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The Honorable Donald W. Riegle, Jr.
House of Representatives

Dear Mr. Riegle:

As you asked on October 1, 1973, we made a limited review of selected aspects of the activities of the Department of Housing and Urban Development (HUD) in selling acquired single-family houses on a noncompetitive basis to the Genesee County Model Cities Development Corporation (MCDC) in Flint, Michigan. The houses were sold under HUD's "as is" sales program. As part of our review, we gathered specific data on and inspected two houses that were purchased by MCDC and subsequently sold to a private investor. 23 D. 2290

As you requested, this report covers matters we discussed at our briefing on January 28, 1974. In addition, answers to specific questions which your office provided to us on the noncompetitive portion of the as is sales program are presented in the enclosure.

AS IS HOUSING SALES PROGRAM

In March 1973, HUD's Detroit area office and the HUD servicing office in Flint established a program to dispose of single-family houses acquired through insured-mortgage defaults by selling them in as is condition to the highest bidder. Sales to nonprofit organizations were to be made on a noncompetitive basis. At the time we completed our field work, all houses sold under the program had been sold to MCDC, a nonprofit organization.

Under its policies HUD can dispose of acquired properties through (1) sale after the property has been repaired to habitable condition, (2) sale of an individual property as is--without repairs, or (3) bulk sale of a number of properties as is. Also, if circumstances warrant, HUD may demolish a property and sell the vacant lot.

HUD generally repairs, rehabilitates, and upgrades acquired properties before offering them for sale. If extensive repairs are required to make a property structurally sound, functionally adequate, and suitable for long-term use, HUD compares the anticipated net recovery from the sale of the property with the anticipated net recovery of the lot if the property is razed. When the net recovery from repairing and selling a property is expected to be more than or approximately the same as the net recovery if the property were razed, the property is normally repaired.

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When needed repairs are not economically feasible, rather than demolishing the property and offering the vacant lot for sale, the property may be offered for sale as is on an "all cash without warranty" basis.

In determining whether to repair, sell as is, or raze an acquired property, the Flint servicing office contracts with an architectural, engineering, and planning firm to prepare repair specifications and determine the estimated cost of repairs. The city of Flint also inspects the property to identify repairs needed to meet local building requirements. A HUD servicing office official in Flint told us that the architectural firm is instructed to identify and estimate the cost of repairs necessary to put each acquired property in a "habitable" condition and at least meet HUD minimum property standards. The official stated that "habitable" meant that the condition of the property after repair should be better than the average condition of similar properties in the same general area.

HOUSES SOLD TO MCDC

From April to October 1973, the Flint servicing office sold 118 houses to MCDC for \$446,190 under the as is sales program. In computing the sales prices, HUD deducted the architectural firm's estimate of the cost of repairs and HUD's estimate of certain administrative costs, sales commissions, and closing costs from its estimate of the value of the house if it were repaired.

Although HUD used the architectural firm's estimate of the cost to repair a house in establishing the as is sales price, HUD officials told us that MCDC, or purchasers from MCDC, were under no contractual obligation to do all the work included in the estimate. Under the sales agreement between HUD and MCDC, MCDC was to insure that the houses met HUD minimum property standards so that they would qualify for mortgage insurance if the houses were to be subsequently sold under one of HUD's mortgage insurance programs. An amount equal to 10 percent of the HUD sales price was placed in an escrow account by MCDC to guarantee adequate repairs and was to be returned to MCDC after the houses were repaired and had been inspected by HUD.

A Flint servicing office official informed us that, if the houses were to be sold under the Veterans Administration loan guaranty program, the Veterans Administration would also require that the houses meet HUD minimum property standards. He stated, however, that, if the houses were to be sold with conventional financing, they would only have to meet local building requirements, which are generally less stringent than HUD's minimum property standards.

HOUSES RESOLD BY MCDC

MCDC records showed that 110 of the 118 houses it purchased were subsequently resold as is to other parties and that MCDC kept the other 8 for rehabilitation. Of the 110 houses, 2 were sold to private individuals for use as their own homes, 5 were sold to another nonprofit corporation, and 103 were sold to 10 investors. The most houses purchased by any investor was 38.

We gathered specific data on two houses purchased by MCDC. Presented below are the pertinent details on HUD's computation of the selling prices of the two houses.

	<u>Property A</u>	<u>Property B</u>
HUD's estimated fair market value as repaired	\$15,500	\$15,900
Less:		
Estimated cost to repair house (per architectural firm specifications)	\$6,507	\$9,664
Estimated holding cost (HUD administrative) (480 days x \$4.40)	2,112	2,112
Estimated sales commission of 5 percent	775	795
Estimated closing costs	<u>200</u>	<u>200</u>
Subtotal	<u>9,594</u>	<u>12,771</u>
Selling price to MCDC	<u>^a\$ 5,910</u>	<u>^a\$ 3,130</u>

^aAs is sales prices were rounded to nearest \$10.

HUD sold these houses to MCDC for the amounts shown above. MCDC added \$300 to the selling price of each house to cover its administrative expenses and resold them to the investor who purchased the largest number of houses.

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We met with the investor to gather data on repairs made to these houses before he resold them. He advised us that his record of expenses consisted of checkbook entries, employees' time cards, and various invoices from suppliers; he could not readily identify all costs applicable to the repair of these specific houses.

At our request, a HUD servicing office official in Flint inspected the houses and estimated that the investor had spent \$2,500 to \$3,000 on each house to correct local building code violations and to paint the interior and exterior of the houses. This official pointed out that some of the items repaired by the investor had not been repaired to the extent recommended by the architectural firm. He identified the following items, listed in the architectural firm's repair specifications, which had not been repaired by the investor before resale of the houses.

<u>Property A</u>	<u>Estimated costs</u>
Replace concrete walks and drive	\$ 139.91
Remove antenna	19.79
Patch holes in roof	11.87
Remove wall milk box	79.19
Replace forced-air gas furnace	561.00
Rewire all circuits	858.00
Replace various lighting fixtures	<u>100.00</u>
Total	<u>\$1,769.76</u>

<u>Property B</u>	<u>Estimated costs</u>
Replace concrete walks and drive	\$ 551.19
Replace public concrete walk and drive	819.00
Replace garage door	292.50
Replace asphalt shingle roof	748.79
Replace gable vents	46.80
Replace concrete step	20.80
Replace gutter and downspouts	200.03
Replace resilient flooring	65.06
Replace counter top	81.89
Replace bathtub	158.60
Replace lavatory	49.40
Replace gas furnace	552.50
Rewire all circuits	845.00
Replace lighting fixture	<u>16.25</u>
Total	<u>\$4,447.81</u>

In October 1973, these houses were sold under the Veterans Administration loan guaranty program for \$16,000 (property A) and \$15,900 (property B). A Veterans Administration fee appraiser inspected the houses before sale and valued them at these amounts. The investor received a sales commission of 7 percent on the sales price of each house, or \$1,120 and \$1,113, respectively.

MCDC and HUD had not inspected the houses as required by the terms of their escrow agreement. However, the houses had been inspected and approved by a Flint housing inspector as having met local building code requirements.

At the time we completed our field work the escrow funds had not been returned to MCDC. A Flint servicing office official told us later that the funds had been returned.

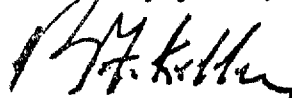
In November 1973, after we initially inquired into this program at your request, HUD area officials advised us that the Detroit area office had terminated as is sales to nonprofit corporations on a noncompetitive basis. The program was terminated in November because, according to HUD officials, the Flint office's administrative controls over the program were lax, as shown by the lack of HUD inspections. These officials added that they questioned the practice of selling houses to MCDC on a noncompetitive basis and allowing MCDC to resell the houses to investors, thus permitting the investors to bypass the normal competitive system. They informed us that they planned to continue offering acquired properties for sale as is to profit and nonprofit organizations on a competitive basis.

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As you requested, we did not give HUD or other involved parties an opportunity to formally comment on the matters discussed in this report. We have, however, discussed information included in this report with these officials and included their comments as appropriate.

We plan to make no further distribution of this report unless you agree or publicly announce its contents.

Sincerely yours,



[Deputy] Comptroller General
of the United States

Enclosure

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RESPONSES TO CONGRESSMAN RIEGLE'S QUESTIONSREGARDING FLINT, MICHIGAN, AS IS HOUSING SALES PROGRAM

1. What housing stock is selected for this program? Is every repossessed house considered?

Only those acquired properties that HUD determined were not economically feasible to repair--generally those located in inner-city neighborhoods--were selected for the as is sales program.

2. What inspection is conducted to determine the expected cost of rehabilitation--if any?

An architectural firm prepared the repair specifications which included the estimated cost of repairs. The firm's employees, accompanied by city of Flint housing inspectors, made physical inspections of the houses. Also, HUD inspected selected houses to verify the value established by HUD appraisers.

The staff of the nonprofit Genesee County Model Cities Development Corporation (MCDC), which was the only purchaser of as is properties in Flint, stated that MCDC had reviewed each house offered for sale to determine if it wanted to purchase the house for rehabilitation.

3. Who makes the above inspections, and who makes a final inspection to grant title?

HUD and MCDC are supposed to inspect houses after rehabilitation, but these inspections do not affect passage of title. The two houses we reviewed had not been inspected. HUD officials advised us that administrative controls in the Flint office were lax, as shown by the lack of inspections.

The city of Flint inspects houses on which ownership is being transferred. The city issues a Certificate of Compliance and Occupancy if building code violations are not found. If violations are found a certificate is not issued until they have been corrected.

4. What codes (local housing codes) are enforced?

As we said in our answer to question 3, the city of Flint is responsible for enforcing local housing codes. The city had an inspection report for only one of the two houses we reviewed; however, the records at the HUD servicing office in Flint showed that the city inspected both houses in November 1972. City records did not indicate any followup on cited code violations. The investor, however, obtained Certificates of Compliance and Occupancy for these two houses.

5. What method of selection is used in selecting prospective owners?

Houses are offered for sale to the general public through newspapers and other publications.

6. Is there any required time period which an owner must possess and/or occupy the property?

There is no required time period.

7. Are there any provisions which are or should be in effect to guard against speculation on the properties (buying as is and selling after a cosmetic repair job for a hefty profit to an unsuspecting buyer)?

For properties sold, HUD required an escrow deposit, to guarantee adequate repairs, equal to 10 percent of the as is sales price. In addition, inspections by HUD, MCDC, and the city of Flint, after rehabilitation, were to give the purchaser some measure of protection. None of these provisions, however, would preclude speculation on as is properties. Also, neither of the two properties we reviewed had been inspected by HUD or MCDC after rehabilitation. The city of Flint, however, made inspections to insure compliance with the local building code, and the Veterans Administration appraised both properties before approving them under its loan guaranty program.

8. What role can nonprofit groups play? Are any groups or individuals given preferential treatment?

Nonprofit groups can help HUD dispose of its large inventory of acquired properties by purchasing as is properties and rehabilitating them for resale at reasonable prices.

During the period April to October 1973, the Flint servicing office sold 118 single-family houses to MCDC in as is condition. MCDC resold 110 of these houses as is to 10 investors (103 houses), 2 private individuals (2 houses), and 1 other nonprofit corporation (5 houses). Considering the various parties who had purchased the houses, it did not appear that any individual or group was given preferential treatment.

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