

GAO

Report to the Ranking Member,
Subcommittee on Economic
Opportunity, Committee on Veterans'
Affairs, House of Representatives

November 2007

DEPARTMENT OF VETERANS AFFAIRS

Actions Needed to Strengthen VA's Foreclosed Property Management Contractor Oversight




GAO
 Accountability-Integrity-Reliability
Highlights

Highlights of [GAO-08-60](#), a report to Ranking Member, Subcommittee on Economic Opportunity, Committee on Veterans' Affairs, House of Representatives

Why GAO Did This Study

In 2003, the Department of Veterans Affairs (VA) significantly revised its in-house approach to managing and selling properties that become subject to foreclosure proceedings due to defaults by veterans on mortgages guaranteed by the department. VA contracted this function out to a private firm—Ocwen Financial Corporation (Ocwen)—after determining that doing so would increase the program's efficiency. VA oversees the Ocwen contract, which terminates in 2008, through onsite property inspections and other means.

GAO was asked to (1) describe VA's inspection and other oversight findings and (2) evaluate VA's overall contract oversight program to determine whether any lessons can be learned prior to the implementation of the next contract in 2008.

Among other steps, GAO reviewed VA inspection reports, accompanied VA staff on visits to three states, interviewed VA and Ocwen officials, and compared VA's procedures to those of other organizations that manage foreclosed properties.

What GAO Recommends

In designing a new property management contract scheduled for implementation in 2008, GAO recommends that VA ensure that it can obtain real-time data and impose penalties for unsatisfactory performance. In written comments on a draft of this report, VA agreed with these recommendations.

To view the full product, including the scope and methodology, click on [GAO-08-60](#). For more information, contact Yvonne D. Jones, 202-512-8678, jonesy@gao.gov.

DEPARTMENT OF VETERANS AFFAIRS

Actions Needed to Strengthen VA's Foreclosed Property Management Contractor Oversight

What GAO Found

VA inspections of foreclosed properties managed by Ocwen have identified a substantial number of deficiencies, such as failure to secure doors and windows, remove trash and debris, maintain lawns, and make needed repairs. GAO observed generally similar conditions in visits with VA realty specialists in Oklahoma, Michigan, and North Carolina, which may have reduced the marketability of the affected properties. VA also has not been satisfied with Ocwen's performance in selling properties in the shortest time possible and at price levels established in the contract. In response, Ocwen officials have raised concerns about the fairness of certain VA contractual requirements and oversight procedures.

While VA has made a committed effort to oversee the contractor's performance, its overall capacity to do so is significantly limited compared to two government-sponsored enterprises (GSE), Fannie Mae and Freddie Mac, which manage large inventories of foreclosed properties. Unlike the GSEs' information systems, for example, VA's system does not include real-time property maintenance and repair information, including expense data. Without this data, VA is not able to fully assess the quality of property maintenance and repairs, the reasonableness of related expenses, and take corrective action on a timely basis to correct deficiencies. VA's contract with Ocwen also does not include sufficient authority for the department to impose penalties for unsatisfactory performance in key areas, such as property maintenance.

Condition of a Lawn at a VA Property in Michigan



Source: GAO.

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Abbreviations

CPTS	Centralized Property Tracking System
FHA	Federal Housing Administration
GSE	government-sponsored enterprise
HUD	Department of Housing and Urban Development
Ocwen	Ocwen Financial Corporation
OMB	Office of Management and Budget
PMOU	Property Management Oversight Unit
ROS	return on sales
VA	Department of Veterans Affairs

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United States Government Accountability Office
Washington, D.C. 20548

November 15, 2007

The Honorable John Boozman
Ranking Member
Subcommittee on Economic Opportunity
Committee on Veterans' Affairs
House of Representatives

Dear Mr. Boozman:

In 2003, the Department of Veterans Affairs (VA) significantly revised its traditional in-house approach to managing and selling foreclosed properties from the Home Loan Guaranty program for veterans by contracting this function out to a private firm, Ocwen Financial Corporation (Ocwen).¹ VA entered into this contract, which terminates in 2008, after determining that a private sector company could more efficiently manage the department's foreclosed property inventory, and thereby reduce costs to the government.² From the time VA's Home Loan Guaranty program was created in the 1940s until 2003, VA had managed its foreclosed property inventory using staff in regional offices nationwide who oversaw a network of property management brokers and other contractors. VA and its contractors were responsible for, among other things, securing foreclosed properties, performing necessary maintenance (e.g., removing debris and cutting lawns) and repairs, and selling the properties within reasonable time frames to minimize tax and other

¹The VA Home Loan Guaranty program generally allows qualified veterans to obtain VA-guaranteed mortgages with certain favorable terms and provides mortgage lenders with substantial financial protection against losses that may be associated with extending such mortgages. By selling foreclosed properties, VA seeks to recover some of the expenses that it incurs in providing such financial protections to lenders.

²VA made this determination through the Circular A-76 cost comparison process. The Office of Management and Budget (OMB) is responsible for publishing and updating OMB Circular A-76 "Performance of Commercial Activities," which establishes federal policy regarding the performance of commercial activities. The circular establishes procedures for determining whether commercial activities should be performed under contract with commercial sources or in-house using government personnel. This process is known as competitive sourcing and is identified as one of the primary initiatives in the President's Management Agenda. The scope of our work did not include an analysis of VA's determination to contract out the management of its foreclosed property inventory through the A-76 process.

expenses. Since 2004, Ocwen has performed these tasks using its own nationwide network of real estate brokers and contractors.³

Under the contract, Ocwen receives a fee for each property sold (about 1.3 percent of the sales price), and VA reimburses the company for the costs of maintenance, repairs, and other expenses. From 2004 to August 2007, Ocwen sold approximately 36,000 VA properties, including about 7,700 in 2006, and received about \$45 million in compensation.⁴ The contract also establishes a variety of performance requirements for Ocwen. For example, the contract requires Ocwen to meet targets for securing and maintaining properties, selling properties within the shortest time possible, and selling properties, on average, at prices that meet established return on sales (ROS) targets. VA's Home Loan Guaranty program staff in Washington, D.C., are responsible for the overall oversight and management of the Ocwen contract. In addition, a VA unit of approximately 16 individuals based in Nashville, Tennessee, is responsible for monitoring Ocwen's compliance with specific provisions of the contract, such as maintenance and repair obligations. To carry out its responsibilities, VA staff in Nashville inspect a sample of properties each year to determine how well they are being maintained. Ocwen also submits maintenance and repair expense documentation to the Nashville VA office for review and approval.

Because of your interest in ensuring that VA manages its operations as efficiently as possible, you asked that we review the department's foreclosed property management oversight. You expressed particular interest in learning whether Ocwen had fully met its obligations under the contract and whether any lessons could be learned that would assist VA in designing the new property management contract that is expected to be finalized in 2008.⁵ Accordingly, this report (1) describes the findings of VA on Ocwen's performance in key areas related to foreclosed property management and the contractor's views on its own performance, and (2)

³While VA and Ocwen signed the contract in August 2003, the effective contract starting date was January 2004. VA continued managing its inventory of foreclosed properties until December 2003 when it began to transition responsibility for managing and selling such properties to Ocwen.

⁴Ocwen compensation data are as of September 7, 2007.

⁵According to VA officials, the department does not plan to resume managing foreclosed properties itself because many of the staff who previously performed this function have left VA.

evaluates VA's overall policies, procedures, information systems, and data for overseeing the foreclosed property management and sale processes.

To meet our objectives, we obtained and reviewed VA's contract with Ocwen; quarterly reports that assess Ocwen's performance in key areas such as property security, maintenance, and safety; 50 randomly selected VA inspection reports and supporting documentation; data on the time it takes Ocwen to sell VA properties; correspondence between VA and Ocwen; and previous GAO reports.⁶ We also interviewed VA officials in Washington and Tennessee as well as Ocwen officials. Further, we accompanied VA realty specialists on site visits to three states—Oklahoma, Michigan, and North Carolina—to observe the department's property inspection process and the condition of foreclosed properties firsthand.⁷ We selected these states on the basis of several criteria, including the number of VA properties for sale in each state, the range in median listing prices of the VA properties, and geographic and economic diversity. Additionally, we interviewed officials from two government-sponsored enterprises (GSE), Fannie Mae and Freddie Mac, which also manage and sell a large inventory of foreclosed properties, and obtained data from the companies on the average time it takes them to sell such properties. We discussed the design of their approaches to managing foreclosed properties with officials from the GSEs and compared these approaches with VA's. We assessed the reliability of the data used and found them to be sufficiently reliable for the purposes of this report.

We conducted our work in Boston, Massachusetts; Nashville, Tennessee; San Francisco, California; and Washington, D.C.; and in Oklahoma, Michigan, and North Carolina between January 2007 and September 2007 in accordance with generally accepted government auditing standards. Appendix I explains our scope and methodology in greater detail.

⁶GAO, *Single Family Housing Opportunities to Improve Federal Foreclosure and Property Sale Process*, [GAO-02-305](#) (Washington, D.C.: Apr. 17, 2002); GAO, *HUD Single Family and Multifamily Property Program: Inadequate Controls Resulted in Questionable Payments and Potential Fraud*, [GAO-04-390](#) (Washington, D.C.: Mar. 3, 2004); GAO, *Single Family Housing: Stronger Measures Needed to Encourage Better Performance by Management and Marketing Contractors*, [GAO/RCED-00-117](#) (Washington, D.C.: May 12, 2000).

⁷VA realty specialists typically conduct onsite property inspections and audits of financial information submitted by Ocwen regarding property maintenance and repairs, among other tasks, as part of their responsibilities.

Results in Brief

In its contract oversight role, VA has identified deficiencies in certain key areas related to Ocwen's performance in managing and selling the department's foreclosed properties. These include the following:

- VA realty specialists found a substantial number of deficiencies related to security, maintenance, and safety issues during their inspections of 2,391 foreclosed department properties during the 6 quarters from October 2005 through March 2007. Specifically, VA inspections found that the number of properties that did not meet overall inspection standards ranged from 32 percent to 46 percent during those 6 quarters.⁸ VA realty specialists cited Ocwen for a variety of problems that included failure to secure doors and windows, remove trash and debris, perform required lawn maintenance, and correct interior and exterior structural conditions that can cause deterioration or make properties unsafe. We generally observed similar conditions, which may have reduced the marketability of the affected properties, when we accompanied VA realty specialists on site visits in Oklahoma, Michigan, and North Carolina. In response, Ocwen officials expressed concerns that one deficiency can cause a property to fail a VA inspection and that such inspections at times focused on trivial items, which is a contention that the department disputes.
- VA has not been satisfied with Ocwen's overall compliance with its contractual obligation to sell the department's foreclosed properties in the shortest time possible. According to VA data, the average time that Ocwen has taken to sell VA properties increased from about 315 days in 2005 to 342 days in the first 6 months of 2007. In comparison, VA reported taking approximately 237 days to sell foreclosed properties when it managed the process in 2000, and data we obtained from the GSEs show they reported selling their foreclosed properties, on average, in less than 230 days over each of the past several years. Although caution must be exercised in making such comparisons among organizations because a variety of factors can affect the time it takes to sell foreclosed properties, data provided by VA and the GSEs for one key area, property location, suggest that the department's concerns about Ocwen's performance may be warranted. According to this data,

⁸VA's contract with Ocwen established a minimum standard of 95 percent compliance in these areas. The original contract established a standard of 97 percent, but was modified by a contract amendment in June 2005. The data for the second quarter of 2007 are preliminary as VA has not finalized the quarterly performance report for the period.

the GSEs have sold relatively more foreclosed properties in states with distressed housing markets in recent years than has been the case for VA property sales. VA has expressed particular concern about the number of foreclosed properties in Ocwen's inventory for a year or longer (23 percent of the inventory in January 2007 according to VA), and requested that Ocwen submit a plan to reduce the number of such properties in January 2007. While VA reviewed the plan that Ocwen submitted in February 2007 and accepted it in June 2007, it is too early to evaluate the plan's effectiveness.

- VA has consistently cited Ocwen for not meeting return on sales (ROS) targets established in the contract. As a result, VA assessed three financial penalties totaling \$1.3 million against the company for failure to comply with these requirements. However, Ocwen officials contend that VA's approach to calculating ROS targets for foreclosed properties is not consistent with industry standards and lacks credibility. VA officials have responded that the department's approach is clearly defined in the contract and that VA has taken steps to address Ocwen's concerns. Nevertheless, Ocwen has challenged VA's penalties, and these challenges remain under review by the department.

VA has made a committed effort to ensure that Ocwen complies with its contractual obligations through onsite inspections and other means, but the department's overall capacity to help ensure the effective management of its foreclosed property inventory is significantly limited. While there are differences between the GSEs' and VA's approaches to managing and selling foreclosed properties, the department could potentially benefit from adopting certain elements of the GSEs' approaches.⁹ These elements reportedly allow the GSEs to develop an understanding as to how individual properties are being managed from the time such properties enter the companies' inventories until the date they are sold to homebuyers or investors. In particular, GSE officials said their companies' information systems contain real-time data on how properties are being maintained and repaired and permit GSE staff to review the appropriateness of maintenance and expense data incurred on an ongoing basis. In contrast, VA's property management system, the Centralized Property Tracking System (CPTS), generally does not capture real-time property maintenance and repair data or data on the expenses the contractor incurs in managing

⁹The GSEs directly manage their network of real estate brokers whereas VA relies on its contractor to perform this function.

the department's foreclosed property inventory. Without such data, VA is not well positioned to assess the quality of the maintenance and repair of its foreclosed properties during onsite inspections or the reasonableness of related expenses and take corrective action on a timely basis to correct deficiencies. Moreover, while VA's contract with Ocwen allows the department to impose a defined penalty for unsatisfactory ROS performance, it does not allow similar penalties for unsatisfactory performance in other key areas, such as property maintenance or the time it takes to sell foreclosed properties.¹⁰ Senior VA officials we contacted recognize there are limitations in the department's contract and oversight processes. For example, the VA officials said the lack of real-time property management data limits the effectiveness of the property inspection program, and the department did not enforce a provision in the contract requiring Ocwen to provide real-time property management information because the company's systems were unable to do so. VA officials also said they are considering steps to address such limitations in anticipation of the new foreclosed property management contract that is scheduled to be in place in 2008, but have not yet reached any final decisions. Without improvements in VA's current contract and oversight processes and authorities, the department will not be well positioned in the future to help ensure that its properties are managed in an efficient and effective fashion.

To improve VA's capacity to oversee the foreclosed management property and sales processes, we recommend the department take several steps in designing, negotiating, and awarding a new contract and relevant oversight processes for the function. Specifically, we recommend VA ensure that the contract includes (1) the requirement that the contractor provide real-time property management data as deemed necessary by the department and (2) the authority to impose penalties for unsatisfactory performance in key areas, such as property maintenance and selling properties within established time frames. We also recommend that VA use real-time data provided by the contractor to monitor the management of its foreclosed property inventory (or a sample thereof) on an ongoing basis and act on a

¹⁰We have previously identified such penalties as important for effective management of the foreclosed property management function. See [GAO/RCED-00-117](#). In this report, we identified deficiencies in the Department of Housing and Urban Development's (HUD) oversight of contractors that manage HUD's foreclosed property inventory. The report concluded that HUD's contracts lacked penalties for key areas, such as selling properties within reasonable time frames. The report recommended that HUD revise such contracts to include appropriate penalties.

timely basis, including the use of penalties as appropriate, to address identified deficiencies.

We provided a draft of this report to VA for its review and comment. In VA's written comments, the department generally agreed with the report's conclusions and concurred with its recommendations. We also obtained technical comments from VA, the GSEs and Ocwen Financial Corporation, which have been incorporated into this report as appropriate. VA's letter and comments are reprinted in appendix II.

Background

According to VA, the department's Home Loan Guaranty program can provide financial incentives for private lenders to offer eligible veterans of the U.S. armed forces mortgages with certain favorable terms, such as not requiring a downpayment. VA guarantees a portion of the mortgage loan in the event that borrowers default, providing lenders with substantial financial protections against some of the losses that may be associated with extending such mortgage loans. To help support the program, veterans are required to pay a funding fee of up to 3.3 percent of the loan amount.¹¹ The VA's Home Loan Guaranty program receives funding through the Veterans Housing Benefit Program Fund.¹²

When veterans fall behind on mortgage payments, VA encourages lenders or mortgage servicers to work with the veterans to avoid foreclosure, such as restructuring the terms of the mortgage.¹³ According to VA officials, the department monitors lenders' and servicers' actions to help veterans retain

¹¹38 U.S.C. § 3729. Veterans receiving compensation (or who, but for the receipt of retirement pay would be entitled to receive compensation) for their service-connected disabilities and surviving spouses of veterans who died in service or from service connected disabilities are exempt from the funding fee. 38 U.S.C. § 3729(c).

¹²38 U.S.C. § 3722. Appropriations from this program account provide for all housing operational costs for the VA's direct and guaranteed housing loans. Additionally, appropriations are provided for the administrative expenses necessary to carry out these programs, which may be transferred to and merged with the general operating expenses account. See for example, the Military Quality of Life and Veterans Affairs Appropriations Act, 2006, Pub. L. No. 109-114, 119 Stat. 2372, 2383 (Nov. 30, 2005).

¹³Mortgage servicers, such as large mortgage finance companies or commercial banks, typically service mortgages insured or guaranteed by VA. Mortgage servicers do not necessarily finance the mortgages they service, but rather service mortgages for a fee on behalf of those entities that own the mortgages, such as the lenders that originated the mortgages.

their homes. However, if veterans still cannot meet their mortgage obligations, foreclosure proceedings or termination proceedings may be initiated. State foreclosure laws establish certain procedures that mortgage servicers must follow in conducting foreclosures and establish minimum time periods for various aspects of the foreclosure process (see fig. 1). For example, servicers are generally required to provide borrowers with certain notices associated with the initiation of the foreclosure process. At the foreclosure sale, lenders or servicers may purchase the properties. Then, they may transfer or “convey” the properties to VA which, in turn, “assigns” the properties to Ocwen for management and sale. However, the contractor may not be able to immediately take control of such properties or evict the occupants in states with redemption laws if the debtor has a right to possess the property during the redemption period. In states with redemption periods (which can generally last 6 months to a year or longer), unless waived, borrowers are provided the opportunity to match the winning bids at the foreclosure sale and reclaim their properties.

Figure 1: Overview of the Foreclosure, Property Management, and Sales Processes



Source: GAO analysis of VA foreclosure processes.

VA contracted out responsibility for foreclosed properties to Ocwen through the A-76 process. Under the A-76 process, federal departments and agencies identify activities that are “commercial” in nature and assess whether it would be more cost-effective for the government to contract such functions out to the private sector. In 1999, at the request of the Office of Management and Budget (OMB), VA initiated an A-76 study to determine whether the department’s foreclosed property management function should be contracted out, and conducted a competitive process to determine whether the private sector could more efficiently manage the department’s foreclosed property inventory. As provided in the OMB Circular A-76, Performance of Commercial Activities, VA’s Home Loan Guaranty program staff reviewed the department’s ongoing approach to property management, developed a proposal for developing a more efficient organization, and submitted a proposal on improved management

of foreclosed properties to VA for review.¹⁴ VA also invited private sector companies to submit proposals and several companies, including Ocwen, did so. VA convened a panel of acquisition officials, which included officials with experience in the Home Loan Guaranty program to review the competing proposals. The panel determined that Ocwen had demonstrated the technical capacity to manage and sell the department's foreclosed property inventory, and concluded that Ocwen's estimated cost in doing so would save 10 percent over the VA Home Loan Guaranty unit's proposal.¹⁵ Accordingly, VA awarded the foreclosed property management contract to Ocwen on August 27, 2003.

After the A-76 contract determination was made, VA reassigned or offered early retirement incentives to many of the staff involved in managing and selling foreclosed properties and assumed responsibility for overseeing Ocwen's performance under the contract. VA Home Loan Guaranty staff in Washington are responsible for overall contract management and policy issues, and staff in VA's Property Management Oversight Unit (PMOU) in Nashville are responsible for assessing Ocwen's compliance with specific contract provisions. As shown in table 1, PMOU conducts onsite inspections of a nationwide sample of properties each year to assess the maintenance and repair work on such properties. Typically, properties subject to PMOU inspections are on the market, with "for sale" signs prominently displayed on the front lawn or elsewhere. After properties are sold, Ocwen submits maintenance and repair invoices to PMOU staff for their review and approval. PMOU staff audit a sample of such invoices to identify potentially questionable expenditures and, if necessary, go back to Ocwen for additional information. PMOU staff also conduct other types of desk audits related to specific contract provisions—for instance, to determine whether Ocwen or its contractors accepted the best offer on a particular property, as required.¹⁶ VA and PMOU have developed an information system, the Centralized Property Tracking System (CPTS) that

¹⁴In its proposal to retain responsibility for managing the department's foreclosed property inventory, VA proposed reducing the 277 staff involved in the process by about half, operating the process out of 4 regional offices rather than 46, and hiring a national contractor with responsibility for property repair work.

¹⁵Ocwen had previously managed foreclosed properties for lenders and other clients.

¹⁶In the case of multiple offers, the determination is based on which offer is closest to the established minimum acceptable net return or produces the highest net return among all the offers and meets the terms of the listing.

maintains information on the department's foreclosed properties, including the results of onsite inspections and other performance audits.

Table 1: Monitoring Tools Used by VA's PMOU Staff

Activity	Purpose	Methodology
Onsite property inspections	Ensure that properties are secured, maintained, and free from safety hazards.	Visit a sample of about 1,800 properties annually in states with highest volumes of foreclosed properties. Inspect properties' interior and exterior conditions.
Invoice audits	Ensure appropriateness of property maintenance and repair expenditures.	Review a sample of about 10 percent of closed property files. Verify that there is adequate documentation to support claimed expenditures and follow up with contractor if documentation is lacking or expenses are questionable.
Desk audit measures (sold properties)	Ensure compliance with various contract provisions, such as those involving accepting offers on a property.	Review a sample of about 10 percent of closed property files. Ensure compliance with contract provisions and supporting documentation.
Vendee loan audit ^a	Ensure compliance with contractual requirements involving vendee loans.	Review a sample about 10 percent of closed property files. Ensure that loan files indicate compliance and documentation is adequate.

Source: VA.

^aVA may finance loans to external parties for the purchase of the department's foreclosed properties. Such loans are referred to as "vendee loans."

Fannie Mae and Freddie Mac, the GSEs, are responsible for managing large inventories of foreclosed properties. Both are private corporations chartered by Congress to provide a continuous flow of funds to mortgage lenders and borrowers. To fulfill their responsibilities of stabilizing the nation's mortgage markets and expanding homeownership opportunities, the GSEs purchase mortgages from lenders and either retain them in their portfolios or package them into mortgage-backed securities that are sold to investors;¹⁷ as a result, the GSEs may become responsible for properties that are foreclosed. To effectively manage the foreclosed properties, both GSEs have established monitoring systems to oversee the efforts of brokers and other contractors in securing, repairing, maintaining, and

¹⁷The GSEs retain responsibility for the credit risks on any of the mortgage-backed securities they guarantee. That is, the GSEs, in exchange for a fee, guarantee the timely payment of principal and interest to investors on the mortgages that serve as the collateral for the securities.

marketing the properties in order to sell them as quickly as possible. In 2006, the GSEs together sold approximately 43,000 foreclosed properties.

VA Has Identified Significant Performance Deficiencies in Key Areas of Ocwen's Management and Sale of Foreclosed Properties

In its oversight capacity, VA has identified significant deficiencies in Ocwen's compliance with key contractual provisions relating to the company's management of the department's foreclosed property inventory. For example, VA has identified deficiencies in Ocwen's performance in securing and maintaining department properties as well as mitigating identified safety hazards. The failure to properly maintain foreclosed properties also may have contributed to other deficiencies VA has identified in Ocwen's performance. That is, poorly maintained properties may take longer to sell than would otherwise be the case and it may be difficult for Ocwen to sell such properties at targeted price levels. In response, Ocwen officials have raised concerns about the fairness of certain of VA's contractual requirements and oversight procedures.

VA's Inspections Identified Substantial Security, Maintenance, and Safety Deficiencies

VA's contract with Ocwen established a 95 percent overall performance standard for Ocwen in maintaining VA's foreclosed properties (or a maximum failure rate of 5 percent).¹⁸ However, as shown in figure 2, VA's onsite inspections conducted during the 6 quarters from October 2005 through March 2007 found that Ocwen consistently failed to meet the overall property maintenance standard.¹⁹ For each quarter, the percentage

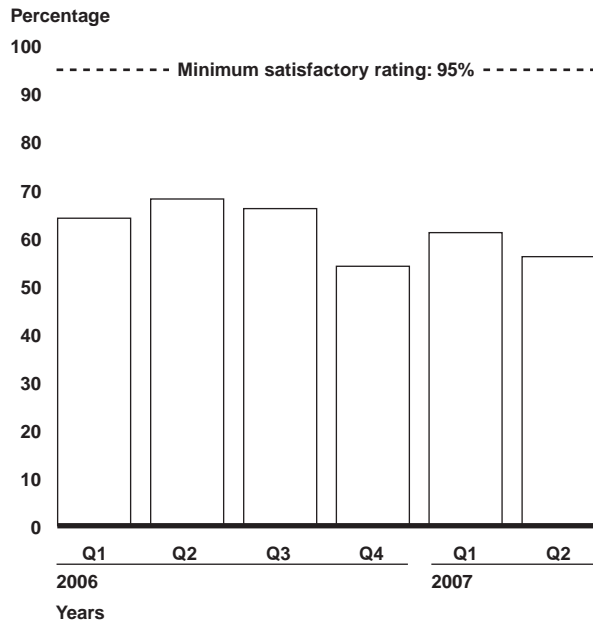
¹⁸VA refers to its overall performance category as property maintenance. As described in this section, the overall category consists of three subcategories: (1) securing properties, (2) performing maintenance and repairs, and (3) eliminating safety and other hazards. In inspecting a sample of properties, VA staff may identify a violation in one or more of the subcategories for each property. For example, a particular property may not be properly secured (e.g., a window is left open) and poorly maintained (e.g., leaking roof not repaired). However, in calculating Ocwen's overall performance in managing the properties sampled, VA only counts the total number of properties with at least one violation in any one of the three subcategories to avoid double-counting. VA reports the results of its inspection findings to Ocwen on a quarterly basis.

¹⁹We chose this time frame for our analysis for two reasons. First, when VA transferred responsibility for managing its foreclosed property inventory to Ocwen in January 2004, there were many foreclosed properties that had been managed by the department. By October 2005, it is likely that many such properties had already been sold; therefore, VA's inspection related directly to Ocwen's performance in managing the department's property inventory. Second, by October 2005, Ocwen had nearly 2 years to develop experience in managing VA's foreclosed properties, which provides a more reasonable basis for assessing its performance compared to earlier periods (e.g, 2004 and early 2005).

of properties that did not meet VA's inspection standards ranged from 32 percent to 46 percent. During the period from October 2005 through March 2007, VA staff conducted a total of 2,391 property inspections in about 25 states, mostly of properties that were on the market and had for sale signs in the front yard or prominently located elsewhere on the properties.²⁰ While VA has sent written notice of Ocwen's failure to meet the overall inspection standards on a quarterly basis, short of terminating the contract, the department does not have effective recourse under the contract to hold the company accountable for its performance. As is discussed later in this report, VA's contract with Ocwen does not provide the department with the authority to impose a penalty on Ocwen for the failure to adequately maintain the department's properties.

²⁰VA realty specialists made 51 visits to about 25 states during 2006.

Figure 2: Ocwen's Overall VA Property Maintenance Ratings, October 2005 through March 2007



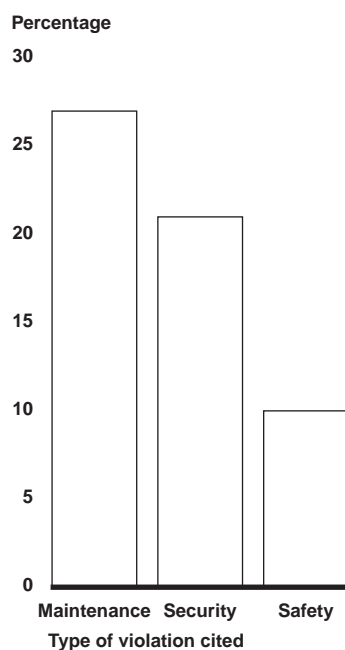
Source: GAO.

Note: Data for the second quarter of 2007 is preliminary because VA had not finalized its March 31, 2007 Quarterly Performance report.

VA's overall property maintenance rating category consists of three specific subcategories (1) securing properties, (2) performing required maintenance and repairs, and (3) eliminating safety and other hazards. For illustrative purposes, figure 3 shows VA's preliminary inspection findings in each of these subcategories for the second quarter of 2007. While Ocwen is required to meet the 95 percent satisfactory performance threshold in each of these categories, the figure indicates that the company failed to comply with this standard. For example, VA realty specialists found maintenance deficiencies in 27 percent of the foreclosed properties inspected during the quarter. According to the VA data we reviewed, Ocwen consistently missed the required performance thresholds for the three subcategories by varying margins during the 6 quarters between October 2005 and March 2007. More specifically, for the 18 total rating segments covering the three subcategories during the 6 quarters, Ocwen failed to meet the 95 percent performance threshold in 17. Ocwen did meet the required performance threshold for the security subcategory in the second quarter of 2006 (with a

satisfactory score of 95.5 percent in the properties inspected) while just missing the threshold for the security category in the third quarter of 2006 with a satisfactory score of 94.4 percent.

Figure 3: Percentage of Inspected VA Properties with Deficiencies in Security, Maintenance, and Safety Subcategories, Second Quarter of Fiscal Year 2007



Source: GAO.

Note: Unlike the overall maintenance score which only counts the number of properties with one or more violations, VA realty specialists may identify a violation in one or more of the subcategories for each property. As a result, the number of violations may exceed the number of properties inspected. Data for the second quarter of 2007 is preliminary because VA had not finalized its March 31, 2007 Quarterly Performance report.

To develop information on the most common property management deficiencies identified by VA realty specialists, we reviewed VA's inspection findings as identified in the quarterly reports that covered the October 2005 through March 2007 period. As shown in table 2, the most common security deficiency VA realty specialists identified involved one or more doors being unsecured. In other cases, VA realty specialists could not gain access to properties scheduled for inspections, largely because their lock boxes had been changed, which, according to VA, also constitutes a violation under the contract because the department is unable to assess properties'

conditions.²¹ Under the largest category, property maintenance, the most commonly cited deficiencies included failure to remove trash and debris, perform adequate property maintenance or repair (e.g., fixing leaking roofs that may cause structural damage), and adequately maintain lawns. Under the third category, safety deficiencies, VA realty specialists identified a variety of exterior and interior deficiencies such as unsafe front steps, missing handrails, and large floor holes.

Table 2: Most Frequent Deficiencies Identified (Security, Maintenance, and Safety) by VA Realty Specialists (October 2005 through March 2007)

Deficiencies		
Security	Maintenance	Safety/hazardous
<ul style="list-style-type: none"> • One or more doors not secured • Door locked (unable to gain access) • Windows not secured 	<ul style="list-style-type: none"> • Trash/debris not removed • Inadequate property maintenance or repair • Lawns overgrown or similar deficiencies 	<ul style="list-style-type: none"> • Exterior structural unsafe conditions • Interior structural unsafe conditions • Pool and/or spa not secured

Source: GAO analysis of VA inspection reports.

Note: Because VA did not break out and summarize the individual types of deficiencies, we developed the information contained in this table. The information is based on our analysis of VA's quarterly performance reports that covered 2,391 properties visited by VA realty specialists.

To assess the documentary support for VA's property inspection findings, we reviewed 50 randomly selected inspection files at PMOU. Our random sample was chosen from the property maintenance subcategory of 698 inspections that VA staff conducted from October 2005 through March 2007 and covered properties in 20 states and inspections by 13 different realty specialists. For each file, we reviewed the VA realty specialists' inspection checklist and notes to identify the types of deficiencies cited, such as poor lawn maintenance. We also reviewed documentation included in the files, particularly photographs, to assess the support for the findings. Our analysis of this documentation was generally consistent with the VA inspection results.

We also visited foreclosed VA properties in Oklahoma, Michigan, and North Carolina to observe the VA inspection process and the conditions of the

²¹The VA realty specialists determined that the lock boxes either did not contain a key or had an incorrect access code.

properties firsthand. These three states were selected to reflect a range in median listing prices of VA properties on the market as well as geographic and economic diversity. Overall, the VA realty specialists found that, on a preliminary basis, approximately 78 percent of the 130 properties inspected in each state had one or more security, maintenance or safety deficiencies, as follows:²²

- The Oklahoma properties represented a mix in terms of their conditions and corresponding values. Although some properties were in good condition, many needed a considerable amount of structural and cosmetic work to improve their condition and appearance. In many cases, the VA realty specialist concluded that Ocwen and its brokers had not taken required steps to correct structural problems before properties were listed for sale (fig. 4). Further, the VA realty specialist found that, in many cases, Ocwen and its brokers had not removed trash and debris from many properties as required (figs. 5, 6, and 7).

²²GAO staff visited 96 of the 130 properties with the VA realty specialists.

Figure 4: Structural Damage at an Oklahoma Property for Sale



Source: GAO.

Note: According to the VA realty specialist, such a structural violation could cause interior water damage as well as allow animals to enter the property.

Figure 5: Trash and Debris Not Cleaned Up at an Oklahoma Property for Sale



Source: VA.

Figure 6: Trash and Debris Not Cleaned Up at an Oklahoma Property for Sale



Source: VA.

Figure 7: Trash and Debris Not Cleaned Up at a Second Oklahoma Property for Sale



Source: GAO.

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- The Michigan properties we visited, primarily in the Detroit area, reflected the distressed housing market conditions in that state, and many had been on the market for a year or longer.²³ Like the properties we visited in Oklahoma, however, the VA realty specialist identified deficiencies in the maintenance of the properties that likely further contributed to the challenges involved in selling them. For example, the VA realty specialist cited 25 of the 48 properties for poor lawn maintenance (figs. 8 and 9). In some cases, the lawn height had reached 2 feet. Furthermore, 13 of the 48 properties were not secure. In addition, in one case, a swimming pool had not been adequately maintained and posed a safety risk to neighborhood children, according to the VA realty specialist (fig. 10).

²³Housing markets in Michigan and other parts of the upper Midwest have been negatively affected by the downturn caused by the declines in the automobile and related industries.

Figure 8: Condition of Lawn at a Michigan Foreclosed Property for Sale



Source: GAO.

Figure 9: Condition of Yard at a Michigan Foreclosed Property for Sale



Source: GAO.

Figure 10: Improperly Maintained Swimming Pool at a Foreclosed Property for Sale in Michigan



Source: GAO.

- The North Carolina properties we visited were generally in better condition than the properties we visited in Oklahoma and Michigan. Many of the properties were newer (no more than 5 to 10 years old), in fairly good structural shape and relatively well maintained (fig. 11). Despite the relatively good condition of the properties, in 17 of 44 cases the VA realty specialist found deficiencies related to unsecured doors or windows. In many of the properties we visited, we were able to walk into the house either through the front or back door or enter through an open window (fig. 12).

Figure 11: Foreclosed Property for Sale in North Carolina



Source: GAO.

Figure 12: Unsecured Window at a North Carolina VA Property for Sale



Source: GAO.

Ocwen officials said the company initially used a different approach to maintaining and repairing VA properties than is the case today. During the initial years of the contract, Owen officials said the company generally tried to sell the VA properties as quickly as possible without spending significant funds on repairs or maintenance. Ocwen officials stated that this strategy, which is a common industry practice, was subsequently revised to make improvements in VA properties before listing them for sale. Ocwen officials also said they had concerns about VA's overall inspection process, including the fact that one deficiency can cause a property to fail an inspection. Ocwen officials have also stated that VA does not always provide the results of its onsite property inspections on a timely basis which impacts their ability to respond and show improvement in the following performance review. While a VA official acknowledged that there will likely always be maintenance and repair deficiencies in a large inventory of foreclosed properties, the department's concern regarding Ocwen is the large number of such deficiencies. Ocwen officials also said

that VA inspections at times focused on relatively trivial items, such as a property having too many pine needles on the front walkway. However, VA officials disputed this allegation and said that department inspections focus on key property security, maintenance, and safety items specified in the contract.

While Ocwen officials raised concerns about VA's inspection procedures, they also said that the company hired two independent consulting firms to inspect VA properties and assess their maintenance.²⁴ Unlike VA inspections that typically focus on properties on the market, Ocwen officials said its contractors inspected properties at varying stages in the foreclosed property management process—for instance, when the properties were being readied for sale. In some cases, Ocwen officials said the inspectors identified substantial deficiencies in their brokers' maintenance and repair of VA foreclosed properties. In other cases, Ocwen officials said they did not believe the inspectors provided sufficient evidence, such as photographs, to support their findings. Nevertheless, Ocwen officials said they follow up on all deficiencies identified in the inspection reports and use the reports to better manage the inventory of foreclosed VA properties. For example, the Ocwen officials said they use the inspection report findings to determine whether additional training for brokers is required or whether certain brokers should be terminated for not performing according to standards.

VA Has Not Been Satisfied with Ocwen's Performance in Selling Foreclosed Properties in a Timely Manner

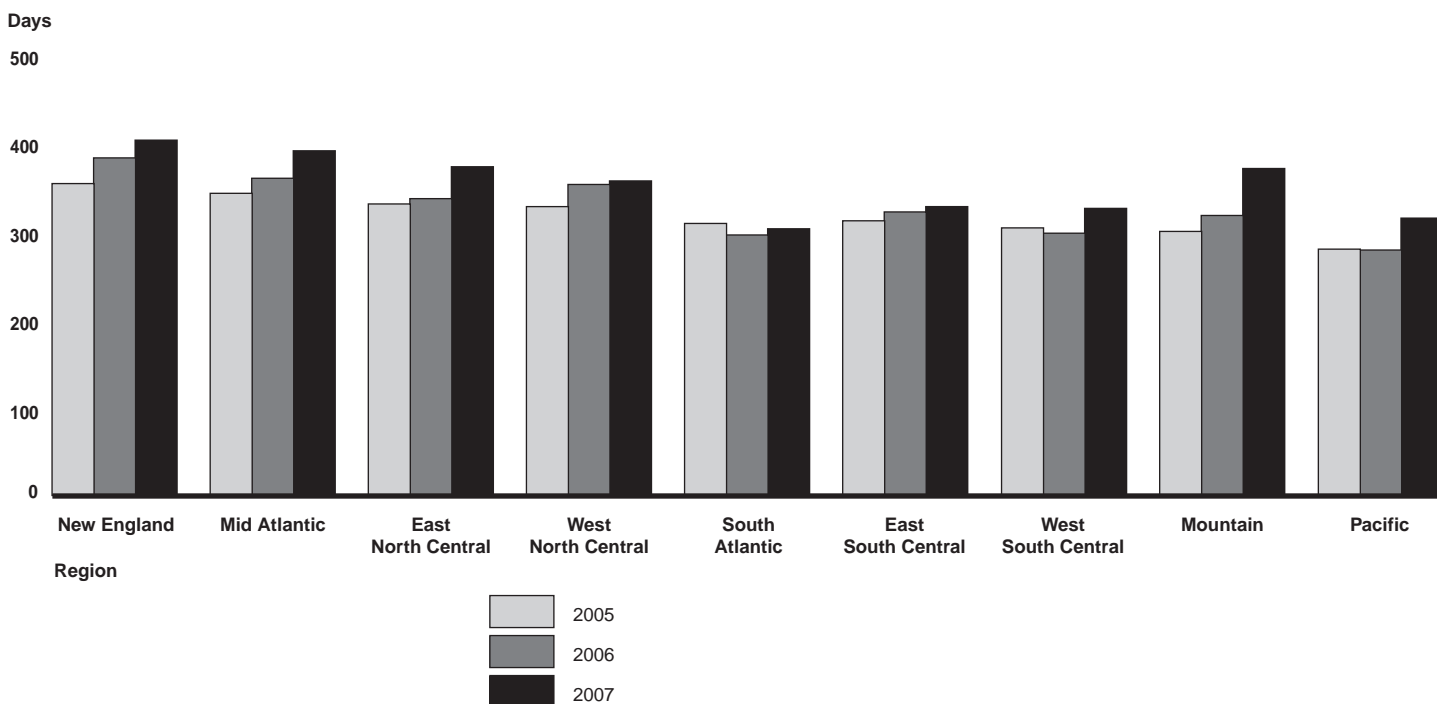
VA has not been satisfied with Ocwen's overall compliance with its contractual obligation to sell the department's foreclosed properties in the shortest time possible. According to VA data, the average amount of time that Ocwen required to sell VA's foreclosed properties increased from 311 days in 2005 to 315 days in 2006 to 342 days in the first 6 months of 2007 on a weighted basis.²⁵ In contrast, our 2002 report noted that when VA

²⁴One contractor conducted 4,653 property inspections from November 2004 through November 2006. The other contractor conducted 455 property inspections from June 26, 2007, through July 9, 2007. Consistent with the contract, Ocwen officials said they did not request that VA reimburse the company for the cost of these inspections.

²⁵VA measures time in inventory from the date the property is assigned to Ocwen (typically within 15 days of the foreclosure sale) until the time the property is sold to either a home buyer or an investor. This period of time includes state redemption periods. Weighting is based on property sales by state. For example, VA's weight for a given state is based on that state's number of sales relative to all VA sales across all states.

managed the process in 2000, the average sale took 237 days.²⁶ As shown in figure 13, the increase in selling times of VA properties from 2005 to 2007 was relatively uniform across the United States. Moreover, approximately 23 percent of VA's foreclosed property inventory had been in the department's inventory for a year or longer as of January 2007. While the contract does not specify a threshold percentage of its foreclosed properties being in the market for a year or longer, VA officials said they viewed 23 percent as excessive.

Figure 13: VA Average Days in Inventory before Sale, by Region (2005 through June 2007)



Source: VA.

²⁶GAO-02-305. The 237-day figure from 2000 is based on a nonweighted average. Data are not available to calculate a weighted average by state. VA also provided holding time data for its various district offices when the department directly managed the sale of its foreclosed property inventory during fiscal years 2001 through 2003. The VA data shows that, on average and not weighted by state, properties remained in the department's inventory for about 8 months during the period.

Data from the GSEs on the time it takes them to sell foreclosed properties suggest that Ocwen's time in selling VA properties may be long by industry standards. The GSEs generally sold foreclosed properties in under 230 days, on average, on a weighted basis over the past several years.²⁷ Although caution must be exercised in making comparisons between organizations due to the variety of factors that can account for the time it takes to sell foreclosed properties, VA and GSE data on property location suggest that the department's concerns about the time incurred to sell its properties may be warranted. According to VA and GSE data, the GSEs have sold relatively more properties in states with distressed housing markets as a percentage of their overall foreclosed property sales over the past several years than is the case with VA property sales.

Ocwen officials we contacted cited several reasons for the company's performance in selling foreclosed VA properties and the reasons some VA properties remained in inventory for considerable periods. For example, Ocwen officials said state redemption periods can add to the period of time a property remains in the inventory. Ocwen officials also noted (1) the slowdown in the national real estate market since 2005, (2) the fact that VA properties were concentrated in rural areas or regions with declining urban centers, and (3) the length of time it could take to complete repairs on VA properties. In response, VA officials said Ocwen's explanations for its performance were generally without merit. For example, VA officials said steps can be taken to manage the foreclosure process in states with redemption laws, such as monitoring such properties to determine whether they have been vacated and whether the occupants had waived their redemption rights. VA officials also said Ocwen's performance in selling properties had deteriorated even at the height of the real estate market boom in 2005 and early 2006 and the contractor failed to market them aggressively. VA officials further stated that any contractor bidding to manage a nationwide inventory of foreclosed properties should be aware that such properties could be located in both urban and rural areas.

In early 2007, after nearly 2 years of seeking to improve Ocwen's performance in reducing the number of properties that had been in the department's inventory for more than a year, VA requested that Ocwen

²⁷As measured from the foreclosure sales date to the date of sale to an external party, including state redemption periods. The comparison may understate the differences between the GSEs and VA because VA measures time in inventory from the assignment date, which may be up to 2 weeks later than the foreclosure sale.

provide a plan for reducing the number of such properties.²⁸ Under the plan that Ocwen submitted to VA in February 2007, the company pledged to take a number of specific steps to meet this goal. For example, the Ocwen plan included company staff visits to cities with high inventories of VA properties that had been on the market for extended periods, such as Detroit and Houston, which would allow staff to develop a better understanding of local housing market conditions and plans to sell properties faster. Ocwen also has created three new job positions whose only focus is to sell properties that have been on the market for more than 12 months and has provided bonuses to real estate agents as an incentive to sell these assets more quickly. VA accepted Ocwen's plan in June 2007, and department officials said they planned to monitor the company's compliance with a series of mutually agreed upon time frames for reduction in the inventory of properties on the market for more than a year. However, VA officials said Ocwen has not yet proposed potential time frames as has been requested. Pending receipt of such proposed time frames, VA officials said the department is monitoring Ocwen's performance. VA officials said the number of properties in Ocwen's inventory for a year or more declined from 23 percent in March 2007 to 21.5 percent in September 2007.

VA and Ocwen Have Disputed the Contractor's Performance in Meeting Foreclosed Property Return on Sales Targets

VA has consistently cited Ocwen for not selling foreclosed properties, on average, at ROS levels established in the contract. Under the contract, VA appraises each property prior to the foreclosure sale to establish an estimated listing price and ROS target.²⁹ At the time the property is assigned, VA applies a discount of approximately 14 percent to this price. For example, if the appraised value of a property was estimated at \$100,000, the discounted value would be \$86,000.³⁰ According to VA officials, the 14 percent discount is based on the department's experience

²⁸Beginning in the spring of 2005, VA correspondence with Ocwen indicates the department sought to impose penalties of approximately \$7 million on Ocwen for its failure to reduce the number of properties that had been in the department's inventory for a year or longer. However, as discussed later in this report, VA later concluded that the contract lacked sufficient authority for the department to impose such penalties. Consequently, VA requested that Ocwen submit a plan to reduce the number of properties in inventory for more than a year.

²⁹These requirements are established in attachment J of VA's contract with Ocwen.

³⁰Based on deducting the 14 percent (which is equal to \$14,000) from the \$100,000 appraised value.

with the expenses, such as real estate broker commissions and maintenance costs that are involved in managing and selling foreclosed properties. The contract also specifies that the cost of any repairs Ocwen or its contractors make on foreclosed properties will be added to the discounted property value. The contract requires Ocwen, on average, to sell VA foreclosed properties at 100 percent of their discounted value, including any repair expenses that have been incurred.

As shown in table 3, Ocwen did not meet the 100 percent ROS target levels specified in the contract from April 2005 through December 2006, according to VA. As specified in the contract, VA has the authority to impose financial penalties on Ocwen if the company's compliance with this requirement drops below 97 percent.³¹ VA imposed a total of \$1.3 million in such penalties on Ocwen for nonperformance in meeting ROS targets for the last 3 quarters of 2005. Ocwen has appealed the penalties to VA and has not paid any funds to the department thus far. In contesting VA's penalties, Ocwen officials said the department's method for calculating ROS targets by conducting preforeclosure sale appraisals was inconsistent with industry standards. Ocwen officials questioned the validity of preforeclosure sales appraisals because appraisers may not be granted access to properties to assess their condition. Rather, the Ocwen officials said it is industry practice to conduct an appraisal and other listing price estimates after transfer of the property and evictions when it is possible to gain access and fully evaluate a property's condition. Ocwen stated that they have asked VA for access to the pre-foreclosure appraisal but have been denied such appraisals. Ocwen officials also said that some state laws establish redemption periods, which allow property owners the opportunity to make good on their debts and reclaim their properties. Ocwen officials said that foreclosed property conditions in states with redemption periods can further deteriorate, raising further questions about the validity of preforeclosure appraisals.

³¹While VA seeks to achieve an ROS compliance rate of 100 percent, the contract provides the department with the discretion to impose penalties on Ocwen if its ROS compliance falls below 97 percent. For example, if all VA properties sold in a particular quarter had an average discounted listing price of \$86,000, VA would have the discretion to impose penalties on Ocwen if the average sales price for such properties was less than \$83,420, which is 97 percent of \$86,000.

Table 3: Ocwen's Performance in Meeting Specified ROS Requirements

Quarter ending	VA's performance requirement (percent)	Ocwen's performance (percent)
June 30, 2005	100	94
Sept. 30, 2005	100	93
Dec. 31, 2005	100	95
Mar. 31, 2006	100	97
June 30, 2006	100	96
Sept. 30, 2006	100	97
Dec. 31, 2006	100	97

Source: VA.

VA officials have responded that the contract clearly specifies the means of calculating ROS targets and Ocwen was informed of these requirements prior to agreeing to manage the department's foreclosed property inventory. VA officials also said that they have agreed not to include in the ROS calculation an appraisal based on an exterior inspection. Further, VA officials also said they have taken additional steps to adjust the ROS calculations in certain conditions to address Ocwen's concerns, yet the company still has failed to meet the established targets.³² As of August 2007, Ocwen's appeal of the VA's penalties for failing to meet ROS targets remained under review by the department. If VA decides against Ocwen, the company has recourse to appeal the decision to the United States Civilian Board of Contract Appeals.

VA Has Limited Capacity to Oversee Its Contractor's Performance in Managing and Selling Foreclosed Properties

While VA has made a committed effort to help ensure Ocwen's compliance with the contract through onsite inspections and other means, the department's overall capacity to oversee the contract and the management of its foreclosed property inventory is significantly limited. The GSEs have established procedures and data systems to monitor foreclosed properties from the time such properties are transferred into the companies' inventories until the time they are sold to external parties. While VA and the GSEs use different foreclosed property management approaches, the

³²VA has periodically recalculated the ROS, such as in cases where properties are damaged due to fire or where no appraised value had been determined at the time of assignment to Ocwen.

department could potentially benefit by adopting elements of the GSEs' approaches to strengthen its contract oversight capacity. Unlike the GSEs, VA generally does not obtain real-time data on the management of its foreclosed property inventory, and its key oversight activities (including onsite inspections and invoice audits) occur relatively late in the process when the department's capacity to take corrective action may be limited. Further, VA does not have clear authority under the contract to impose penalties for unsatisfactory performance in key areas that are important for effective foreclosed property management contract oversight. VA officials recognize that the department's contract oversight policies and systems have limitations and said they are considering steps to address such limitations when the next contract is awarded in 2008. Without taking corrective measures, VA may not be able to effectively ensure the efficient and effective management of its foreclosed property inventory.

GSEs Have Designed Processes and Information Systems to Monitor and Control Foreclosed Property Management on an Ongoing Basis

The GSEs use generally similar processes and information systems that provide for ongoing oversight and control of the foreclosed property management and sales processes. For example, officials said the GSEs select and train the real estate brokers who are responsible for managing and selling their foreclosed property inventories. Officials said the GSEs use a variety of criteria in selecting their contractors, including their overall sales volume and experience.

GSE officials also said that their real estate brokers and other contractors are required to perform a variety of steps as soon as foreclosed properties are conveyed and report their actions on an ongoing basis. For example, brokers are required to inspect conveyed properties and identify any hazards as well as their plans to mitigate these hazards and report this information to GSE officials responsible for monitoring each property. GSE officials also said that brokers are required to develop strategies for maintaining and marketing each property and reporting this information. In addition, the GSEs require their brokers to develop and report estimated listing prices for each property. According to GSE officials, they have developed information systems that allow their staff to monitor the information that brokers are required to submit on an ongoing basis. An official from one GSE said that, given the importance of selling foreclosed properties as expeditiously as possible to minimize related costs, the GSE's information system tracks each property's status throughout the management and sales processes. The GSE official said that having a real-time information system allows staff to better monitor contractor performance and ensure that properties move from one stage of the

process to the next (e.g., from the maintenance stage to the listing stage) on an expedited basis.

Additionally, GSE officials said they have developed processes to monitor the condition of their foreclosed property inventories as well as maintenance and repair quality and costs. Officials from each GSE said they have hired outside firms or use in-house staff to periodically inspect a sample of their foreclosed properties to help ensure they are being maintained according to established standards. Further, GSE officials said their staff are responsible for reviewing and approving repairs that exceed established thresholds. GSE staff may review and approve bids to conduct such repair work and may require that before and after photographs be taken to document the need for proposed repairs as well as the quality of the repair work. According to officials from one GSE, their inspectors have full information about proposed repair work so they can assess its quality during onsite property inspections. Officials from both GSEs said they will not reimburse contractors for repairs unless their brokers certify that the repairs have been completed.

VA's Oversight Capacity Is Limited by a Lack of Real-Time Property Management Data

There are important differences between the GSEs' approaches to foreclosed property management and VA's approach, which complicate comparisons among the organizations. The main difference between the GSEs and VA is that the GSEs directly oversee the management and sale of their foreclosed property while VA's contractor, Ocwen, is directly responsible for this function with the department acting in a contract oversight role. Therefore, VA is not directly involved in the management and sale of its foreclosed inventory as are the GSEs and cannot be expected to do so. Nevertheless, VA must oversee its contractor's performance, through inspections and invoice audits among other measures, and there are elements of the GSEs' approaches that, if adopted by the department, could potentially enhance the efficiency and effectiveness of these oversight efforts. The GSEs use these elements, among others, to manage the sale of far more properties together than VA (43,000 in 2006 as compared to about 7,700) and have sold such properties in considerably shorter periods over the past several years as discussed earlier.

The key aspect of the GSEs' approaches that VA could potentially benefit from adopting is that, unlike the department, the GSEs reportedly collect and analyze data and information that allows them to monitor the management and sale of foreclosed properties on an ongoing basis. For example, similar to GSE procedures, VA's contract with Ocwen requires the

contractor to conduct initial inspections of foreclosed properties and develop marketing strategies for them. However, Ocwen is not required to submit any of these inspection reports or marketing strategies at the time they are completed to VA for its review. Rather, a VA official said the department may request documentation of such inspections and marketing strategies as part of desk audits that take place after a property has been sold, which may be a year or more after a property has been assigned to Ocwen. The VA official said this documentation may be requested to help assess Ocwen's claims for reimbursement for property repair expenditures and to help assess the reasonableness of the marketing strategy on a particular property.³³ Since this process takes place after properties have been sold, however, it does not provide VA with any information on properties' conditions at the time of assignment to Ocwen or how the contractor plans to repair and market such properties. Nor does the process provide VA with any opportunity to take reasonable steps to help ensure that any deficiencies noted in the repair and marketing strategies are addressed before actions are taken that could impede the contractor's ability to sell the properties within a reasonable timeframe and within ROS targets. For example, without such documentation and information on a sample of properties recently assigned to the contractor, VA officials are not in a position to hold meetings with contractor officials and potentially agree to changes in repair and marketing strategies.

Similarly, VA's property management information system, CPTS, lacks critical real-time information necessary for the department to develop an ongoing assessment of the maintenance and repair work on its foreclosed property inventory and the related expenses that Ocwen and its contractors incur. For example, CPTS generally does not include any information regarding the type of repair work that is ongoing on foreclosed properties or the status of such repairs.³⁴ As a result, VA staff, unlike GSE inspectors, are generally not effectively positioned to identify and assess the quality of repair work on foreclosed properties when conducting inspections. Additionally, CPTS does not capture real-time property

³³The VA official said that Ocwen does not always provide complete documentation of, for example, the marketing plans as it is required to maintain under the contract. However, the VA official said that the department's reviews generally do not seek to ensure complete compliance with documentation requirements, but rather, the overall reasonableness of the marketing plan and Ocwen's compliance with it.

³⁴CPTS may have some repair information in those cases when large expenses are involved (generally repair expenses of \$10,000 or more).

maintenance and repair expense data so that VA staff can review and assess the reasonableness of such expenses on an ongoing basis. Instead, under the terms of the contract, Ocwen may submit property expense documentation, such as invoices, to VA staff for review after the sale of such a property. VA staff in Nashville review such documentation and may question expenses that do not appear to be reasonable or adequately supported. According to a VA realty specialist, staff can identify potentially questionable or erroneous expense claims based on their experience in performing such work and because of weaknesses in supporting documentation. For example, one VA realty specialist said that sometimes duplicate or similar receipts will be submitted for maintenance work on a particular property, such as nearly identical receipts for lawn care on the same property on the same date. However, in the absence of such obvious weaknesses in supporting documentation, VA staff may lack a basis for questioning repair expense claims on properties that have been sold. Without the ability to monitor data on ongoing repair work, even on a sample of properties, VA's capacity to assess the reasonableness of its expenditures on such repair work is limited.

The importance for VA to develop an enhanced and ongoing process to oversee contractor performance in managing the department's foreclosed property is demonstrated by evidence suggesting that the current oversight process has not been effective. As discussed earlier, despite VA's ongoing property inspection program and quarterly communications with Ocwen, overall property maintenance has not improved and remains far below standards established in the contract. For example, VA realty specialists identified overall maintenance deficiencies in, on a preliminary basis, nearly 80 percent of the properties we visited in Oklahoma, Michigan, and North Carolina. Although VA officials said there was a slight decline in the percentage of properties in inventory for a year or longer between March and September 2007, data provided by the department indicate that the overall average time incurred in selling properties increased from 315 days in 2006 to 342 days in the first 6 months of 2007 on a weighted basis. Further, as shown in figures 14 and 15, there appears to be the potential for questionable reimbursements and practices in the management of the department's foreclosed property inventory. Without improvements in VA's contract oversight processes, its capacity to identify and address potentially questionable reimbursement and practices is undermined.

Site Visits Demonstrate Potential for Questionable Reimbursements and Practices

During our May 2007 visit to Michigan to observe the VA property inspection process, the VA realty specialist identified potentially questionable repairs at a foreclosed property that had been on the market for 3 years, as shown in figure 14.

Figure 14: Questionable VA Repair Reimbursement at a Michigan Foreclosed Property for Sale



Sources: VA (left); GAO (right).

According to VA's property records, the department had reimbursed Ocwen \$9,900 for property repairs that had taken place in 2004. The expenses included \$6,000 for a new roof and \$3,900 for new gutters and downspouts, and repairing and refinishing the interior walls. While VA generally does not reimburse Ocwen for repair expenses until after a property has been sold, a department official said that the department had reimbursed the contractor in this particular case due to actions the department took in response to Hurricane Katrina.³⁵ Because the repair reimbursement data were listed in CPTS, the VA realty specialist was in a position to review the quality of the work at the time of the onsite inspection. Because the same realty specialist had visited the property in 2004, he was able to provide us with

³⁵In October 2005, VA requested that Ocwen remove all foreclosed properties from the market in anticipation that such properties might serve as shelter for Katrina victims. VA then reimbursed Ocwen for any repairs that had previously been done on such properties prior to their removal from the market. Subsequently, Ocwen placed the property back on the market, and the reimbursement to Ocwen for \$9,900 was listed in CPTS.

photos taken in 2004 while we took similar pictures during our 2007 visit. As shown in the two photographs above, the interior wall area that VA paid to have repaired in 2004 had gotten significantly worse by 2007. As a result, the VA realty specialist determined that the repairs were never completed by 2007. Therefore, VA has set up a bill of collection against Ocwen in the amount of \$2,400 for interior wall repairs that were not done.

While VA was able to identify this instance of potentially questionable repair work, it was only able to do so because Ocwen had already been reimbursed for the work due to the actions the department took in response to Hurricane Katrina. Other than cases associated with Hurricane Katrina and cases where VA has reimbursed Ocwen for repairs exceeding \$10,000, VA realty specialists generally would not have information about property maintenance and repairs in conducting onsite inspections. In most cases involving repair work costing less than \$10,000, VA realty specialists would have a limited basis for raising questions regarding the quality of such repairs or the appropriateness of VA reimbursements to the contractors for such repairs.

During the same Michigan trip in May 2007, the VA realty specialist also learned that a property he was to inspect had already been demolished, as shown in figure 15.

Figure 15: Demolished VA Foreclosed Property



Source: GAO.

According to both VA's and Ocwen's records, the home was listed for sale at \$12,750 and had two bedrooms, one bath, and a total of 696 square feet of living space. The VA realty specialist had no knowledge that the house had been destroyed and contacted Ocwen to determine who authorized its demolition. Ocwen informed the VA realty specialist that the house had been demolished by the city of Detroit in March 2007, even though it was still on Ocwen's Web site for sale in May 2007 prior to our visit. According to Ocwen, the property was demolished without its knowledge because the listing agent failed to: (1) provide accurate reporting with regard to the house, (2) follow up with the city, (3) perform authorized repairs, and (4) inform Ocwen when the house was demolished. As a result, Ocwen is requiring the listing agent to reimburse VA \$15,664 through Ocwen for the value of the house and repairs that were made. The agent has already started the repayment process. As a result, Ocwen has already paid the VA \$10,442.68 toward the settlement. In addition, the VA will recover

additional funds when the vacant lot is sold and it determines the amount of its loss on the property. Ocwen currently has the vacant land for sale at \$1,200.

VA's Contract Does Not Include the Authority to Impose Penalties for Unsatisfactory Performance in Key Areas

In addition to not obtaining and analyzing real-time property management data as would be consistent with the GSEs' approaches to foreclosed property management, VA also lacks clear authority to hold its contractor accountable for unsatisfactory performance in key areas. As discussed earlier, although VA's contract with Ocwen allowed the department to impose defined penalties on the contractor for its failure to meet contractually established ROS targets, the contract did not provide such authority for other key areas, including property maintenance and selling properties within the shortest time possible.³⁶ In a previous report on the Department of Housing and Urban Development's (HUD) oversight of contractors that manage its foreclosed properties, we found that HUD's contracts did not include sufficient penalties to ensure compliance with contract provisions because the department believed it had sufficient authority to carry out its responsibilities.³⁷ For example, our report found that HUD's contracts did not include penalties for failure to reduce the number of properties that had been on the market for 6 months or longer and recommended that it develop such penalties. Because VA's contract does not allow for penalties for property maintenance deficiencies, the department has not been able to impose penalties on Ocwen for not meeting maintenance requirements in the contract and better ensure compliance. Similarly, while VA required Ocwen to submit a plan to reduce the inventory of foreclosed properties that have been on the market for a year or longer, the department has not been able to impose monetary or other penalties on the contractor for its performance in this key area. Without clearly defined penalties, VA's capacity to hold the contractor accountable for nonperformance is limited.

³⁶The contract did include a provision for assessing a penalty for properties held for 12 months or more in which the contractor failed to take action. However, according to VA officials, this provision may not be enforceable because it does not specify how the penalty would be calculated.

³⁷[GAO/RCED-00-117](#). HUD, through the Federal Housing Administration (FHA), provides insurance on certain types of mortgages extended by lenders. If borrowers default on such mortgages, FHA may become responsible for the management and sale of properties secured by the mortgages to external parties.

VA Officials Recognize Contract and Oversight Limitations and Are Considering Approaches to Address Such Limitations

Senior VA officials we contacted recognize there are limitations in the department's capacity to oversee contractor performance in managing and selling the department's foreclosed property inventory. PMOU officials said that much of VA's oversight activities occurs "after the fact" when foreclosed properties have already been sold, which limits contractor oversight. For example, PMOU officials said the lack of property repair information in CPTS limits the ability of VA realty specialists to assess the reasonableness of property repairs. As a result, VA staff said they are not able to assess the quality of the repair work on which the department is expending taxpayer funds. In addition, VA officials said the process of reviewing property expense documentation after properties are sold is labor intensive and does not necessarily enhance the department's capacity to assess the reasonableness of such expenses.

VA officials also said the department had not enforced a provision in the contract that required Ocwen to provide real-time property management information because the contractor's computer systems lacked the necessary capacity. Under the terms of the original contract, Ocwen was required to develop an information system that could submit, on a daily basis, key property management information and data, such as repair information and expenses incurred to manage the properties. However, VA officials also said that, once the contract was in place in 2003, they determined through discussions with Ocwen officials that the company's systems lacked the capacity to provide such information.³⁸ VA officials also said that requiring Ocwen to upgrade its systems to provide the required data would have been prohibitively expensive. VA officials also said they required Ocwen to make other upgrades to its systems that took a higher priority than the property management information, such as changes necessary to track the department's efforts to provide housing for victims of Hurricane Katrina.³⁹ While PMOU officials said Ocwen offered VA staff access to the contractor's system to monitor foreclosed property management, department staff were often unable to gain access and generally did not use it. Ocwen officials said they have worked with VA on providing repair data and have reprogrammed their systems to provide

³⁸It was beyond the scope of this review to assess why VA did not ensure that Ocwen could provide the required data prior to entering into the contract. VA officials also said that many of the staff involved in the A-76 process and assessing Ocwen's capacities are no longer with the department.

³⁹According to VA officials, some VA foreclosed properties were used temporarily to house victims of the Hurricane Katrina crisis.

such data, but also stated that additional changes were not necessarily cost-effective because the contract expires in 2008.

VA officials said the contract with Ocwen does not include a penalty for unsatisfactory performance in property maintenance because the VA team that developed the contract solicitation proposal (during the A-76 process in 2003) believed a penalty for unsatisfactory ROS performance would provide sufficient incentive for the contractor to meet performance targets in other areas. That is, VA officials believed a sufficiently large ROS penalty would provide the contractor with incentives to perform in areas like property maintenance, since failure to do so could negatively affect property sales prices. However, VA officials also said that, after the contract award, Ocwen and VA agreed to changes in the ROS penalty outlined in the contract solicitation, which lowered the size of the ROS penalty and likely diminished its potential to incentivize the contractor's performance. As discussed earlier, VA officials also said the contract language regarding penalties for the failure to reduce the number of properties that were in Ocwen's inventory for considerable periods was vague and has complicated the department's capacity to impose penalties in this area.

In anticipation of VA's new foreclosed property management contract that is scheduled to be in place in 2008, department officials said they are considering approaches to address existing limitations, but they have not yet reached any final decisions. For example, VA officials said the department is considering a variety of means to address weaknesses in its ability to monitor the contractor's performance on an ongoing basis. One VA official said the options under consideration include requiring the contractor to provide real time property information or for the contractor to provide department staff with access to its system. Further, VA officials said they were exploring the idea of developing a performance-based contract that would focus more on results than the current contract, such as selling properties within reasonable time frames at targeted prices. VA officials also said they would seek to eliminate certain reporting and other compliance-related requirements in the current contract that are labor intensive for the department and the contractor but may not add value to the overall property management and sale process. To accomplish these objectives, VA staff said they have consulted with the department's property management staff as well as outside organizations that manage foreclosed properties to obtain their views. VA officials further stated that they expected to issue a request for proposals to companies seeking to bid

on the new contract in late 2007 or early 2008 with the final contract expected to be awarded in the spring of 2008.⁴⁰

Conclusions

VA has faced challenges in ensuring contractor performance and the effective management of its foreclosed property inventory. VA inspections have found that many properties are not adequately maintained and repaired as required under the contract, which may have contributed to the increasing period of time it has taken to sell the department's foreclosed properties as well as the failure to meet ROS targets. Moreover, Ocwen has disputed VA's findings in key areas, such as property maintenance and ROS compliance, and has contested the department's ROS-related compliance penalties. The disputes between VA and Ocwen can be counterproductive and time consuming and detract from the overall objective of managing and selling the department's foreclosed properties in an efficient and effective manner and identifying potentially questionable repair work and claims for reimbursement.

Without significant enhancements in VA's contract and oversight processes, which VA officials said they are considering, there is a substantial risk the department will continue to face challenges in ensuring contractor performance after a new foreclosed property management contract is awarded in 2008. While VA has made a committed effort to oversee the contractor's performance, the department's activities, such as property inspections and reviews of expense documentation, are labor intensive and occur comparatively late in the foreclosed property management and sale processes, rendering the department's capacity to take corrective actions less effective. Lacking real-time property management data, such as initial inspection and marketing strategy reports as well as data on repairs and their related costs, VA cannot assess how Ocwen manages the department's foreclosed properties on an ongoing basis or take steps to encourage improved contractor performance. With real-time data, VA staff could potentially assess the management of its foreclosed property, or a sample thereof, on an ongoing basis and intervene on a timelier basis to better ensure contractor performance in terms of managing properties and incurring reasonable expenses in so doing.

⁴⁰A request for proposal is a solicitation issued by the government to prospective offerors describing what the government requires and how the offers will be evaluated. Negotiations may be conducted with offerors and the award is typically based on a combination of price and technical merit.

Finally, while we acknowledge that the authority to impose penalties for failing to comply with contract provisions can result in ongoing disputes like the one currently taking place between VA and Ocwen over the company's ROS compliance, the fact that the contract did not include sufficient authority for the department to impose adequate penalties for unsatisfactory performance in other key activities was significant. Without the clear and enforceable ability to impose defined penalties in such areas as property maintenance and selling properties within reasonable time frames, VA lacks an important tool to hold its contractor accountable for not meeting expectations in carrying out its responsibilities.

Recommendations for Executive Action

To improve VA's capacity to oversee the foreclosed management property and sales processes, we recommend that the department take several steps in designing, negotiating, and awarding a new contract for the function. Specifically, we recommend that VA include in the contract (1) the requirement that the contractor provide real-time property management data deemed necessary by the department and (2) the authority to impose defined penalties for key property management activities, including penalties for unsatisfactory performance in maintaining properties and selling them within established time frames. Prior to awarding the contract, we also recommend that VA thoroughly review and verify the capacity of the contractor's information systems and the ability to provide required property management data. Finally, we recommend that VA use real-time data provided by the contractor to monitor the management of its foreclosed property inventory (or a sample thereof) on an ongoing basis and act on a timely basis, including the use of penalties as appropriate, to address identified deficiencies.

Agency Comments and Our Evaluation

VA provided written comments on a draft of this report, which are reprinted in appendix II. In its comments, VA generally agreed with the report's conclusions and agreed to implement its recommendations. VA stated that it is preparing a solicitation for a new foreclosed property management services contract (that is anticipated to be awarded in June 2008), which will include the requirement that the contractor provide real-time property management data. VA also said it is requesting that all bidders on the contract, among other things, include proposed incentives for good performance in their bids as well as disincentives for poor performance. We encourage VA to use this information, along with its own independent analysis, to develop appropriate contract penalties for poor

performance in key property management areas, such as maintenance and the time that it takes to sell properties. Further, VA stated that it plans to use real-time data provided by the contractor on an ongoing basis and address identified deficiencies on a timely basis. VA also provided technical comments, which are reprinted in appendix II, as did the GSEs and Ocwen. We reviewed all of these technical comments and made revisions to the draft as appropriate.

We note that, among VA's technical comments, the department stated that the draft report did not define the differences between the VA and GSE approaches to foreclosed property management. VA stated that, unlike the GSEs which directly manage their foreclosed property inventory, Ocwen is responsible for performing this function on the department's behalf and is awarded or penalized by VA based on the company's ROS performance. Further, VA stated that (1) the department cannot be expected to track the actions on each foreclosed property as they happen for the purpose of telling the contractor what needs to be done in real time, and (2) the GSEs' approach is fairly unique within the foreclosed property industry whereas VA's approach is more commonly used.

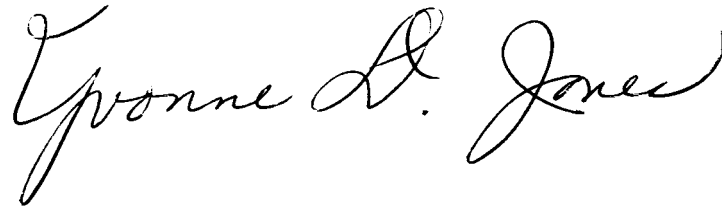
We believe that both the draft and final reports include an accurate description of the differences between the VA's and GSEs' approaches to foreclosed property management, and recognize that department staff cannot be expected to be directly involved in the property management and sale processes as are GSE staff. However, we believe that there are elements of the GSEs' approaches, particularly the use of real-time data, that could benefit VA's contract oversight function if adopted by the department. As noted in the report, the GSEs use real-time property management data to oversee networks of real estate brokers and other contractors that manage foreclosed property inventories far larger than VA's and sell such properties in considerably shorter periods, on average. We are encouraged that VA recognizes the importance of obtaining real-time property data and will require such data under the new foreclosed property contract. With such real-time data, VA staff could potentially assess the contractor's performance on a sample of foreclosed properties, rather than each property, and take steps as necessary on an earlier basis than is currently possible to help ensure better foreclosed property management and sale outcomes.

In both VA's written and technical comments, the department also said that, contrary to a statement in the draft report, VA did maintain data on the time it took to sell foreclosed properties prior to the award of the Ocwen

contract. We have removed that reference from the final report and included additional holding time data provided by VA, as appropriate.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies of the report to interested committees; to the Secretary of the Department of Veterans Affairs; and to the heads or designees of Fannie Mae, Freddie Mac, and Ocwen Financial Corporation. We will make copies available to others upon request. In addition, the report will be available at no charge on our Web site at <http://www.gao.gov>. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. If you or your staff have any questions about this report, please contact me at (202) 512-8678 or jonesy@gao.gov. Key contributors are acknowledged in appendix III.

Sincerely yours,

A handwritten signature in black ink that reads "Yvonne D. Jones". The signature is written in a cursive style with a large initial "Y" and a long, sweeping tail on the "J".

Yvonne D. Jones
Director, Financial Markets
and Community Investment

Objectives, Scope, and Methodology

This report's objectives were to (1) describe the Department of Veterans Affairs (VA) findings on Ocwen Financial Corporation's (Ocwen) performance in key areas related to foreclosed property management and the contractor's views on its own performance, and (2) evaluate VA's overall policies, procedures, information systems, and data for overseeing the foreclosed property management and sale processes.

To address our objectives, we reviewed VA's foreclosed property management contract with Ocwen and identified the requirements and performance targets for three key areas: property maintenance, selling properties within the shortest possible time frames, and selling properties at established price goals, which are referred to as return on sales (ROS) targets. We reviewed a variety of VA documents related to each of these areas, particularly VA's quarterly performance reports developed as a result of its onsite property inspections and other oversight measures, such as invoice audits and desk audits. These VA reports, which generally covered the 6 quarters starting on October 1, 2005, and ending on March 31, 2007, addressed how well Ocwen secured, maintained, and kept the properties free from hazards as required under the contract as well as other requirements.¹ We also reviewed VA property inspection reports, oversight procedure documentation, data on the time it takes to sell VA foreclosed properties, Ocwen's February 2007 plan to reduce the number of VA properties in the department's inventory for a year or more, and correspondence between VA and Ocwen, including VA penalty letters to Ocwen regarding the contractor's performance in meeting ROS targets and Ocwen's responses to these letters. Further, we reviewed VA's quarterly inspection reports for October 2005 through March 2007 to identify the most frequently cited violations in each of the three maintenance subcategories.² We also interviewed VA Home Loan Guaranty officials in Washington, D.C., and the Property Management Oversight Unit (PMOU) in Nashville, Tennessee, to develop an understanding of VA's oversight procedures and Ocwen's performance under the contract.

¹In some cases, we reviewed information outside of this time frame. For example, the report presents data on Ocwen's ROS performance for the quarters ending June 30, 2005, and September 30, 2005, because the department is seeking to impose penalties on the contractor for not meeting established ROS targets during those quarters.

²Data for the second quarter of 2007 is preliminary because VA had not finalized its March 31, 2007, Quarterly Performance report.

We also took two steps to review the results of VA's property inspection findings regarding Ocwen's performance and, in the process, better understand the department's general oversight procedures. First, we reviewed and analyzed a random sample of 50 property maintenance inspection reports and supporting documentation. Our sample was based on 698 properties where the VA realty specialists identified maintenance violations during their visits from October 1, 2005, through March 31, 2007. We selected 50 of these reports at random to avoid any potential for bias in our review. This sample was not designed to be generalizable to the population of 698 properties. We reviewed the inspection checklist, inspection notes, and supporting photographs. In addition to helping to assess the support for VA's inspection findings, this analysis provided us with a basis for understanding VA's overall property oversight program, which was primarily addressed under objective (2).

Second, we accompanied the VA realty specialists on their visits to three states – Oklahoma, Michigan, and North Carolina. The states represented geographic diversity as well as locations that face different economic conditions and housing issues. In our state selection process, we also considered the number of VA properties for sale in each state, the median listing prices of VA properties as identified on Ocwen's Web site in April 2007, and VA's property inspection schedule. During the visits, which included about 100 properties, we took pictures and observed the process that VA realty specialists follow to assess how well Ocwen and its network of brokers were maintaining and preparing the properties for sale. We also discussed the inspection findings with VA staff.

To gain a perspective on the time it has taken Ocwen to sell VA properties, we compared available VA data to data provided by Fannie Mae and Freddie Mac, two government sponsored-enterprises (GSE) that manage and sell large volumes of foreclosed properties. Specifically, we compared Ocwen's performance in selling VA properties on a weighted basis (weighting is based on property sales by state) to the GSEs' aggregated performance on a weighted basis for calendar years 2005 and 2006 and the first 6 months of calendar year 2007. For example, the weight for a given state is based on that state's number of sales relative to all sales across all states, for each entity.

We defined the measurement period, generally, as the date of the foreclosure sale until the date a property is sold to an external party, such as a homebuyer or investor. Our analysis may understate the time it takes to sell VA properties because lenders or mortgage servicers have up to 15

days from the date of the foreclosure sale to transfer a property to VA. VA measures the “assignment date” or the date a property is assigned to Ocwen for management and sale rather than the foreclosure sales date. To determine the appropriateness of our comparisons, we analyzed the geographical distribution of VA, Fannie Mae and Freddie Mac foreclosed property data. We determined that overall, VA’s foreclosure inventory as compared to that of Fannie Mae and Freddie Mac was not disproportionately concentrated in states that were identified by VA and the GSEs as having particularly distressed housing markets. We also assessed the reliability of these data by interviewing officials at these organizations knowledgeable about the data and found them to be sufficiently reliable for the purpose of this report.

To obtain Ocwen’s views on its performance, we reviewed the contractor’s written responses to VA inquiries regarding its performance with respect to property maintenance, selling properties within the shortest period possible, and meeting ROS targets. We also obtained and reviewed the results of inspection reports prepared by two companies that Ocwen hired to assess the maintenance of VA foreclosed properties. We also interviewed Ocwen officials to obtain their views on the company’s performance under the contract as well as VA’s contract oversight procedures.

To specifically address objective (2), we held discussions with GSE foreclosed property management officials to develop an understanding of their policies, procedures, and information systems for managing the function. We also prepared written summaries of the GSEs’ approaches, which we provided to the companies for their review and verification. We then compared and contrasted the GSEs’ overall approaches to foreclosed property management to those of VA. In addition, we reviewed provisions in VA’s contract with Ocwen to assess the authority it included for penalizing the contractor for unsatisfactory performance in key foreclosed property management areas. We also reviewed a previously issued GAO report that identified certain penalty provisions as important for the effective oversight of the foreclosed property management and sales processes.³

We conducted our work in Boston, Massachusetts; Nashville, Tennessee; San Francisco, California; and Washington, D.C.; and in Oklahoma,

³[GAO/RCED-00-117](#).

Appendix I
Objectives, Scope, and Methodology

Michigan, and North Carolina between January 2007 and September 2007 in accordance with generally accepted government auditing standards.

Comments from the Department of Veterans Affairs



THE SECRETARY OF VETERANS AFFAIRS
WASHINGTON

October 30, 2007

Ms. Yvonne D. Jones
Director, Financial Markets and Community Investment Issues
U. S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Jones:

The Department of Veterans Affairs (VA) has reviewed the Government Accountability Office's (GAO) draft report, **DEPARTMENT OF VETERANS' (sic) AFFAIRS: Actions Needed to Strengthen VA's Foreclosed Property Management Contractor Oversight** (GAO-08-60) and generally agrees with GAO's conclusions and concurs with GAO's recommendations.

VA is developing the next solicitation for a new property management services contract. Using a performance-based acquisition strategy, the new solicitation will include the requirement for real-time property management data as well as incentives for good performance and disincentives for poor performance. VA anticipates awarding the new property management services contract in June 2008.

Enclosure (1) specifically addresses each of GAO's recommendations and provides technical comments to the draft report. GAO states VA does not maintain data for properties it held in inventory when VA managed its own foreclosed properties. Enclosure (2) is a report of holding time data for the periods when VA managed its own foreclosed properties. VA appreciates the opportunity to comment on your draft report.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Gordon H. Mansfield".

Gordon H. Mansfield
Acting

Enclosures

Enclosure (1)

Department of Veterans Affairs (VA) Comments to
Government Accountability Office (GAO) Draft Report
**DEPARTMENT OF VETERANS' AFFAIRS: Actions Needed to Strengthen
VA's Foreclosed Property Management Contractor Oversight**
(GAO-08-60)

To improve VA's capacity to oversee the foreclosed management property and sales processes, GAO recommends that the Department take several steps in designing, negotiating, and awarding a new contract for the function. Specifically, we recommend that VA:

- ◇ **Include in the new contract the requirement that the contractor provide real-time property management data deemed necessary by the Department.**

Concur - VA is preparing the next solicitation for a new property management services contract and will include the requirement for real-time property management data. VA anticipates awarding a new contract by June 2008.

- ◇ **Include in the new contract the authority to impose defined penalties for key property management activities, including penalties for unsatisfactory performance in maintaining properties and selling them within established time frames.**

Concur - VA is preparing the next solicitation for a new property management services contract. VA is using a performance-based acquisition strategy. This strategy requires all companies bidding on the contract to propose appropriate business strategies that will ensure effective management of our properties with a high return on sale. In addition, VA will ask that interested bidders include in the bid proposals incentives for good performance as well as disincentives for poor performance.

- ◇ **Prior to awarding the contract, GAO also recommends that VA thoroughly review and verify the capacity of the contractor's information systems to provide required property management data.**

Concur - VA will ask that interested bidders include in their bid proposal their capacity for providing VA with real-time data, and VA will review and verify that capacity before awarding the contract.

- ◇ **GAO recommends that VA use real-time data, provided by the contractor, to monitor the management of its foreclosed property**

Enclosure (1)

Department of Veterans Affairs (VA) Comments to
Government Accountability Office (GAO) Draft Report
**DEPARTMENT OF VETERANS' AFFAIRS: Actions Needed to Strengthen
VA's Foreclosed Property Management Contractor Oversight**
(GAO-08-60)
(Continued)

**inventory (or a sample thereof) on an ongoing basis and act on a
timely basis, including the use of penalties as appropriate, to
address identified deficiencies.**

Concur - VA will use real-time data provided by the contractor to monitor the management of VA foreclosed property inventory on an ongoing basis and to act on a timely basis to address identified deficiencies.

Technical Comments:

Page 5, first bullet, the report states: "While the contract does not establish specific time frames for selling VA properties, the Department has not been satisfied with Ocwen's overall compliance." While it is true that VA has not been satisfied with Ocwen's overall compliance, Section 3.2.2 and corresponding J-8.5 of the Property Management Services Contract describe a disincentive penalty for properties remaining in the service provider's custody for 12 months or more. VA considers this a stated timeframe for selling properties.

Page 6: In the comparison of VA's Property Management operation with Freddie Mac and Fannie Mae—Government Sponsored Enterprise (GSE) approaches: the report states, "...there are differences between the GSE's and VA's approach to managing and selling foreclosed properties..." Unfortunately, the report does not define the "difference," and this omission is significant.

The GSEs directly manage their foreclosed properties. This means that the GSEs make the daily decisions regarding management and marketing. The approach that the selected GSEs employ is fairly unique in the industry and strongly resembles the approach employed by VA prior to awarding the contract for management of VA foreclosed properties to a private sector contractor.

The VA contract requires Ocwen to make those daily decisions. Under the current contract, Ocwen manages the properties through to sale and is rewarded or penalized based on the results of their Return on Sale (ROS). In this type of contractual arrangement, the client company (VA) is not expected to track the actions on each property as they happen for the purpose of telling the real estate owned (REO) management company (Ocwen) what needs to be done in real time. VA's current approach is a standard industry approach that many mortgage companies employ, where client mortgage companies contract with REO management companies to manage and market their inventory. It is the approach the Department of Housing and Urban Development uses, and is very

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Department of Veterans Affairs (VA) Comments to
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(Continued)

typical of the REO industry in general. VA's oversight operation is in place to evaluate the effectiveness of Ocwen's decisions.

Page 7, last paragraph, the report states that VA's program: "is an entitlement that provides eligible veterans with certain favorable terms." To be accurate, VA provides a guaranty, which serves as an inducement to private lenders to make home loans on favorable terms to veterans.

The report also states that: "the loans are offered to veterans of the U. S. armed forces by private mortgage lenders and include benefits such as no-downpayment loans." To avoid confusion with what constitutes the VA benefit entitlement versus favorable lender terms, we suggest substituting language such as "include such favorable terms as no requirement for downpayment" for the last clause of that sentence.

Page 8, first full paragraph, line 1: substitute "encourages" for "allows", as it is one of VA's top priorities to help veterans retain their homes. Also insert after the first sentence the following: "VA monitors lenders and mortgage servicers' efforts in this regard, and also actively engages in its own efforts to help veterans retain their homes."

Page 8, first full paragraph, line 9, the report states: "At the foreclosure sale, the servicers may purchase the property by bidding on the property whose value may be the outstanding debt or the fair market value." We recommend the following instead: "At the foreclosure sale, loan holders may purchase the property by bidding the amount calculated pursuant to the formula in 38 U.S.C. § 3732."

Page 8, first full paragraph, line 11, insert "may" before "transfer or "convey" the properties...."

Page 8, footnote 11: strike "with" after "Veterans" and insert "receiving compensation (or who, but for the receipt of retirement pay, would be entitled to receive compensation) for their".

Page 8, footnote 12, insert "housing operational" before "costs for VA's direct and guaranteed housing loans."

Page 26, late October 18, GAO added this statement in the last paragraph: "Ocwen was also concerned with VA's overall inspection process including the

Enclosure (1)

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(Continued)

fact that one deficiency can cause a property to fail an inspection and the lack of timeliness in notifying Ocwen of the results of the quarterly performance reports. Ocwen officials have also stated that VA does not always provide the results of its on-site property inspections on a timely basis.”

The Performance Requirements Summary (Figure J.5.2, Reference 3.7.4) has clearly stated since the contract began that when VA was reviewing property maintenance, three questions would be asked. Is the property secure? Is the property adequately maintained? And is the property free of hazards? If the answer to any of these three questions is no, VA reports in its audit that the property failed to meet the contractual requirements. VA uses these criteria to emphasize the importance of proper maintenance in protecting the value of the asset from deterioration or damage and the public from injury.

When VA employees inspect properties and observe that a property is not secure, or that an immediate health or safety hazard exists, the employee conducting the site visit calls the Nashville Property Management Oversight Unit and reports the condition. The Nashville staff e-mail Ocwen to alert them of the problem with the property for corrective action. VA also follows up with Ocwen a week later requiring that Ocwen report back corrective action it has taken. VA provides Ocwen the complete report on all property inspections as part of the quarterly performance review. It is important to remember that the purpose of the field inspections of the properties is to enable VA to assess the performance of Ocwen as far as property maintenance. Ocwen should have its own internal control procedures to measure the performance of their subcontractors.

Page 28, Note #27, the report states: “VA does not maintain comparable data (for average days in inventory) for earlier periods when it directly managed the foreclosed property inventory.” VA does have holding time data for the periods when it managed its own foreclosed properties (see Enclosure (2)). In addition, historical property management data for the years 1997 through 2000 are included in J-4 of the contract.

Page 31, late October 18, GAO added this sentence to the last paragraph: “Ocwen stated that they have asked VA for access to the pre-foreclosure appraisals but have been denied such appraisals.”

Enclosure (1)

Department of Veterans Affairs (VA) Comments to
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(Continued)

While technically this is true, VA did agree to exclude from the Return on Sale (ROS) calculation any property where the VA liquidation appraisal was based on an exterior inspection.

Page 33, paragraph 1, line 12 the report states: "...VA does not have the authority under the contract to impose penalties for unsatisfactory performance in key areas that are important for effective foreclosed property management contract oversight." The contract provided for two penalties: the ROS bonus/penalty and the aged properties (holding time) penalty. Management found the language for the holding-time penalty vague and difficult to enforce.

Under Section J-5.3 of the contract, the VA Contracting Officer does have other enforcement mechanisms for poor contractor performance including "performing the work through other means and deducting the cost from the Service Provider's invoice." However, the Contracting Officer did not elect to do so because there was no alternative contractor readily available to which VA could reassign its VA properties. Thus, VA chose to continue to work with Ocwen to improve its performance.

Page 38, Figure 16: VA update to the report's statement: "VA is still awaiting a response from Ocwen" for repairs that were billed to VA but apparently not completed. After Ocwen's response, VA determined that some of the repairs were made but set up a Bill of Collection against Ocwen in the amount of \$2,400 for interior wall repairs that were not done.

Page 38, late October 18, GAO added this note after Figure 16: "In October 2005, VA requested that Ocwen remove all foreclosed properties from the market in anticipation that such properties might serve as shelter for Katrina victims. VA then reimbursed Ocwen for any repairs that had previously been done on such properties prior to their removal from the market. Subsequently, Ocwen placed the property back on the market and the reimbursement to Ocwen for \$9,900 was listed in CPTS."

Ocwen's comment is extraneous and does not address the fact that the interior walls were not repaired.

Page 39, Figure 17: VA update to the report's statement: "...that a determination will be made as to whether or not Ocwen will be held liable for damages when information is received," for a property that Ocwen demolished

Enclosure (1)

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(Continued)

without VA authority. VA received \$10,442.68 from Ocwen toward settlement. Additional funds will be recovered when the vacant lot is finally sold, and VA determines the amount of its loss on the property.

GAO Contact and Staff Acknowledgments

GAO Contact

Yvonne D. Jones (202) 512-8678, jonesy@gao.gov

Staff Acknowledgments

In addition to the individual named above, Wesley M. Phillips, Assistant Director; Emily Chalmers; Janet Fong; Marc Molino; Richard LaMore; Linda Rego; Tom Taydus; Richard Vagnoni; Shana Wallace; and William Woods made key contributions to this report.

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