND STANLEY CZERWINSKI, ASSOCIATE DIRECTOR, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Ms. CINCOTTA. I have testimony I've submitted, and I'm also submitting other material for the record.

Mr. MICA. Without objection, your full testimony will be made part of the record.

Ms. CINCOTTA. While Mr. Apgar is still in the room, he should remember September 9th, I had Ira Peppercorn from his office and Charles Gardner from the regional office in our office at NTIC in Chicago, where they said, and he has said in his office, there are no inspectors in the United States. We have to then therefore maybe get appraisers to do the inspections.

They came with a thick thing like this of paper saying, now, this is what the appraisers would have to do. I know that after they left their office, and there were NHS people, myself, our staff, et cetera, that they took it to some lenders. The lenders called me the next day and told me, and even showed me exactly what they had left in our office.

So he is lying to you under oath that they have not tried to get appraisers to do inspections. And he is either lying to me or lying to you when he says there are enough inspectors in the country.

What bothered me today was how much time they spent trying to trash a story that was on television, on one building out of the thousands of vacant buildings——

Mr. KUCINICH. Excuse me, Mr. Chairman.

Mr. MICA. Yes?

Mr. KUCINICH. I'm a little bit concerned about a statement the witness made. I know her, I respect her, I worked with her years ago when she was working with Monsignor Boroni. But when somebody makes a charge in front of a committee like that, I'm kind of uneasy about hearing those charges made.

Mr. MICA. Well, the witness is free to express herself.

Ms. CINCOTTA. I'm under oath and he's here. Bill, didn't you tell us that, or are you going to sit there and lie?

Mr. MICA. Ma'am, we don't want to get into an exchange, but you're welcome to testify and comment as best you can in your own words. And we do appreciate that.

Ms. CINCOTTA. But it's hard to sit that long, having been involved with this, and again, to go after something that was on television on one building out of 76,000. And on that building, again, the loan was insured by FHA, the tax bill was billed to them. The home was foreclosed on, and now it's part of an FHA program. Nobody's been in that building since September.

But they take any criticism and try and find something to get you, rather than, that is a problem. This is a list, and I want to submit this, of over 800 foreclosed buildings, FHA buildings in Chicago that we got recently. They found out we had this when another city, I think it was Carl's city, asked for the same thing. They didn't give it to them, and they have shut it down for us getting it in Chicago. There are over 800 homes in Chicago that they have on this thing, addresses, et cetera.

So what I'm trying to say, the frustration of your own Government, that you expect to do good for you and do better, lies through their teeth, hides the facts, and instead of working to solve the problem, wants to pretend there is no problem, wants to ignore this. And what we've been facing for years upon years, of fighting once to get FHA in, we didn't get FHA originally in any of the cities, because it was started as a new construction program.

Then ever since then, fighting to clean it up so it would function well. It led us to try and get the Community Reinvestment Act passed, that our older neighborhoods, they need mortgages, they need the Government to protect them, they need the Community Reinvestment Act. They don't need hundreds upon hundreds of people being put out, promised the American dream and being put out of their home over and over and over again.

Seventy-six thousand foreclosures, if you look up on it, it's the history of my life, it starts around 1972 when NPA was formed. There were 63,000 foreclosures in 1973. One of the things that worked, and when the numbers went down was when Senator Proxmire was head of the Banking Committee. There was something that was put in called 518 (b) and (d), that any home, older existing home, sold on an FHA mortgage, if within the first year anything went wrong with the systems or roofs or porches, there could be reimbursement.

That worked excellent, because you needed something like that. They needed the inspections before that. But you can see I'm looking at this, at that time in history, that worked.

It's not a new home with a warranty. There have to be different things, a new home has a warranty, I guess with the new construction, 10 years. An older, existing home should have a full inspection and a warranty. I know you don't like to spend money, but I think you spend money in the long run after the fact.

The other thing, there's something pending called H.R. 595, Mortgage Assistance Program, where if people have a chance, within 1 year and get some assistance, the majority of them will be able to keep their homes.

If you want to house American citizens in existing construction and older buildings, you have to figure out a way to protect them. You can't do like Mr. Apgar and Mr. Cuomo, shuck and jive, lie through their teeth, change the story, do this, do that. Why don't they bite the bullet and do what's right? It won't cost that much, in the long run, it will be cheaper.

But they're really happy when they tweak you and try and make you look bad. But I think we're talking about families that we see every day in our neighborhoods that shouldn't be offended by their own Government. They trust their Government.

I did bring a list, I thought we were going to be able to put it up, of all the foreclosures in Chicago, so that maybe by seeing the addresses, address by address by address, it could give some urgency to what's happening. And if you get those folks back here to testify, why don't they come up with solutions rather than trying to hide the problem over and over and over again?

If you don't do anything, they smirk at you behind your back, at me, et cetera. Nothing happens good for the citizens.

[The prepared statement of Ms. Cincotta follows:]

Testimony of
Gale Cincotta,
Executive Director, National Training and Information Center, Chicago

Before the
Committee on Government Reform

Hearing on:

"HUD Losing $1 Million per Day - Promised 'Reforms' Slow in Coming"

Tuesday, March 23, 1999

Thank you Mr. Chairman and other members of the Committee for this opportunity to testify. I speak not only as executive director of the National Training and Information Center, but as chairperson of National People's Action, a nationwide coalition of over 300 grassroots neighborhood groups working on neighborhood issues such as community reinvestment, anti-crime and -drug strategies, and reform of the Federal Housing Administration (FHA). We have been fighting abuse, fraud, and neglect of the FHA program that has destroyed too many neighborhoods and too many families' dreams of homeownership for more than 25 years.

The FHA is a frightening example of a government program trying to supplant private investment and the marketplace while doing a much worse job. The FHA program has a national default rate 3 to 4 times the conventional market, and in many urban neighborhoods it routinely exceeds 10 times. In addition, the FHA program is hemorrhaging money. In 1998, the FHA program paid out over $6 billion in claims, a 30 percent increase over 1996.

In 1998 alone, over 76,000 families with FHA loans lost their homes. This is almost a 25% increase over 1996. This means over 200 families a day are losing their piece of the American Dream. Even more troubling is that foreclosures continue to rise amidst the strongest economy this nation has seen in 25 years. In fact, if you follow the FHA foreclosure rate and the unemployment rate over the last eight years you will notice that the number of FHA foreclosures moves in direct relation to the nation's unemployment rate through 1996. But, in 1997 and 1998 the FHA foreclosure rate jumps through the roof, while the unemployment rate reached record lows. Furthermore, this increase in foreclosures is happening despite the FHA losing market share. The numbers mentioned above our not NTIC's numbers, but come directly from the Department of Housing and Urban Development.

I would like to take this moment to refute a misleading statistic often bandied about by the Department of Housing and Urban Development. In an effort to downplay the fact that over 76,000 families with FHA loans lost their homes in 1998, HUD has issued press releases stating that only 1% of the loans originated in 1998 have fallen into foreclosure. While this sounds very impressive, I would like to make it clear that it is very uncommon for families to fall into foreclosure in the first 12 months of the loan.

Two major changes in the FHA program took place in 1996 that we feel have led to this increase. First, HUD changed the FHA appraisal process to what is called lender select, meaning lenders are able to choose their own appraisers. This has led to thousands of families across the country being sold homes that were over appraised, often by over $20,000 per home. Second, HUD's mortgage assistance program was replaced with the Loss Mitigation program that makes it optional for mortgage bankers to do workouts with families who are facing foreclosures.

The rise of FHA foreclosure during this administration has lead to abandoned buildings throughout our nation's neighborhoods. According to a 1998 report by the HUD Inspector General, there are over 41,000 HUD owned properties across the country on any given day. Information my office received from the HUD Homeownership Center in Atlanta states that there were over 800 abandoned HUD properties as of August of 1998 in the City of Chicago. Unfortunately, HUD has refused to continue sharing this information with NTIC and other neighborhood groups across the country. As a result, local community based organizations are unable to track information on abandoned buildings in their ongoing effort to ensure that these properties are secure and do not adversely impact the neighborhood. Without cooperation from HUD at the local level it is very difficult for neighborhood organizations to address the issues of FHA foreclosures and HUD abandoned properties in their communities. To make matters worse, HUD's decision to downsize their local field office and move to having four homeownership centers around the country has left neighborhoods with very little available HUD staff and seems to have led to the most basic decisions being made in Washington. Now local community groups are stuck working with "community builders" who seem to have very little in the way of decision making power.

An example of this has been the over 300 families who were ripped off on FHA loans as part of a real estate scam on Chicago's westside. The families were sold dilapidated properties that were overappraised by more than $20,000 in some cases. This scam was a direct result of poor HUD oversight on the local, regional, and national level. How could three hundred families be taken advantage of with FHA loans and HUD not know it?

To get any resolution on this issue, we had to bring a thousand people to Washington to convince HUD headquarters to send a representative to Chicago. The agreement we reached with HUD (which by no means has provided the assistance needed for families) is now administered by the Director of the Atlanta Homeownership Center. At a recent follow-up meeting at which the ripped off families were not pleased with the answers to their requests, the Director of the Homeownership Center said, "This is a policy decision and policy decisions are not made in neighborhoods like this. These decisions are made in Washington." To those of us out on the front line it is clear that HUD has taken decision-making power out of the hand of the few remaining local HUD staff and moved it to Washington, DC. As a result, HUD has become less, not more, responsive to HUD related neighborhood issues.

We are aware that as of March 29 of this year HUD will have privatized the function of the management and maintenance of their single-family inventory. While it is hard to imagine anyone doing a worse job dealing with these abandoned buildings than HUD, we are seriously concerned about the lack of information that has been shared with national non-profits and local neighborhood organizations about this new program. As of March 1, 1999 staff from our office had called two senior staff at the FHA numerous times inquiring about information concerning the new Management and Maintenance contracts. No one from HUD has returned these phone calls. The only information we were able to acquire was a mortgagee letter posted on the world wide web from FHA commissioner Bill Apgar to mortgage companies informing them of the new contracts. NTIC and neighborhood groups across the country welcome the opportunity to work with HUD and these new private contractors, but we cannot do so without information and cooperation.

Furthermore, while we do sincerely appreciate HUD trying to improve its Real Estate Owned functions, we feel that focussing the majority of their energies on the abandoned homes is another case of mopping up a problem rather than stopping the leak that caused the problem in the first place. The proposal does nothing to address the numbers of properties that HUD owns but only makes it someone else's problem.

At NTIC we have always felt that the best way to address the issue of HUD abandoned properties is to prevent foreclosures. We feel there a multitude of ways in which this could be accomplished. Ourselves and community residents and representatives from neighborhood organizations across the country would welcome the opportunity to sit down with members of this committee and HUD Secretary Andrew Cuomo and FHA Commissioner Bill Apgar to have a constructive series of meetings to work together to improve HUD oversight, reduce financial loss to the department, and prevent FHA related foreclosures and HUD abandoned properties in our nation's neighborhoods.

The following are a few of the ways in which we feel HUD can prevent FHA foreclosures and reduce the number of abandoned properties:

1) Mandate an Inspection on all FHA insured homes.

Congress should enact an amendment to the current National Housing Act that would mandate an inspection on all FHA insured homes. By instituting a "fee panel" model of random HUD

HUD does not require pre-purchase inspections on homes sold with FHA loans. This is standard practice on homes sold with conventional loans because the lender is at risk and wants the family to stay in the home and because the home will become the lenders if there is indeed a foreclosure. In many cases, FHA-financed homes are purchased after cosmetic rehab work has been done to mask serious structural defects. This leads to thousands of families a year being forced to pay unforeseen repairs and then fall behind on their mortgage. I have included with my testimony large scale examples of two such cases that took place in Chicago and upstate New York. Congressman Danny Davis has worked with NTIC and neighborhood groups on the westside in our attempt to clean up one such mess.

2) FHA appraisal reform.

As mentioned early, HUD's change to a lender select appraisal system has left thousands and thousands families with homes overappraised by $20-30,000. NTIC and neighborhood groups are working with Congressman Rick Lazio's office to try to prevent families from being taken advantage of by fraudulent appraisers, realtors, and lenders.

3) Pass HR 595, The Emergency Mortgage Assistance Act.

On February 4, 1999 Congressman Luis Guttierez introduced a bill that would provide mortgage assistance from the FHA mortgage Fund to help families who fall behind on their mortgage through no fault of their own and can demonstrate a realistic prospect of repaying the loan. This bill is modeled after the state of Pennsylvania's very successful Homeowner Emergency Mortgage Assistance Program (HEMAP). Over 95% of the families who enter the program save their homes. The program is now operating solely on repayments of past loans.

4) Develop partnerships with new M&M contractors and neighborhood groups.

Community based organizations across the country would welcome the opportunity to work closely with the new contractors who will manage and maintain HUD's abandoned building inventor. However, to do so we need to begin meeting with the Directors of each region as soon as possible. The new contracts begin on the 29th of this month, but we still have little information about who we should be talking to and how this will play out in each of our communities.

In closing Mr. Chairman and Committee members, I feel strongly that HUD could do itself and the nation a big favor if it would follow the Congressman Rick Lazio's advice that "HUD must stop legislating by press release and get back to basics." If the agency would spend as much time and energy on fixing the problems with the department as they do being defensive, putting out press releases, and pointing the finger at everyone else, HUD and the country would be in much better shape.

My office and neighborhood groups across this nation stand ready to work with your committee and the Department of Housing and Urban Development to do whatever it will take to improve HUD oversight, prevent foreclosures, and reduce the number of abandoned HUD properties in our country's neighborhoods.

Mr. MICA. Thank you for your testimony.

I'd like to recognize Mr. Edwards, who's president of the New Eastside, Indianapolis.

Mr. EDWARDS. Thank you.

First of all, I'd like to thank you, Mr. Chairman, and the other members of this committee, for holding this hearing today, because it gives me the opportunity to let you know my perspective on how things are going.

I've heard a lot of talk today about statistics and numbers, and they're very shallow and very cold. This is a face that's been affected directly by how FHA and HUD is affecting our communities.

Nine years ago, I was a very young man. I purchased a home. It was an FHA insured loan. I dealt with a realtor that obviously didn't have my best interests in mind. I was under the impression the home that I had purchased had an inspection done on it. It was actually termed an appraisal.

FHA appraisals are fairly thorough. It was done by an inspection service. I didn't know any better, like many people in this country who buy their first home, didn't know any better.

I bought this house, and it turned up to have several mechanical problems, such as heating and cooling and plumbing and hot water heater and a leaky roof. I heard a lot of talk today about the economy is good and the bankruptcy rates are high, and the segment that FHA is serving, which is me, they're high risk people.

Well, I'm one of those people who was 18 years old and had his own business and had his life together, but had his life destroyed by a faulty program. Had there been a mandatory inspection in place, had there been this inspection in place, I may not have bought this home, or I would have gone into this purchase knowing full well what was ahead of me.

But that wasn't given to me. I bought a house that I thought had a Federal stamp of approval on it, and lo and behold, 2 years later, I was homeless. Has anyone been homeless in this room? Does anyone know what it feels like to actually lose your home? It's not a very pleasant feeling, is it.

We had the opportunity to bring Charles Gardner from HUD in last year. He's the Regional Director for HUD in our area. We had a large public meeting with over 100 in attendance. We told some stories about properties and nightmares that were in our community, one of them being a house that had been vacant for several years that had eventually, after several things happening to it, caught on fire.

Mrs. Debbie Thompson of Indianapolis got up and gave a very emotional testimony, with tears in her eyes, spoke of how she woke up at 4 a.m., to the smell of smoke, not knowing if it was her house, wondering if her children were OK, and talking about the lasting emotional effects that this has had on her family.

Charles Gardner and the other officials from HUD listened to her testimony. Toward the end of her testimony, she held a picture up and showed the audience and Mr. Gardner and the others a picture that her 8 year old daughter had drawn of a house, a two story house with flames coming out of it, teeth and arms. She made the comment that, my daughter drew this for me before I came here today and said, Mommy, I want you to show these people what this house has done to our lives. Consequently, their house was damaged by smoke and water, not to mention the emotional effects to their family.

One of the things we asked Mr. Gardner and the other people from HUD that day was, will they process the claim to have this house, to have this claim expedited. Mr. Gardner agreed to do that. It's 9 months later, and they've not seen 1 penny toward this claim.

You know, people in the community are on the front line day in and day out. We have to deal with what is going on in our own backyard. I've seen the effects of abandoned houses in my community. You see it, it's classic, I don't care what city you're in, you see one abandoned house, in my example, one abandoned HUD house. Three people that live in that community for over 20 years got fed up with dealing with this particular house that I spoke of that caught on fire. As I said earlier, it sat vacant for almost, I would say almost 3 years before it caught on fire, attracted children, attracted vandalism, attracted drugs.

Several homeowners got fed up with dealing with that, got fed up with dealing with fighting the system, and moved, as so many people do. I've been in my community for almost 26 years, I've lived in Indianapolis all of my life. I like where I live, but I too am getting tired and fed up. I traveled to Washington last year and testified, hoping that my experience would have a positive effect on HUD, and here I am again today.

That really about sums up my testimony. I just have one other comment I'd like to make. I'd like to know, is it going to take an act of Congress to get this check processed for the Thompson family? That would be a good thing to know.

Thank you.

[The prepared statement of Mr. Edwards follows:]

Testimony of Carl Edwards

Thank you Mr. Chairman and other member of the Committee for this opportunity to testify. I am a very active member of my community and I have seen the ill effect that HUD can have on a community like mine. Over the last few years I have seen more than enough waste and broken promises from HUD.

I bring you today a point of view that is full of personal experience. I have been the victim of HUD on many occashions but one should never be a victim of an agceny that is funded by our tax dollars and should help people become homeowners.

People in my community, as well as my self, have suffered the broken dreams of loosing their homes, FHA foreclosure rates are still alarming high. Once hard working Americans loses their homes and ruin their lives with bad credit, the community then has to deal with the abandon house and HUD is less than responsive to responding to the problems. Homes are often taken over by drug dealer and long time home owner get fed up with "fighting the system" and move away to the suburbs. People wonder way our urban neighborhoods are decaying. Children often play in unsecured abandon homes, sometime these buildings are infested with rats, used drug paraphernalia or are open unsafe builds that have either burned or have major lead contamination. Over the years we have had many people raped and even killed in abandon homes in Indianapolis. All of this from a government agency that is supposed to "on our side". The only thing that I have seen HUD do well lately is run a persistent public relations campaign on television.

I had to opportunity to work with local and national groups to bring in Charles Gardner, the regional director for HUD, to Indianapolis. We had specific request for him and HUD to improve what we saw as major problems. We had many people from the community, Charles Gardner and the local HUD officials at a large public meeting. We had the opportunity to give them our suggestions and they agreed with what we said. They said that our requests were "very valid". They only promise that both Gardner and the local HUD

office honored was to give a small training on how to use some the their loan programs to fix up run down houses.

Our big concern at that meeting was the destruction caused by a fire in an abandoned HUD house in my neighborhood. The neighbors on each side of that house woke up terrorized at 4:00 in morning with flames and smoke everywhere. Both homes were damaged by that fire.

Charles Gardner, representing HUD agreed to process damage claims for that fire. Today, eight months later, HUD has not paid out a single penny. This is just another example of HUD not serving the needs of the community. HUD should be pro-active and not reactive to the needs of neighborhoods. Until things change with the way HUD conducts business things will never change.

We had three other requests for HUD. It has been almost a year and we still have not seen any of the other requests happen. One simple request was to have on each abandoned house a 1-800-phone number that people could call to report any bad activity that the property may have. Well we have not seen these signs on the HUD properties in my community. From what I have heard from people that have the signs in place and can call - get no action about the problems anyway.

HUD should listen to what people in the community have to say. We are the ones on the front line day after day. We see what is happening to our communities. I have live in the same neighborhood for more that 26 years now and I have seen it change like many others across the country. HUD had played a major part in the decay of our neighborhoods.

I was grateful for the opportunity to testify before the Subcommittee on housing and Community Opportunity on April 1, 1998. I was hopeful that bringing my experience to Washington would have a positive effect on HUD. From what I see day after day that things are still the same. I hope that this trip will bring some badly needed change to the way HUD operates. Thank you for you time.

Mr. MICA. Thank you, Mr. Edwards. That's why we're here, to pass acts of Congress, to try to get things done. Sometimes it's very frustrating.

I'd like to recognize now Grace Jackson, who's a volunteer with the Roseland Neighborhood Housing Services in Chicago. You're recognized, ma'am, and welcome.

Ms. JACKSON. Thank you for having us here. My name is Grace Jackson, and I've lived in the Roseland area of Chicago almost 30 years.

But there's something that I'd like to say before I do my testimony, if it's all right. I heard some gobbledy-gook about HUD keeping the houses 60 days and 6 months and 30 days and 45 days before they're sold. There's a house by me that has been vacant and people have been put out of it nine times. It's still sitting by me.

But in the meantime, it has been rehabbed now and will be sold. But for 3 years, HUD had it under this real estate company who was supposed to take care of it, cut the grass, shovel the snow, make sure that the windows and doors were boarded up. Nobody, in all this time that I took care of this house, for the whole 3 years, I think that's about 36 months, came out and did not one mumbling thing. So let nobody tell you that they take care of vacant property, unless they started it yesterday. Because it has not been done.

On my block now there are five vacant houses. In a two block radius, they do nothing. We, as the block club members, get out and make sure it stays boarded, make sure the grass stays cut, because who wants all these weeds. So if your insurance man happens to come by, and you happen to get a letter, and he tells you your insurance has been canceled, we can't have that. Most of us who are getting to be senior adults, we can't afford it. So we need our insurance that we have.

They don't take care of the property.

I also heard something, please give me enough time, he lost some of his, I'll take his, about this foreclosure. I've heard a lot of excuses on that, why this and why that and why some people are foreclosed. We do have some people probably that do not take care, because they still have that mentality that "I'm a renter." You might have that.

I'm not going there. I'm going here. When people buy that home, and there's not a mandatory inspection, and they try as hard as they can, when you've got a furnace to replace and you've got a roof to replace, and you've got electrical to replace, you cannot, on what you make, and I've heard this said, I didn't like it, but I listened, because it's true, African-Americans and Hispanics, some of them make pretty good, but some of them don't.

I got an FHA loan, so I'm not fighting this, it's needed for a whole bunch of homeowners, if you ever want to have that American dream. But don't tell me that you can have the American dream and pay for all the rotten things that are in the house, when you're trying to pay a house note, you're trying to pay a gas bill, you're trying to pay for the furnace, trying to get the windows fixed, trying to pay for the roof. That's another reason why we have a lot of foreclosure.

When I was here last year, I told you all that at one time, we had the distinction of being on the list that we had more foreclosures than anybody. And I said, well, I'm not bragging, I said, take that back, we're back on the road to having the distinction of having more foreclosures again. I know this is the reason why this is about.

I'd like to share two stories with you how FHA has failed families in Roseland. Mrs. P, she's a working mother of four, she bought a home with an FHA insured mortgage in Roseland. A few weeks after moving, she was told by a Chicago policeman that the building she had just bought was supposed to be demolished. The building had previously been foreclosed in June 1995, and HUD paid the lender $85,000. HUD then sold the house 3 years later for $26,000, which means the property was vacated for 3 years and represented a loss of a good deal of money to the Government.

The realtor then sold the house to Mrs. P. for $122,000. Mrs. P. and her four children were living in the home when the water actually came pouring through the roof, a leak when it rains. Only 30 percent of the electric is working, and all the major systems are not working. Mrs. P. and her children are ill, and she will likely lose this home. I would have given it back to them in the first place.

Once again, the neighbors will be looking at an open and abandoned HUD home.

Then we had another one. Mr. S. purchased a home with an FHA loan from a realtor. The family moved in but the house was falling down. He could not afford all the repairs, so he used an extension cord to go get him some heat from next door.

Everybody on the block is dismayed that the Federal Government would insure a loan on such a house. Houses such as these are a bad investment for the Government and put the health and finances of the family and children in danger.

I understand that March 29th, HUD will begin having a private company taking care of that abandoned property. While we appreciate this effort on the part of HUD, I have two questions for Secretary Andrew Cuomo. How does privatizing the management of abandoned property keep the building from becoming abandoned in the first place? The best way to address the issue of abandoned HUD homes is to prevent FHA foreclosure in the first place.

We need to make inspection mandatory on all homes sold on FHA loans and reform the way in which FHA appraisals are done. They'll come by and look at your house up and down the street and say, oh, this house is fine. I've seen this done. And they go around the back and come back around and get in their car and tell somebody, and you know what happens, they go right ahead. These are unscrupulous, it's not HUD, now, and it's not FHA, I didn't say that. This is the unscrupulous realtors and mortgage companies. They'll take you around the corner, around the house and say, this is fine. Then you move in and you turn the heat on in September, your furnace is out.

I thank you all for having us, and I hope and pray this is the last time we have to be fussing with HUD. We're tired of the problems, and you all as Congressmen and we as grass roots citizens ought to be able somewhere to sit down in a room and come up with a solution.

Thank you.

[The prepared statement of Ms. Jackson follows:]

Testimony of Grace Jackson
Before the
Committee on Government Reform
Hearing on:
"HUD Losing $1 Million per Day – Promised 'Reforms' Slow in Coming"
March 23, 1999

Thank you Mr. Chairman and other members of the Committee for this opportunity to testify. I would also like to thank Congressman Davis, Congressman Blagojevich, and Congressperson Schakowsky for all they are doing to help us address these issues in the City of Chicago.

I am a long-time board member and former president of Roseland Neighborhood Housing Services in Chicago, Illinois and have been on the front line fighting abuses of the FHA program for over 20 years.

I come to you as a resident of a community that for many years had the distinction of having the highest FHA foreclosure rate of any neighborhood in the entire country. Even today, after years of fighting to fix the FHA problem, the Roseland neighborhood still has a default rate of over 18% on FHA loans.

When you live in a neighborhood that has been destroyed by FHA lending abuses it is sometimes hard to believe that the program was actually intended to help families and communities. The large number of FHA foreclosures in my neighborhood has meant an increasing number of families losing their homes and having their credit ruined for years. It has meant abandoned HUD homes on block after block in my neighborhood. Homes that are taken over by drug dealers, homes that are not taken care of by HUD, homes that children are raped in and young people are killed in.

On April 1 of 1998, I had the opportunity to testify before the Subcommittee on Housing and Community Opportunity. As I testified at those hearings, I was hopeful that traveling to Washington and speaking to the committee about mismanagement at HUD would lead to substantial improvements within the FHA program. Unfortunately, I am here to tell you that today it is business as usual at the Department of Housing and Urban Development.

I live next to a house that has been sold 9 times over the last 22 years. Each time with an FHA loan. This means 9 different families pulled their resources together and entered the biggest investment of their life, hoping to get their piece of the American Dream. And nine different families lost their homes, their credit ruined and went away with nothing to show for their investment. But because these loans are insured for 100% by the federal government, the mortgage bankers did not lose any money, the realtors got their commission, and the family, who the program was supposedly designed to help, is out on the street.

I would like to share two very recent examples of how the FHA program has NOT worked for families in the Roseland neighborhood. Mrs. P, a working mother of four bought a home with an FHA insured mortgage in Roseland. A few weeks after moving in, she was notified by a Chicago Police Officer that the building was scheduled for demolition. Here is a little history on the building. The building had previously been foreclosed on in June of 1995. HUD paid the lender a claim of $85,000. HUD then sold the building (almost 3 years later) in February of 1998 for $26,000. The new owner then sold the property to Ms. P for $122,000. Ms. P and her four children are living in a home with a roof that is allowing water to pour in the house, only 30% of the electricity is working and no major systems are working correctly. Her family has been ill ever since moving into the home and her finances are ruined. She will likely lose the home in the coming months and be forced to find housing with a now very bleak credit record.

The case of Mr. S is equally frightening. Mr. S purchased a HUD house from a local realtor. The family moved in but found the home falling down around them. The family could not pay for all the unforeseen repairs and pay the mortgage. There were so many problems with the systems that Mr. S had to run an extension cord to his neighbor's house to get power. Everyone on the block is in dismay that the Federal Government is providing mortgage insurance on properties that are bad investments and put the health and finances of families at risk. The house was foreclosed on in 1998. Mr. S had experienced the American Nightmare. HUD paid the mortgage banker a claim of $75,000 for a house that should have never been insured in the first place. People on the block are now stuck with an abandoned HUD building and are fearful that another family will fall victim to this nightmare. These cases are just two examples of how families are ripped off and abandoned HUD homes come to litter our nation's neighborhoods. These foreclosed, HUD-owned properties are currently living nightmares for myself and other residents in the Roseland neighborhood. There are dozens and dozens of these properties in my neighborhood alone (which is just one of 75 neighborhoods in Chicago). They are more often than not, wide open, stripped of all their appliances, and havens for drugs, crime, and prostitution.

I understand that Secretary Andrew Cuomo has developed a plan that as of March 29, 1999 will privatize the management and maintenance of their disposition responsibilities. I will say that I commend them for at least trying to do something. However, I would like to ask Secretary Cuomo how property disposition reform will prevent cases like these from occurring again? The answer is simple, it does not. The best way to address HUD's inability to care for its abandoned property inventory is reduce the number of properties that it needs to care for in the first place. The way to do this is prevent FHA foreclosures. Once we accomplish this we will truly achieve our goal of helping families achieve and sustain homeownership while also reducing the number of properties in HUD's inventory.

One often overlooked issue with the FHA program is the fact that there are no required inspections on homes sold with FHA loans. This dreadful fact, coupled with the 100% government backing for the lender, has created a gigantic loop hole that is being taken advantage of at the expense of first time homebuyers. We need mandatory inspections on all homes sold with FHA loans. We also needs ways for local community groups to have some power to monitor FHA lending patterns and abuses at the local level, including monitoring that would prevent fraudulent FHA appraisals.

HUD would also do us all a favor if they would implement a foreclosure prevention program like the one Congressman Luis Guttierez has introduced into Congress, HR 595. The Emergency Homeowner Assistance Act would prevent foreclosures and government loss by keeping families in their homes. I hope all of you will sign on to this bill.

While we are all anxious to see how the privatization of HUD's property disposition will affect both HUD's ability to reduce financial loss to the government and reduce the adverse impact these properties have on neighborhoods we are concerned by covertness of the early stages of this new operation. Local community based housing organizations like Roseland Neighborhood Housing Services have not received the information we need to be able to work together with the Department to fix up and sell these buildings to working American families. We would greatly appreciate Members of the Committee working with us to arrange meetings with the regional directors of these new private contractors. We feel that those of us who are out on the front line have a great deal of insight to offer these contractors as they take over this important responsibility.

HUD abandoned properties cost the government over $1 million a day. It is very troubling to me that problems with one HUD program, the FHA, has led to the need to develop a new HUD program, the Abandoned Building Initiative for which HUD is asking Congress to appropriate $50 million to in FY 2000. Because of the large number of abandoned properties in urban neighborhoods the money is needed. But, we would do the nation well to reform the program that has caused the abandonment in the first place.

In closing I would like to thank the Chairman and other Members of the Committee for the opportunity to testify today. Myself and many other neighborhood leaders from around the country stand ready to work with each of you and Secretary Cuomo to address the issues of questionable HUD oversight, rising FHA foreclosures, and fraud and abuse. Thank you.

Mr. BURTON [presiding]. Thank you, Ms. Jackson, for your very informative testimony.

Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman.

I would like to thank the House Government Reform Committee chairman, Dan Burton, for convening this hearing today that includes a panel on the effectiveness of HUD's programs, especially as its relates in my case to homeless persons.

It is a pleasure for me to testify in front of the committee that includes Congressman Dennis Kucinich, who has been a tireless advocate on behalf of homeless persons, and the organizations that provide services to them in my community.

Today I would like to discuss the status of the local continuum of care system for homeless persons in Cleveland, OH, and the surrounding Cuyahoga County. In this context, I will cite a particular problem we have had with the way the Department of Housing and Urban Development has handled a program operated by the Salvation Army, and give a number of recommendations on how this process can be improved.

The Salvation Army PASS program is one of the most effective programs in Cleveland, and is ranked as the highest priority for renewal funding in the 1998 community supportive housing grant. But because someone checked the wrong box on their application, they were denied funding.

As you know, the supportive housing grant is intended to help homeless people move into some degree of stability. It is not an emergency service, it is longer term stability. We have recently learned that HUD is reviewing the Cleveland appeal, and there should be some resolution of this decision in the next few weeks.

HUD is a valuable caretaker of the appropriations from Congress. But we're just asking that they be more sensitive to the priorities in our community. The Federal dollars extended to PASS and other organizations allowed 200 people over the last 2 years to move into some degree of stability. We recommend a few changes to the HUD funding process which would maintain community oversight of the funding and allow HUD to act as an independent adjudicator to keep some of the local community from over-politicizing the process, or strain from the goal of moving homeless people into stable living arrangements.

In Cuyahoga County, we currently see about 22,000 homeless people on the streets every year. That's about 3,000 to 5,000 every night. In 1998, according to the U.S. Conference of Mayors report, we saw a 15 percent increase in requests for shelter attributed to the changes in the welfare system and the lack of a livable wage job in the city.

My agency, which does not receive HUD funding, but represents the interests of homeless people in the funding process, has seen a number of problems with the current process. One of our biggest problems is that the funding for projects that are seeking a renewal of their HUD grant require a greater amount of local community allocation every year, which is stifling our ability to fill some of the gaps in services. In this last year, we have, if we just renewed all the projects that have been funded in the past, it would total about

$11.1 million, and we have a pro rata share of the allocation of about $9.3 million.

There are minor administrative problems with an application that has caused HUD to skip some projects. Many high priority, worthy projects in Cleveland have had to wait 1 or 2 years because of an error in their application. The local community cannot receive technical assistance from HUD on a direct basis. If HUD is a partner in the continuum, then this blackout period is a hardship to the local community.

There need to be modest changes in the HUD homeless assistance grant, but we do not believe that H.R. 1073, the HUD block grant proposal, is the answer. We do recommend that renewal funding for programs that support people in permanent housing such as shelter plus care be funded for mainstream housing programs for low income individuals, and not the Stewart B. McKinney funds.

We also urge you to create a separate NOFA, or urge HUD to create a separate NOFA for renewal applications and a separate one for new and expanding programs. And we urge some modification of Section 103 of the HUD Reform Act to allow better communication between HUD and the municipality in order to improve the application.

We have a daunting task ahead of us, to assist those families who cannot successfully make the transition from welfare to work, and those who are trying to find housing for low income individuals in an environment of fewer affordable housing opportunities in our cities. HUD must be a partner in this undertaking by creating housing opportunities for homeless people, and should not be relegated to checking to see if boxes were correctly checked on a form.

Because I probably won't get another chance, I'd like to thank the Members of Congress for the AmeriCorps VISTA program, which we take advantage of. That has had a tremendous impact on our agency and our community.

Thank you.

[The prepared statement of Mr. Davis follows:]

Written Testimony
by Brian P. Davis
Executive Director: Northeast Ohio Coalition for the Homeless
to
U.S. House Government Reform Committee Hearing
"Local level perspective in HUD management and reform"
March 23, 1999

Thank you, Mr. Chairman. I would like to thank the House Government Reform Committee Chairman Dan Burton for convening this hearing today that includes a panel on the effectiveness of HUD's programs for homeless persons. It is a pleasure for me to testify in front of a Committee that includes Congressman Dennis Kucinich, who has been a tireless advocate on behalf of homeless persons and the organizations that provide services to them.

Today, I would like to discuss the status of the local Continuum of Care system for homeless persons in Cleveland, Ohio and the surrounding Cuyahoga County. In this context, I will cite a particular problem that we have had with the way that HUD handled a program operated by the Salvation Army, and give a number of recommendations for how the process can be improved.

Northeast Ohio Coalition for the Homeless

NEOCH was founded in 1989 as a successor to the Emergency Shelter Coalition. The new organization was primarily intended as a network for homeless shelter and service providers in the City of Cleveland. *The mission of the Coalition is to empower and organize homeless and at-risk men, women and children to end the cycle of homelessness and poverty through public education, advocacy and the creation of nurturing environments.* **NEOCH activities are now concentrated in five areas: coordination, empowerment, public education, research, and advocacy**. As the Executive Director of NEOCH, I supervise a staff of seven people including three AmeriCorps*VISTA members and two Cleveland State University interns. NEOCH staff serve on the Boards of the: Coalition for Housing and Homeless in Ohio, the Shelter Plus Care Advisory Board, and other organizations. Additional background on NEOCH is available in Attachment 1.

Homelessness in the Cleveland Area:

NEOCH estimates that 22,000 different people are homeless and on the Cleveland city streets during each year with 3,000 to 5,000 people on the street on any given night. There is currently a 30- to 60-day wait for women with children to get a space in an emergency shelter. Despite a healthy economy and high employment rates in most market areas, national authorities expect that homelessness will increase over the next five years. The increase will result from recent-year changes in the welfare system and continued reductions in the stock of affordable housing. In 1998, the City of Cleveland reported to the U. S. Conference of Mayors an increase of 15% in total requests for shelter with a 20% increase in requests for shelter by families. These requests were largely denied since all of the Cuyahoga County emergency shelters are full every day. The fastest growing segment of the homeless population is single women with children. In Cuyahoga County, the number of households removed from welfare cash assistance rolls far exceeded the number of jobs created in Cuyahoga County over the last two years. More information on the extent of the homeless problem is included as Attachment 2.

Continuum Planning in Cuyahoga County:

Cleveland is in its infancy with regard to community planning of homeless services. The Cuyahoga County community is working hard to get local elected officials and the larger social services boards (Alcohol and Drug, Mental Health, etc.) to recognize the need for planning a Continuum of Care to move homeless people into permanent housing. The County still has huge gaps in services, and homeless service providers must work with refugees from a wide array of crumbling systems. The City/County Office of Homeless Services coordinates our local grant application. They convene a group of business leaders, social service organizations, government officials, and local foundation representatives to act as an independent, impartial planning body. The homeless service providers meet to discuss the gaps in services and they rank the programs that are seeking funding. This Continuum of Care Planning group looks at the gaps in services and ranks the gaps with high, low and medium priorities. Later in the year, they review the projects that are requesting support, and attempt to match them with the high and medium gaps in services. This planning body chooses the programs that will be forwarded to HUD for funding and ranks those programs in order of priority.

The Northeast Ohio Coalition for the Homeless brings the perspective of individuals who have experienced homelessness to the Continuum of Care process. NEOCH assists two homeless people who have a vote on the Continuum of Care planning body. NEOCH goes into the community and stages meetings with homeless men and women in the shelters and drop-in centers to update the gaps in services and then review and rank the programs that are submitting a grant to HUD. Typically, 40 to 60 homeless people participate in the review of the programs seeking HUD funding. The rankings by homeless people are presented to the final planning body as are the rankings of the homeless service providers.

In Ohio, the rural communities' combined Continuum of Care application and the Columbus/Franklin County application were rated as two of the best applications in the country. They both do a wonderful planning process, which is inclusive of elected officials, homeless people, and community leaders. Columbus has been able to successfully coordinate all the systems that touch the lives of homeless people and put them under a large umbrella to do long range strategic planning. They have provided advice and their expertise to the staff in Cleveland to improve the Cuyahoga County homeless planning process.

The NEOCH problems with the current local HUD funding process:

- The local advisory planning bodies do not have the ability to thoroughly review renewal applications because of the time it takes to address the requirements of the HUD planning process.
- Funding for projects that are seeking a renewal of their HUD grant require a greater amount of the local community allocation every year. This is stifling our ability to fill some of the gaps in service.

- Each community's pro rata funding level is not published and available in writing to each community.
- Minor administrative problems with an application has caused HUD to skip those projects. Many high priority, worthy projects in Cleveland have had to wait one or two years because of an error in their application.
- The local community cannot receive technical assistance from HUD or HUD funded technical assistance agencies after the grant is released by HUD. If HUD is a partner in the Continuum of Care planning, then this "blackout" period is a hardship to the local community.
- The directions contained in the application are not very clear especially with regard to HUD funded programs such as the innovative grants which no longer exist.
- HUD does not work closely with the communities to improve social service organizations that are seeking renewal funding. HUD staff is busy reviewing the merit of each program's application, but is losing sight of the merit of each program.

The most egregious example of the problems with the HUD Continuum process:

The Salvation Army, in October 1996, opened a program called PASS (Pickup, Assessment, Shelter & Services). The program was funded in 1995 under an Innovative component of the by the Supportive Housing Program (SHP) NOFA administered by HUD as part of the McKinney funds. PASS has had 537 guests with 37% of their population declaring that they were veterans of the United States Armed Services. PASS works with outreach workers in the community to identify men who have had repeated stages of homelessness. When a space becomes available PASS staff will place the individual in a bed. PASS has treatment for drugs and alcohol, job counseling, and a housing specialist, but best of all they have a warm family atmosphere. Like any good family, they allow the guests to stay until they are ready for independent living. They do not pressure the men to move on to other facilities. They help the men with any disability or health concern, and then help them find a job. They will not allow the men to take a temporary job or a dead-end low wage job. Those who have the ability to hold down a job must find a job that will allow them to live independently. Then when they have some money saved up, they move into permanent housing. Some will need daily support services, but others can move into an apartment without such regular assistance. All receive follow-up calls and continued contact.

PASS has succeeded in placing 51% of their clients in permanent housing, a very high success rate for a service that caters to the chronically homeless. They have been able to place over 200 men in permanent housing in their two years in operation. The PASS program is a model for successfully integrating one of the most difficult to serve populations back into the community. They received the highest ranking by the community for continued funding.

HUD is currently reviewing the appeal by the local County with regard to the PASS program. **NEOCH has strongly urged HUD to review the PASS application, and we are still waiting for a decision on Cuyahoga County's appeal.**

HUD Continuum of Care 1997

In 1997, NEOCH did a great deal of work with homeless people to assure that their opinions were heard by the Continuum of Care committee. Homeless people identified transportation as a high priority, which was added to the list of gaps in service. As frequently happens, many of the highest priorities are not addressed, because no service provider steps forward to fill many of those gaps in the Continuum. The community, including homeless people, ranked a number of programs as high priorities that HUD skipped, which adds to the frustration with the program. The Cuyahoga County community had three programs that were viewed as absolutely necessary for the community, but did not meet threshold as determined by HUD Washington. One of the programs was poorly conceived and poorly written, and HUD legitimately returned that one to the community for further development. The other two needed only minor changes which could have been attached as conditions for approval of the projects. One was housing for the mentally ill to address the growing waiting list for this difficult to serve population. The other project skipped was for people who need transitional housing upon discharge from the hospital who have some chronic health problems. In fact, these two programs made minor changes in their application, and were funded in 1998.

Our community had to wait an extra year for these much needed programs. There is too much concern for the paperwork and not enough about the viability or strength of a project. From our experiences in Cleveland, HUD reviews the application, and has refused to fund a two valuable programs for arbitrary reasons. Representatives from the local Continuum planning body appealed this decision, but did not receive a legitimate reason for their rejection.

HUD Continuum of Care 1998

In 1998, the local community submitted 19 projects for support from the HUD McKinney funds. Our highest priority for renewal was the Salvation Army PASS program. The PASS program was denied funding because of an error in checking the box marked "Renewal" instead of a "New" program on the grant application. Basically, there was a question about the status of the program since it was originally under a time-limited "Innovative program" initiative, which HUD had subsequently discontinued. However, since the program existed for the last two years it was logical to check the box "Renewal." This small technical error has left one of our most successful programs without funding. Our community is now struggling to find bridge funding for the year to keep the program open. This means Community Development Block Grant funding or Health and Human Services funding will be withdrawn from other existing or expanding programs to address this crisis in our homeless services safety net.

One of the highest ranked new programs that sought funding was a proposal to provide support services to homeless people coming out of treatment for addictions. This project submitted by Recovery Resources of Cleveland was rejected by HUD because the grantee did not identify where the clients would stay while they were working with the counselors of Recovery Resources. HUD could have approved a program the community had deemed a high priority and made it a condition of receipt of the funds that they address the client's housing in their budgetary second submission. Because the 1999 funding will be dominated by the large number of programs that will need renewal funding, the Recovery Resources program will have to wait until 2000 to apply for funding.

NEOCH Opposes Block Granting HUD Continuum Funds

The Northeast Ohio Coalition for the Homeless does not support H.R. 1073 which would block grant the HUD McKinney Homeless Assistance Funds. HUD's involvement in the

Continuum of Care program insures that legislative goals are being met. An example is that in 1999, Congress asked that HUD use more of the funding for permanent housing. HUD has designated a certain percentage of the 1999 allocation for housing. There are a few simple fixes that need to take place to strengthen the current Continuum of Care funding program. HUD needs to be involved in the process to provide expertise as a partner in creating a strong planning process to move people into stable living arrangements. With a block grant there is a danger that the process will be politicized at the local level and the funds will be used to support a local politician's pet projects at the expense of the existing programs. HUD acts as an active, impartial adjudicator to assure that a fair community process is undertaken and that the funds are being used to move people into stable living arrangements.

Recommendation: Modest changes need to be implemented in the HUD Homeless Assistance Funding, but H.R. 1073 is not the answer.

Recommended Solutions

The Northeast Ohio Coalition recommends:

1. **Renewal funding for programs that support people in permanent housing** such as the Shelter Plus Care program **should be funded from the mainstream housing programs** for low income individuals and not the Stewart B. McKinney funds. Funding to keep people in permanent housing should be transferred (retaining the same administrative flexibility) during the renewal process to the housing authority or the Section 8 program as was previously done with the Single Room Occupancy housing component of the HUD McKinney program. Renewal funding for permanent housing programs is so expensive that it does not leave any additional funding to expand services for the increasing number of people using the emergency shelters and shelters in our community.

2. **Create a separate NOFA for renewal applications and a NOFA for new and expansion programs.** HUD should put out a Notice of Funding Availability on its current schedule which would fund only renewal projects. Then three months later put out a second NOFA and announce to each community how much money the jurisdiction has left in their pro rata allocation for new or expanded programs. Each community would still engage in a long range planning process to prepare their applications. The HUD staff should work with the community to fund the top priorities submitted. Unless the funding request is absolutely outside the HUD parameters or the agency has demonstrated an inability to effectively use federal funding, HUD staff should attempt to fund projects that a community deems as a high priority.

3. **Make HUD a partner in the Continuum of Care process.** Since HUD now requires a community planning process and the local governmental jurisdiction is intimately involved in the process, Section 103 of the HUD Reform Act should be modified to allow communication between HUD and the municipality in order to improve an application. HUD staff should be allowed to communicate minor problems with an application to the local government contact or at least to local HUD staff who could work with the community to improve the application before a final decision is made. It should never be the case that a strong program is denied funding because of a minor mistake in the application, such as an incorrect check mark. HUD staff has to keep in mind that the decisions that are made in Washington have a huge impact

on the lives of the homeless people in Cleveland and other cities. If it were not for the support of Congressman Dennis Kucinich and other local leaders, in 1998, an incorrectly checked box would have made 47 current PASS residents homeless.

4. **Local HUD staff should be assigned to assist municipalities with their applications** to prevent simple technical errors from subverting a quality program. HUD now staffs Community Builders in each field office. One community builder in each office could become proficient in the HUD Super NOFA applications and work with the local Continuum planning body to prepare the application. The HUD staff person could review the application and the process to help improve the strength of each community's submission. This would require this arbitrary "blackout" period in which HUD staff cannot provide technical assistance on grants be abolished. One simple correction that could be implemented is to improve the directions for the applications. The common problems that tripped up many communities should be addressed in the application to reduce those problems in the future.

5. **HUD should take a more active role in evaluating the programs that are seeking renewal funding**. In too many communities the local applicant cannot make the tough decision to demand more from an existing service provider. HUD can provide formal guidance to local participants including a review of the annual performance audit report for each social service organization. Locally, there is a sense that an ineffective program is better than no program at all. Too often the local applicant will allow a program to stay open when it is having little or no impact on the community. The local body that submits the application often recommends funding out of fear of creating a bigger gap in the system if that funding is not extended. It is also easier for the local jurisdiction to deflect community opposition to replacing an ineffective service provider if HUD is involved in the decision. HUD staff has the knowledge and insight to be able to communicate to the local jurisdiction the problems with an agency seeking renewal funding. HUD staff can compare the projects with other similar programs in other cities and can question low success rates by a provider.

In Cleveland, the McKinney funds have helped many people obtain stable housing. These funds leverage other dollars in the community, and assure that we continue to address the growing homeless population. In the Shelter Plus Care program alone, our community has placed over 500 families or adults in permanent housing. The planning process mandated by HUD has forced collaboration and a sharing of resources. It has brought all the stakeholders to the table on a regular basis and compelled us to begin to investigate long term solutions to homelessness. The process needs some improvement, but is fundamentally sound. We face a daunting task to assist all those families who cannot successfully make the transition from welfare to work as we also try to find housing for low income individuals in an environment of fewer affordable housing opportunities in our cities. HUD must be a partner in this undertaking by creating housing opportunities for homeless people and should not be relegated to looking to see if boxes were correctly checked on a form.

NEOCH Background

NEOCH was founded in 1989 as a successor to the Emergency Shelter Coalition. The new organization was primarily intended as a network for homeless shelter and service providers in the City of Cleveland.

In early 1990s, NEOCH advocated for greater coordination between the City of Cleveland and Cuyahoga County in responding to the growing needs of an expanding homeless population in the Cleveland area. The outcome was the creation of a City-County Office of Homeless Services (OHS) in 1993. Goals for the OHS included coordination of government and the integrating a service delivery system and a creating continuum of care to assure that allows homeless people to move into affordable housing.

With the creation of the OHS, NEOCH made a transition from a service provider coordinator to a homeless advocacy organization. *The mission of the Coalition is to empower and organize homeless and at-risk men, women and children to end the cycle of homelessness and poverty through public education, advocacy and the creation of nurturing environments.* As a consequence, **NEOCH activities are now concentrated in five areas: coordination, empowerment, public education, research, and advocacy**.

NEOCH activities in partnership with the homeless include:

- the publication of the *Homeless Grapevine* street newspaper, distributed by homeless vendors,
- co-sponsorship of the Homeless Stand Down service fair,
- staffing for the Shelter Provider Group,
- co-sponsorship of an Annual Homeless Conference,
- sponsorship of the Homeless Vigil,
- publication and distribution of the Street Card that lists all the services in the community,
- the development of a program to successfully place homeless people into public housing,
- the supervision of a program to offer tutors to homeless children through the Americorp*VISTA program,
- a Community Voice Mail system for homeless people, and
- the construction of a host of educational and advocacy activities.

Brian Davis is the Executive Director of NEOCH and supervises a staff of seven people including three AmeriCorps*VISTA volunteers and over 50 community volunteers and two Cleveland State University interns. NEOCH also coordinates the activities of over 50 volunteers.

Homelessness in the Cleveland Area

NEOCH estimates that 22,000 different people are homeless and on the Cleveland city streets during each year with 3,000 to 5,000 people on the street on any given night. Nearly 60% of the street population are single, adult men. The other 40+ % are composed of single, adult women, young people under age 18 who are on their own, and families. In downtown Cleveland, all emergency and transitional shelters are full every day and have been operating at or above capacity for the last two or more years. There is currently a 30- to 60-day wait for women with children to get a space in an emergency shelter.

Despite a healthy economy and high employment rates in most market areas, national authorities expect that homelessness will increase over the next five years. The increase will result from recent-year changes in the welfare system and continued reductions in the stock of affordable housing. **Estimates made by the U.S. Conference of Mayors and the National Coalition for the Homeless suggest an increase of up to 40% over the next five years.** In 1998, the City of Cleveland reported to the U. S. Conference of Mayors an increase of 15% in total requests for shelter with a 20% increase in requests for shelter by families. These requests were largely denied since all of the Cuyahoga County emergency shelters are full every day.

It was estimated that 40,000 American's parents and children became homeless in 1998 due to their ineligibility for funds under the new federal welfare guidelines and most will seek shelter with a family member or friend. Others remaining on welfare in 1999 will lose their entitlements beginning in the year 2000. The hardest hit are single women with children — the fastest growing segment of the homeless population. Anticipated Federal budget cutbacks will also reduce access for homeless and other very poor people to substance abuse treatment, other medical treatment, and educational and training opportunities.

In Cuyahoga County, the number of households removed from welfare cash assistance rolls far exceeded the number of jobs created in Cuyahoga County over the last two years. The Council of Economic Opportunities of Greater Cleveland reported that the number of heads of households cut from food stamps exceeded the number of jobs created by almost 4,000 in the last two years.

HUD reported in 1998 that 45,000 households (41 percent of all very low income renters) in Cleveland pay more than 50 percent of their income for housing, many in substandard housing. In 1997, the Cuyahoga Metropolitan Housing Authority (CMHA) reported over 11,000 people on the public housing waiting list. The Section 8 certificate program waiting list, administered by CMHA, has been closed since 1994. This inability to access affordable housing in Cuyahoga County was made worse by the recent and impending closure of several federally-assisted apartment projects.

Mr. BURTON. Thank you, Mr. Davis. We appreciate your being here with us.

Mr. Czerwinski. Before you speak, the gentleman who spoke earlier from FHA, at the conclusion of our hearing, Mr. Apgar, I wonder if we might be able to have you either come back and say a few words in response to what they've said, or else meet with us back in the lounge. I'd like to have some of these questions answered that they raised. Would you do that?

Mr. APGAR. Yes.

Mr. BURTON. Thank you.

Mr. Czerwinski.

Mr. CZERWINSKI. Thank you, Mr. Chairman.

It's been a long hearing, so I promise to keep my comments very brief.

Mr. Chairman and members of the committee, we are here today to provide information on GAO's work on homelessness. Up to 600,000 people may be homeless on any given night. The homeless population, once primarily transient males, now includes women, families with children, the mentally ill, and those dependent on drugs and alcohol.

As a result, addressing the needs of the homeless has grown to a challenge that far exceeds the ability of State, local and private organizations. Recently, several Members of Congress, including you, Mr. Chairman, and you, Mr. Kucinich, have asked GAO to look into how well the Federal Government is helping these State, local and private entities address this need.

At your request, we've initiated a body of work that I'd like to briefly summarize today. Last month, we completed a study that identified key Federal programs that can potentially serve homeless people. Our findings were 50 programs administered by 8 Federal agencies can serve the homeless. These include programs that are specifically targeted at the homeless, and those that are generally available to low income populations which include the homeless.

Over $1.2 billion was spent in 1997 on programs that serve the homeless. About $215 billion went to general programs that include the homeless in the types of services they provide. The types of services they provide include housing, but it's much more than housing, it's health care, training, et cetera.

We concluded that coordination is needed if these 50 programs are to work effectively to achieve what they're supposed to. We also found there's a need for better program evaluation, especially common outcome measures among the eight Federal agencies.

Finally, we believe that Federal agencies can make better use of the framework the Government Performance and Results Act provides for cross-cutting coordination and evaluation.

Before I conclude my statement, Mr. Chairman, I'd like to spend a couple of minutes summarizing reviews we have planned or ongoing. First, this summer we plan to issue a report that complements the study I've just described of Federal programs. This report will provide case studies on some of the more successful efforts of States and localities. Specifically, we'll focus on how they coordinate their programs with one another and the Federal Government, and the use of outcome measures to improve their management of programs.

Also this summer we plan to issue a report on HUD's Supportive Housing Program. This program recognizes that in addition to housing, many homeless people need services such as mental health, substance abuse, and employment assistance. Our review of over 1,200 providers will, among other things, show the types of housing and other services provided, the types of sources of funding—Federal and non-Federal—and the importance that the providers at the grass roots level place on Supportive Housing Programs from HUD.

I'd like to close by talking about a study that I know has a special interest to you, Mr. Chairman, and Mr. Kucinich. As I've just described, there's a myriad of Federal programs that are supposed to partner with the State, local and private providers.

Many of the grass roots providers are very dependent on Federal funds. At your request, later this year we plan to study how well the Federal, State, local and private priorities mesh, and how closely the Federal funding matches the priorities that are set at the grass roots level.

This concludes my statement. We'll be pleased to answer any questions you may have.

[The prepared statement of Mr. Czerwinski follows:]

United States General Accounting Office

GAO

Testimony

Before the Committee on Government Reform, House of Representatives

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HOMELESSNESS

Overview of Current Issues and GAO Studies

Statement of Stanley J. Czerwinski, Associate Director, Housing and Community Development Issues, Resources, Community, and Economic Development Division

Mr. Chairman and Members of the Committee:

We are here today to provide you with information on GAO's recently issued report[1] and ongoing and planned body of work on homelessness. As you are aware, homelessness has persisted in America for decades. While no one knows exactly how many people in the United States are homeless, according to the most widely accepted estimate, up to 600,000 people may be homeless on any given night. Moreover, the causes of homelessness have become more complex, and its effects are now more widespread than in the past. The homeless population no longer consists primarily of transient adult males but also includes women, families with children, the mentally ill, the unemployed, and those who are dependent on drugs or alcohol. Addressing the needs of homeless people is often a formidable challenge because many of them face a combination of personal, social, and economic problems that prevent them from maintaining permanent housing.

Recognizing that states, localities, and private organizations had been unable to respond to the crisis of homelessness in America, the Congress enacted the Stewart B. McKinney Homeless Assistance Act in 1987. The McKinney Act was the first comprehensive law designed to address the diverse needs of the homeless and was intended to provide both shelter and supportive services.[2] Over time, some McKinney Act programs have been consolidated or eliminated and some new programs have been added.

Recently, several Members of the Congress, including you, Mr. Chairman and Representative Kucinich of this Committee, have become increasingly concerned about the apparent lack of impact that federal programs have had on homelessness. This concern has arisen because federal agencies seem to have made little progress in addressing the root causes of homelessness, and federal programs seldom focus on preventing homelessness. Some congressional leaders are further concerned because, in trying to solve the problems of homeless

[1] Homelessness: Coordination and Evaluation of Programs Are Essential (RCED-99-49, Feb. 26, 1999).

[2] Supportive services include those that provide day care, education, employment and training, legal assistance, health care, mental health care, and substance abuse treatment.

people, the federal government has created a separate system of programs designed specifically to serve the homeless that often mirror existing federal and state social service programs that serve other populations (generally called mainstream social service programs)—raising questions about efficiency in the use of limited federal resources. To address some of these issues, GAO initiated a body of work in 1998 on homelessness that we would like to describe for you today. First, we will discuss the results of a recently completed review, and then we will briefly describe four additional pertinent assignments that we have started or planned.

Last month, we completed a study identifying key federal programs that could potentially serve the homeless. Entitled Homelessness: Coordination and Evaluation of Programs Are Essential, this study identifies 50 programs, administered by eight federal agencies, that either are specifically targeted to the homeless or are nontargeted and therefore available to low-income people in general, including those who are homeless. We found that both the targeted and "nontargeted" programs provide an array of services, such as housing, health care, job training, and transportation. In some cases, programs operated by more than one agency offer the same type of service. For example, we found that 23 programs operated by four federal agencies offer housing services, and 26 programs operated by six agencies offer food and nutrition services. We also determined that over $1.2 billion was obligated in fiscal year 1997 for programs that specifically served the homeless and about $215 billion was obligated for programs that served low-income populations, including the homeless. Although information is not available on how much of the funding for nontargeted programs is used to assist homeless people, we estimate that a significant portion of the funding is not likely to benefit them.

Given the multiple agencies and the large number of programs that can potentially serve the homeless, we believe that coordination among federal agencies and evaluations of programs' effectiveness are essential to ensure that these programs achieve their desired outcomes in a cost-effective manner. Through our review, we found that federal efforts to assist the homeless are coordinated in several ways, and many agencies have established performance measures as required by the Government Performance and Results Act of 1993. For example, coordination can take place through the Interagency Council on the Homeless, which brings representatives of federal agencies addressing homelessness together, and through compliance with the requirements of the Results Act. The Results' Act requires federal agencies to identify crosscutting responsibilities, specify in their strategic plans how they will work together to avoid unnecessary duplication of effort, and develop appropriate measures for evaluating their programs' results.

We found that most agencies that administer targeted programs for the homeless have identified crosscutting responsibilities related to homelessness, but few have attempted the more challenging task of describing how they expect to coordinate their efforts with those of other agencies or develop common outcome measures. In addition, we found that while most federal agencies have established process or output measures for the services they provide to the homeless through their targeted programs, they have not consistently developed results-oriented and outcome measures for homelessness in their plans. While some agencies have developed outcome measures for their targeted programs, other agencies either plan to develop outcome measures in the future or told us that developing such measures would be too difficult. Consequently, we concluded that federal agencies have not yet taken full advantage of the Result's Act and that their efforts could be strengthened through increased coordination and the development of common outcome measures for federal programs that serve the homeless.

To address the other issues raised by congressional leaders, we have started or planned work in the following areas:

- State and Local Efforts to Integrate and Evaluate Programs for the Homeless. To provide the wide range of services that homeless people often need, local communities sometimes have to find ways to better integrate their services for the homeless with mainstream social service systems. In addition, some states are increasing their use of outcome measures to ensure that their programs do not only focus on providing services, but also on the goal of moving people out of homelessness. Our ongoing study will describe how some states and localities have tried to (1) link their homeless programs to mainstream social service systems to better serve the homeless and (2) use program outcome evaluations to better manage their programs. For this study, we identified and visited Massachusetts, Minnesota, Ohio, and Washington. According to national experts on homelessness, these states are generally recognized as having made good progress in integrating or evaluating their programs for the homeless. We believe that the examples included in our study will be useful to other communities seeking to better integrate and evaluate their own programs, as well as provide information that can be used by federal agencies attempting similar improvements at the national level.

- Use of Grants Under the Supportive Housing Program to Provide Services to the Homeless. The Congress established the Supportive Housing Program as one of the nonemergency housing programs under the McKinney Act.[3] This program recognizes that many homeless people will need supportive services, such as mental health treatment, substance abuse treatment, and employment assistance, along with housing to help them make the transition from homelessness and live as independently as possible. In fiscal year 1997, the Department of Housing and Urban Development obligated $620 million for this program. These funds were then awarded through a competitive grant process to providers of services for the homeless, nationwide; about 60 percent of the funds were used to provide supportive services. Our ongoing review of the Supportive Housing Program will provide information on the (1) types of housing and supportive services that grant applicants provide for the homeless, (2) other sources of federal and nonfederal funding that grant applicants rely on to fund supportive service programs for the homeless, and (3) the importance of the Supportive Housing Program's funds to grant applicants' programs. To provide this information, we will analyze data obtained through a nationwide survey of about 1,200 service providers who applied for Supportive Housing Program grants.

[3]The Supportive Housing Program was originally established as a demonstration program; the Congress made the program permanent in 1992.

- Programs That Serve Homeless Veterans. According to the Department of Veterans Affairs (VA), veterans make up about one-third of the adult homeless population. To address the needs of homeless veterans, over the past decade VA has established a number of targeted programs, and in fiscal year 1997 it spent approximately $84 million on these programs. Our ongoing review of VA's programs for the homeless is designed to (1) describe the various programs that serve homeless veterans, (2) determine what VA knows about the effectiveness of its programs for the homeless, and (3) identify some promising approaches that serve the needs of different groups of homeless veterans.

- Barriers to Accessing Services. We also plan to study the barriers faced by homeless people when they try to gain access to and use services provided by mainstream social service systems. As part of this review, we will determine how existing mainstream social service systems can be changed to facilitate homeless people's access to services. Making mainstream programs and services more accessible to homeless people would expand the range of programs and services available to them.

In conclusion, Mr. Chairman, homelessness has been and continues to remain a formidable challenge facing our nation. Given the federal government's high level of investment and involvement in developing solutions to this problem, we believe that addressing homelessness will continue to be a priority for the Congress, federal agencies, states and localities, private organizations that serve the homeless, and the public. Consequently, work on homelessness will continue to be important for GAO, and we look forward to providing the Congress and the public with the information they need to address this issue in the future.

Mr. Chairman, this completes our prepared statement. We would be happy to respond to any questions that you or Members of the Committee may have.

(385796)

Mr. BURTON. Thank you, Mr. Czerwinski.

Mr. Edwards, I missed part of your testimony. You're from Indianapolis?

Mr. EDWARDS. Yes, correct.

Mr. BURTON. You said that a home that FHA had taken possession of sat vacant for a long time, then it caught fire and burned down?

Mr. EDWARDS. Yes.

Mr. BURTON. How long did it sit vacant?

Mr. EDWARDS. It sat vacant, even after the fire, almost 3 years. It was a real mystery for almost the first year as to who owned the house. Several letters were written to the city of Indianapolis. I was very uneducated on how to go about finding it, there was no marking on the house, there was no information on the house. I had no clue who to contact.

Mr. BURTON. Did you ever see anybody from HUD out there, or anybody from FHA?

Mr. EDWARDS. No. I mean, I didn't watch the house continuously, but no, I didn't.

Mr. BURTON. Did you ever see any contractor come by and do any work on the house?

Mr. EDWARDS. Yes, after we sent several letters to the mayor of Indianapolis.

Mr. BURTON. How long was that?

Mr. EDWARDS. It took about 9 weeks, after a battery of letters went to Mayor Goldsmith.

Mr. BURTON. From all over the neighborhood?

Mr. EDWARDS. Yes, and phone calls.

Mr. BURTON. Mayor Goldsmith apparently got hold of FHA?

Mr. EDWARDS. The city of Indianapolis claimed the property the first time.

Mr. BURTON. So it wasn't FHA? It was the city of Indianapolis?

Mr. EDWARDS. Correct.

Mr. BURTON. But it was an FHA house?

Mr. EDWARDS. Correct.

Mr. BURTON. Where is this located?

Mr. EDWARDS. On 16th Street, on the east side of Indianapolis.

Mr. BURTON. How far east?

Mr. EDWARDS. It's in the 2800 block.

Mr. BURTON. That's not a bad area out there. I know where that is.

Mr. EDWARDS. It's right behind me.

Mr. BURTON. And it sat there for 9 weeks, you got the city of Indianapolis to help you do something, but FHA didn't do anything?

Mr. EDWARDS. Correct. The neighbors pitched in together and mowed the yard after they cleaned the property up, for a whole year, because once again, had we not done that, we would have had grass that was waist high.

Mr. BURTON. But it did sit vacant, even after the mayor got somebody out there?

Mr. EDWARDS. Correct.

Mr. BURTON. For how long?

Mr. EDWARDS. About a year and a half.

Mr. BURTON. A year and a half?

Mr. EDWARDS. Yes.

Mr. BURTON. Did FHA ever come out, that you know?

Mr. EDWARDS. They came out. We held a press conference last year, and shortly after we held that press conference, they paid some attention to the house at that point.

Mr. BURTON. What did they do?

Mr. EDWARDS. Boarded it up and secured it.

Mr. BURTON. After a year and a half, they boarded it up?

Mr. EDWARDS. Correct. The house had been boarded up prior, too, right after it became vacant, it had been boarded up.

Mr. BURTON. By whom?

Mr. EDWARDS. I'm not sure exactly whom. All I know is that there were boards in place. They had been removed, however. An abandoned property tends to draw the worst of our children and vandals, however.

Mr. BURTON. But it sat a year and a half before it was re-boarded up by FHA?

Mr. EDWARDS. Yes, longer than that, actually.

Mr. BURTON. Did any other neighbors see FHA or that they had people out there?

Mr. EDWARDS. To my knowledge, no.

Mr. BURTON. Did the property improve in quality or did it deteriorate?

Mr. EDWARDS. No, the house caught on fire. Actually, it was being used, we had made several complaints to our local police department about it being used in the middle of the night for people, we're not quite sure what they were doing. We were told that it was actually being used for squatters, I guess squatters, people that would go in in the middle of the night. It was cold, and they would start a fire in the middle of the room and do their drugs, because there was paraphernalia inside.

Mr. BURTON. After the property burned down, the claim has not yet been settled?

Mr. EDWARDS. The claim of the damage of the property owners to each side of the house, particularly the house to the east side of the house, the houses are in very close proximity to the abandoned HUD house that caught on fire.

Mr. BURTON. They were damaged by the fire, too?

Mr. EDWARDS. Right. There was smoke damage and water damage to that property, as well as some exterior siding and water damage, that has to this day not been paid.

Mr. BURTON. Has anybody made a claim against FHA or asked FHA about that?

Mr. EDWARDS. I'm sorry, sir?

Mr. BURTON. Has FHA been contacted?

Mr. EDWARDS. Oh, yes, they have.

Mr. BURTON. Have they responded?

Mr. EDWARDS. To my knowledge they have responded on many occasions. They want, from my understanding, they want the homeowners to do the out of pocket expenses up front and they'll be reimbursed. That was one understanding of it. Another one was they should file on their own homeowners, which to me is ludicrous. That's a mark against your homeowners. Why should they have to take that? Why should their homeowners be responsible for something that HUD should be responsible for?

Mr. BURTON. They would reimburse the insurance company, is what they're saying.

Mr. EDWARDS. Right.

Mr. BURTON. And how long has it gone unpaid?

Mr. EDWARDS. The fire happened November 1997.

Mr. BURTON. In 1997?

Mr. EDWARDS. Yes, 1997.

Mr. BURTON. So it's been almost a year and a half.

Mr. EDWARDS. Correct. We had Charles Gardner, the regional director of HUD, in Indianapolis in July, and got a commitment from him that he would personally process the claim. Still to this day we have not seen a penny.

Mr. BURTON. Ms. Jackson, we're paying $29 a day to maintain these homes, and you and your neighbors have been doing the work?

Ms. JACKSON. Right.

Mr. BURTON. Who else has been helping maintain them? Has FHA helped?

Ms. JACKSON. Please, sir, no, sir.

Mr. BURTON. Have they been paying you $29 a day?

Ms. JACKSON. Not a penny. We had a meeting at NTIC about 4 or 5 years ago and talked to the real estate. I said, you don't want to do it, you're not sending anybody out. My and my girlfriend, she uses the gas mower, I pick up the trash and sweep, I'm kind of senior, and I can't do that. She has the snowblower, and I do all that.

We keep it clean. But I did all the nailing. So I told the real estate person who was taking care of it. That's when he told me he was getting $43 a day. I said, well, you can give me $15 a week and I'll still cut the grass and so on. So my girlfriend said, no, you give me the $15.

Mr. BURTON. Was the real estate man that you're talking about, was he being paid by HUD?

Ms. JACKSON. By HUD. You said $29, he said $43.

Mr. BURTON. And he didn't do anything?

Ms. JACKSON. You weren't there, were you, sir?

Mr. BURTON. No, I wasn't there. And how long was this, about 3 years?

Ms. JACKSON. Three years.

Mr. BURTON. You took care of it for nothing and he was getting $43 per day?

Mr. BURTON. Per day. Sounds like a heck of a deal for him.

Ms. JACKSON. Isn't that a kick in the foot.

Mr. BURTON. That's a kick someplace else. Did anybody else ever come out there besides this fellow?

Ms. JACKSON. No. You know when they finally came, we had a, HUD came in the neighborhood, one of the ladies, she came out and was looking at property. She came by and saw it, and I said, I need to buy this house, because it's nice, I keep it up for you. When you're getting ready to sell it, sell it to me. She said, well, see the real estate man. So I called him, he said, you don't qualify, so I said, OK. That took care of that.

Mr. BURTON. Let me just ask you a couple more questions, then I'll yield to my friend Mr. Kucinich. I appreciate you inviting some of your constituents up here to talk about their problems.

When Mayor Guiliani of New York came and testified, he talked about what he called the broken window theory. He said if one window is broken in a neighborhood and nobody fixes it, then other windows get broken out and eventually the entire neighborhood starts to run down. Did you folks find that to be the case?

Ms. JACKSON. Sure. That's the reason, if you don't get up, I can say this, it's my problem, I don't have nothing to do with it. But, sir, I would be lying. Because it has something to do with me. It affects me.

Mr. BURTON. It affects everybody in the neighborhood.

Ms. JACKSON. And if it affects me, it affects her and him and what have you. So we all have to go together.

Mr. BURTON. Let me just say, Mr. Waxman, in one of his comments, disputed the initial findings of HUD's Inspectors General that the contractors are not doing the job. He was evidently saying that the contractors were doing the job. Everything you guys are telling us backs up what the IG said, that they weren't doing their job.

Ms. JACKSON. I was almost to have a fit or something in this chair while he was talking. Because I was waiting on him. All of you up there so very nice, I was waiting on him. He's gone, but I had something for him, I'm sorry.

Mr. BURTON. He's still here, I think.

Ms. JACKSON. Well, bring him on. Bring him on.

Mr. BURTON. Excuse me for laughing, Ms. Jackson. You inspire great humor in me.

Anybody else have a comment? Ms. Cincotta.

Ms. CINCOTTA. The difference, like when Grace was talking to you about the house next door to her in 20 years has had 9 FHA mortgages, all the people evicted, when she tried to buy it, they said, oh you can't, you own one, we only help homeowners. The only reason that building even existed enough that finally NHS of Chicago could get it and rehab it is because she took care of it.

If you can imagine, nine FHA homeowners, we have helped home ownership. The frustration of the selling pitch that we're helping people, well, people, their lives, the community, are destroyed. We had a press conference about a year ago to dramatize what was happening. This one was one that HUD said they knew, at that time they had about an inch or so only. It was locked, the rest of the street was taken care of. We go to have the press conference.

An older woman poked me on the shoulder and said, I live across the alley, and I've got to tell you what happened last night. The back is wide open, as you know. Three guys grabbed a 12 year old there and raped her.

You hear this every minute. Now, that was one they said they owned. They're paying somebody for it. And not only are they losing a great building, but the other things that happen in that building, like the rape of this young woman, like other things that happen over and over again. They want to pretend it's not their problem.

The sad part is they represent us and we're paying their salaries. And they're still messing us over.

Mr. BURTON. We're going to ask the gentleman from HUD to respond, Mr. Apgar, in just a minute.

Mr. Kucinich.

Mr. KUCINICH. Thank you very much, Mr. Chairman, and I again want to thank the Chair for calling this hearing. I think it would be important for the panelists to know that I served four terms in the Cleveland City Council, working at a neighborhood level. I'm very familiar with the problems people have to deal with on a day to day basis.

Whether the problems are in connection with HUD or some other agency, I know how difficult it can be. I would sit there as a member of city council and take anywhere from 50 to 70 calls a day about concerns that people would have in a community. My purpose in this Congress is to try to keep the Congress focused on community based things.

Ms. Cincotta, as I mentioned earlier, years ago when the Community Reinvestment Act first came out, I know your effort in that. You also remember Monsignor Boroni and the effort that was done then to try to improve housing for people. We worked together successfully on a project in Cleveland, which I'm proud to say stands today as one of the most successful senior citizen projects that's been built in our community.

I'm very sympathetic to the concerns that have been expressed here. I think some of the things that have been said, I'd like to point out, I think when Mr. Edwards testifies that HUD should be proactive and that HUD should listen to what people in the community have to say, I think it's very valuable. I just mention this to the representatives of HUD who are here.

I think it's very valuable to open up lines of communication even better than they have been, not from a defensive posture. Because certainly, you're on the defensive, but it doesn't need to be that way. There needs to be cooperative communication here. I think that's what will make the system work better.

I've seen the same problems that you speak of for many years. Ms. Jackson, you probably remember the Model Cities program back years ago that ended up being a disaster, despite the best intentions of the program.

So I would like to point out that that testimony I felt was very important, as well as the citation of the concerns of Gale Cincotta about just what will the privatization function of management and maintenance of the single family inventory do or mean. Will it mean anything any better? That's something that remains to be seen, for sure.

I know that as you say, it might be hard to imagine anyone doing a worse job. But we want to make sure that we don't promote structures that basically take it out of public access and control. I think we have to be impressed, Mr. Chairman, at this testimony, because it's the testimony of people who don't just live in the communities, they're the builders of the communities, they're the protectors of communities.

But I also think that we need to shift the debate in the sense of this process here, admittedly here, is one which sets up kind of a contest between the people and HUD. We need to find a way to close that, we really do. HUD obviously has much work to do in improving its communication.

When you look at the size of any bureaucracy, any bureaucracy can have failings in that regard, any one of them. I've seen it here for the time I've been in Congress, I've seen it when I was at City Hall. But it's not adequate when you come here with these stories and talk about the difficulties you're having. That's not acceptable.

Now, Mr. Davis, I had the good fortune of working with him on some homeless problems. Frankly, we were told for a while that we couldn't do anything about it. I'm a Member of Congress and I was told that. We worked very hard and kept pressing our case. Finally, we got the attention of HUD.

The other thing that I'd like to point out to you is that I remember, as a member of city council, some of the other areas that we pursued to get help while we were trying to shake up the Federal Government. One was trying to make sure the City Hall itself kept an active list of the properties and kept inspecting them and issuing reports. I found that could be helpful at times.

But I salute your efforts to try to keep neighborhoods clean, to try to keep them livable, to try to make sure that Government is responsive. Because if we can't assure that Government is responsive, we're not doing the right thing by the people in being here.

So I take your participation here with the utmost gravity and seriousness, because this is the reason why I'm in the Congress, and I'm sure it's the same for the Chair. That's why I appreciated his effort in moving forward to get some answers.

And going back to HUD, let's find some ways to improve this and talk to the people and look at the systemic things that are revealed by what they're saying. Because I really believe, one final comment, Ms. Cincotta, I really believe that no matter how bad things may appear here that we can make them better, that we can change them. But it's only with our efforts.

So I thank you for being here, because your testimony is part of our necessary efforts to improve it.

Mr. BURTON. If the gentleman will yield, he's on the Democrat side, I'm on the Republican side. Let me just say that I think if we talk to Mr. Cuomo about the contracts that are going to be let to the contractors who will be overseeing these properties, if we could jointly talk to him about imposing not only stringent requirements on them, making sure they do their job, but also penalties if they don't do their job, in addition to losing their contracts, I think that might have a real positive impact.

The communication you're talking about should be not just from the bureaucracy and the people that work over there, but it should be those contractors and those people that are supposed to be out there on the firing line taking care of these properties.

Mr. KUCINICH. The chairman makes a good point. I think what we've heard here today, Mr. Chairman, in conclusion, is we have contractors who are not doing their job. We have plenty of testimony on that. And we have the Department attempting to defend itself saying, well, some contractors are doing their job.

It's the job of this committee to try to make Government work better. That's our charge, that's our challenge as well. I look forward to continuing to work with the chairman so that we can make Government work better for you.

Mr. BURTON. We'll see if we can draft a joint letter to Mr. Cuomo.

Mr. KUCINICH. I'd be glad to work with you, and also it would be good to have our ranking member involved, Mr. Waxman.

Mr. BURTON. If I can ever talk to him.

Mr. Ose.

Ms. CINCOTTA. Send him to some of our neighborhoods and we'll show him around.

Ms. JACKSON. That's it.

Ms. CINCOTTA. And maybe put him in the basement of one of these vacant buildings for a week and see how he comes out.

Mr. KUCINICH. Wait, if the gentleman would yield, and the gentlelady would yield, just let me state something. I happen to believe there's not a finer Member of the U.S. Congress than Mr. Waxman. I'm not worthy to hold his briefing books, but I will tell you this. It's experience that you have shared that all of us are going to take back and talk about what we need to do. I think it's always good as we approach these things, and the Chair knows I really believe in this, never to personalize our observations. Because when we do that, we really fall short in the mark of trying to get things done.

Ms. JACKSON. Please? May I say just one thing? I didn't mean to say that we wouldn't have gotten along. What we need to do is this, and I've had this work before, when we had one of the worst things in the world, when we were fighting everybody, because everybody was doing the neighborhoods and the communities bad. You've got to sit down with a clear head. You can't be mad all the time, and we can't always be ready to get one up on the other one.

We've got to sit down and reason together. We don't need to always bring Congress in. We can have some of you all, and have some of us. We sit down and clear it up and have a good solution. Because we have to have a solution about this, this is 30 years old. Thank you.

Mr. OSE. Thank you, Mr. Chairman. As with Mr. Kucinich, I too am privileged to serve on this committee. And as compared with Mr. Kucinich, I have the privilege on my side of working with the distinguished chairman from Indiana, Mr. Burton, whose briefing books I daresay I am probably not qualified to carry, either. But we do learn day by day and I appreciate the opportunity to be here.

I'm especially interested in any of your experiences with respect to the base re-use and the homeless communities' involvement in that process. Have any of you been involved in that? Military bases that have been closed and subject for re-use, have any of you been involved in the process of utilizing all or a portion of those bases for homeless or neighborhood services or things of that nature?

Mr. DAVIS. We've been offered a base in northeast Ohio, but it was so distant from the community that it would have been impossible to transport individuals and get them to services. It was too remote.

Mr. OSE. Absent the geographic distance, what feedback can you provide us in terms of the process by which bases scheduled for closing are being offered for use by organizations such as the four of you represent?

Mr. DAVIS. Our only experience is the one official extending an invitation to buy a property, but it was so remote. We've had no other experience besides that.

Mr. OSE. Mr. Czerwinski, how about you?

Mr. CZERWINSKI. Mr. Ose, we haven't looked at that program.

Mr. OSE. Ms. Cincotta.

Ms. CINCOTTA. What we found, we work with a group, Coalition for the Homeless, in Chicago. A lot of the homeless are Vietnam vets. There had been a lot of veterans hospitals closed in the area, closed off even to be able to take care of them before they became homeless. It seems like that one area of folks, like Vietnam vets, nobody wanted to pretend we had a war in Vietnam. My husband and I had two kids over there.

They closed hospitals that should be servicing them even before they get homeless. They could be servicing them close in, right now, and rehabilitate them. It's just, nobody cares.

Mr. OSE. That's not a housing issue, that's a job training or medical services issue.

Ms. CINCOTTA. But with the hospital, there's rooms, there's beds, there's meeting areas. There are ways to do a lot of things. It's just not—nobody cares.

Mr. OSE. This is one of those unique circumstances where a Congressman doesn't have anything to say. Mr. Chairman, I yield back.

Mr. BURTON. That is rare.

Mr. Allen, you are recognized.

Mr. ALLEN. Thank you, Mr. Chairman, and I want to thank you for holding these hearings. This is a very important topic to millions of people across this country, and I am pleased to be part of this discussion.

Most of my questions are probably for Mr. Czerwinski. But if others want to join in after he's had a chance to speak, that will be fine.

Just a little bit of background—in Maine, we had applications in for the renewal of several homeless programs. At the end of the day, after an initial denial, some of those programs were renewed. But the Shelter Plus Care program for both the State and the city of Portland were not renewed.

What's interesting is that there were different perspectives on this. My understanding is when you look back at the entire way this was done, HUD's scoring resulted in five of the six New England States receiving less funds in 1999 than 1998, while the eight western States each received more funds. Three of the largest funding decreases occurred in New England.

It also showed that the 20 poorest States, with 27 percent of the population, received only 14 percent of the funds. If you look not in terms of poverty but in terms of how heavily populated a State is, the Nation's 20 least populated States—of which Maine is of course one—home to 10 percent of the country's population received only 5 percent of the homeless funding.

In Maine, the applications for both the city of Portland and the State of Maine were done by the same person who had done them year after year. What was interesting is that suddenly, instead of being praised, we didn't even qualify for funding. So the question arises, is there a problem with consistency in scoring? As this program has become more competitive, are we evaluating the paper and not the program?

I understand the pressures on HUD, I understand—as the number of applications grows, and the funding doesn't keep pace—how applications that have been approved in the past might not be considered in the future.

Here are some issues. First, three questions. Is there a way to assure more consistency in scoring year to year? Second, is there some way to recognize geographic need in this process, so that we don't have a purely competitive system, which can, as happened in Maine, suddenly leave a State without any funds at all? And third, I understand that a suggestion was made to perhaps consider separating renewal applications for homeless funding from new applications for homeless funding. Is this reasonable?

Mr. Czerwinski, I'd be interested in your reaction to those three questions.

Mr. CZERWINSKI. They're very good questions. Unfortunately, the answer to the homeless situation is not a simple one.

What we are trying to do is first of all, just get a handle on the Federal programs that are out there, and then look at the interaction between the Federal Government and the State and locals. The kinds of issues you raise are some of those that are coming up quite a bit as anecdotes in our filed work. The local governments have their priorities, private organizations have theirs, but then there's a mismatch between what we're hearing from them and the Federal Government.

What we're planning to do, at the request of Mr. Kucinich and Chairman Burton, is to actually go out and pull a sample of applications from the local areas. We will then match the priorities they have set with those set by the Federal Government. In that way we will try to come up with the answers to the very questions you asked. If Mr. Burton and Kucinich are willing, we would be quite glad to add you to that request and do that work for you.

Mr. ALLEN. We would like to be added to that request list because Federal homeless funding has been critical for people. The State and city just fell off a cliff this year, suddenly there was no money where there had been money before.

I think whether it's a matter of regulations, whether it's a matter of legislation, it's an impact that we probably don't want to see. We want to maintain some competition, but we don't want people to fall off a cliff when they've been running a highly recommended program for years.

Mr. CZERWINSKI. When you talk about competitive funding, you've touched on the paradox of the issue. That is, people want to have competitive funding for their projects, but then again, they want some consistency. They know they can get funding consistently from year to year with the formula grant programs.

But the concern of the homeless advocates is that with formula grants, housing and other kinds of services to the homeless sometimes may fall right off the table. It's an all or none type of situation under two different scenarios. So what you're talking about is probably the most critical issue.

Mr. ALLEN. Thank you, Mr. Chairman.

Mr. BURTON. Thank you very much.

Let me thank the panel very much for being here. You've been very informative. I wish I could have heard everything you had to say, unfortunately I had to go to another meeting temporarily. You've not only been informative and helpful, but you've been entertaining, Ms. Jackson. You could make it big as a standup comedienne. [Laughter.]

I thank you very much, we're going to take everything that you say to heart, and I'd like to have Mr. Apgar come back to the table so I and my colleagues can briefly ask him some questions.

Then we'll adjourn and let everybody go get a sandwich or something.

Mr. Apgar, you're still under oath, as you know.

Mr. APGAR. Yes.

Mr. BURTON. First of all, Ms. Jackson said that she has taken care of an FHA house in Chicago for 3 years, and has never seen anyone from FHA go near the house. She's been out there taking care of the house. I think she said she saw a fellow come by that said he was getting $43 a day instead of the $29 a day.

Have you terminated the contracts of any contractors in Chicago?

Mr. APGAR. Yes, we have.

Mr. BURTON. You did?

Mr. APGAR. Yes.

Mr. BURTON. When did you do that?

Mr. APGAR. Last year we terminated some. I'd have to get the exact time. But we have terminated some contracts, including in Chicago.

Mr. BURTON. Do you know if one that you terminated was the gentleman that was in the neighborhood where she is?

Mr. APGAR. I'm not sure of that. If he said to her that he was getting paid $43 a day, that has to be a misstatement on his part. Contractors under the current system are paid on a reimbursable basis. So he wouldn't have anything to reimburse against.

In the new system, contractors are only paid for selling the properties, so that's what gives them the incentives to maintain and process the mortgages.

Mr. BURTON. Could you do me a big favor and check and see if that gentleman is still a contractor for you in her neighborhood? I'd like to know.

Mr. APGAR. OK.

Mr. BURTON. Are you aware of any other problems with contractors in Chicago? You said you've fired a couple of them. Are there any others you have problems with?

Mr. APGAR. Reviewing our contractors, I don't know of any other problems at this stage. We routinely tell contractors if they're not doing their job, if we get a citizen complaint, we'll notify the contractor and get them to go out and fix the problem.

Mr. BURTON. If you could give me an update on the Chicago area and maybe Indianapolis as well, I'd really appreciate it. That would give us a chance to take those two as examples and spot check them.

Mr. Edwards said that an FHA house in Indianapolis sat vacant for a year and a half and then burned to the ground. He said they wrote letters, a lot of letters to the FHA, but the only ones who came out to look at the house was the city of Indianapolis. Do you know if the contractor in Indianapolis is still there and doing his job?

Mr. APGAR. I don't know about that situation. I know that Mr. Edwards talked with our HUD staff about this matter last summer. And based on that, our HUD staff took action, including the items that Mr. Edwards mentioned, boarding up the property, securing it as best they could.

Mr. BURTON. And it burned to the ground?

Mr. APGAR. I don't believe they said it caught fire, they said they had to board it back up. So I believe from his testimony, I'm not familiar with the case, the property must be still standing.

Mr. BURTON. It burned down, didn't it?

Mr. EDWARDS. It did catch on fire, and it was deemed unsafe. I was told it was salvaged to some poor guy who couldn't fix it up, another nightmare.

Mr. BURTON. So it's just a shell.

Mr. EDWARDS. Yes.

Mr. APGAR. Just a shell, yes.

Mr. BURTON. What about the people next door there, and their compensation for the damages to their houses?

Mr. APGAR. There was a discussion about that. It's my understanding we are processing that claim.

Mr. BURTON. Would you check on that and let me know as well?

Mr. APGAR. Sure.

Mr. BURTON. And along with that last question I asked, I'd like to know why this claim since 1997 has not been paid. It's almost a year and a half later. So if you could give me an answer on that, too.

Ms. Cincotta said that a young girl was raped on a property that was vacant in her neighborhood. Have you yourself gone to any of these neighborhoods to see for yourself how bad the problem is?

Mr. APGAR. I've been in HUD foreclosed properties, yes.

Mr. BURTON. Well, I'd like to have a report on Ms. Cincotta's neighborhood and that house as well, where that girl was raped. I think that's important, if you could take a look at that.

Let me ask you one final question, then I'll let you go and I'll go vote, because I've got a bunch of votes coming up. Suppose I'm a homeowner like Ms. Jackson, and I'm living next door to one of the neglected HUD properties. Can you walk me through the specific steps that I need to go through to get HUD to take action? These people who testified said they've called, they've written letters and everything else, and they had problems. Just tell me, what's the quickest way to get action from HUD when you have that kind of a problem?

Mr. APGAR. They should call the HUD office in their area and get the name of the contractor. That's one approach. We have established in many neighborhoods neighborhood watch systems, in which cooperation between us and the police department, they're able to get immediate attention.

In most instances, there are HUD signs up. I think the IG testified there were well over 90 percent of the properties have signs which identify who to call. And in this select group of communities where we're working cooperatively with the police officers, we have a hotline to the local police department where they can call.

Mr. BURTON. I want to thank you very much, Mr. Apgar, for being with us. We'll be in touch with you and I appreciate the answers to the questions. Give my regards to Mr. Cuomo and tell him that we would like to work with you to make sure these problems are solved as quickly as possible. Toward that end, Mr. Kucinich and I will probably write a couple of notes over to you.

Mr. APGAR. Right. Well, obviously I stayed to hear the testimony because I think it is important to work with the community groups, as we have in the past. Quite frankly, here we have a significant disagreement with methods of addressing this problem, with the group from Chicago. They have repeatedly asked us to do things, which among other things, we've not been able to get congressional authority for.

But in terms of the diagnosis of the problem, we appreciate the fact that quickly disposing of these properties is in everybody's interest.

Mr. BURTON. I think one of the biggest problems, and if you could convey this back again to Mr. Cuomo, is it's extremely important that you have good contractors. If they're not doing the job when you spot check, fire them or fine them, whatever it takes, to make sure you get competent people on a job. I think if you did that, that would go a long way toward solving the problem.

Mr. APGAR. Thank you.

Mr. BURTON. Thank you, sir.

We stand adjourned.

[Whereupon, at 4:13 p.m., the committee was adjourned, to reconvene at the call of the Chair.]

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