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March 17, 2000

Audit Related Memorandum
00-AT-123-0802

MEMORANDUM FOR: Charles E. Gardner, Director, Homeownership Center, 4AHH

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

SUBJECT: Atlanta Homeownership Center, Real Estate Owned,
Single Family Property Disposition Program, Area-2

We have completed a survey of the Atlanta Homeownership Center's (HOC) Single Family Property Disposition Program for the HOC jurisdiction known as Area-2. Our survey was performed as part of an ongoing national assessment of the performance and success of the Management and Marketing (M&M) contracting initiative. Area-2 has been managed by HOC employees since the failure of Intown Management, cancellation of its contract, and bankruptcy of the firm in September 1999. Our survey did not focus on Intown's failure, but rather on HUD's contingency planning, ability to recover from failure of its contractor, and most importantly, ability to sustain the program's mission.

Based on the survey, we believe the HOC has generally been effective in correcting many of the problems created by Intown. Operations have improved under the supervision and guidance of the HOC management and staff, and we commend your efforts in resolving many of the significant challenges you faced following Intown's failure. Not surprisingly, however, is that HUD still has not met its program mission. Our survey found increasing inventory, decreasing revenues, properties not maintained according to requirements, untimely disposition programs, and incomplete inventory files. While our assessment of Area 2 operations gave ample evidence of the superior management capabilities of HOC employees over the private contractor, it did not give credence to the benefits of outsourcing single family property disposition operations.

HUD anticipates implementing a new M&M contract for Area-2 in July 2000. In view of this upcoming event, we do not plan additional audit work of Area-2 at this time nor do we offer any formal recommendations.

BACKGROUND

The National Housing Act of 1934 confers on the Secretary the authority to manage, rehabilitate, rent, and dispose of properties acquired under the Single Family Property Disposition Program. Title 24, Code of Federal Regulations, part 291 implements statutory authority to manage and dispose of acquired properties. Handbook 4310.5, REV-2, dated May 17, 1994, *Property Disposition Handbook - One to Four Family Properties*, supplements the regulations.

The mission of FHA's single family property disposition program is to reduce the property inventory in a manner that expands home ownership opportunities, strengthens neighborhoods and communities, and ensures a maximum return to the mortgage insurance fund. FHA's Office of Insured Single Family Housing, Asset Management Division, is responsible for administering the program.

On March 29, 1999, FHA awarded 7 companies a total of 16 M&M contracts to manage and market its properties nationwide. This was done as part of a nationwide restructuring of HUD's Single Family Property Division. FHA awarded seven of the contracts to Intown Management Group, LLC of Norcross, Georgia. One of the contracts was for properties located in Atlanta HOC Area-2. Area-2 consists of Alabama, Georgia, Mississippi, North Carolina, and South Carolina. The Single Family Property Divisions located in FHA's four HOCs are responsible for monitoring contractor performance and enforcing compliance. The Atlanta HOC was responsible for overseeing Intown's management of Area-2 properties.

Because of Intown's failure to effectively manage and market properties, FHA terminated all of the Intown contracts. On September 23, 1999, the Atlanta HOC assumed management and marketing responsibilities for Area-2 properties pending procurement of a new M&M contractor. Intown's mismanagement had created an excessive property inventory, poor property conditions, poor records, poor customer relations, and many other problems. As a result, the HOC was faced with significant challenges.

OBJECTIVE, SCOPE AND METHODOLOGY

Our survey objectives were to gather background data, become familiar with overall operations, responsibilities, and management control systems, and determine whether an audit is warranted. We reviewed activities and management controls over FHA's critical case processing steps. These steps include the processes to acquire and secure properties, record appraisals, determine the disposition methods, maintain and market properties, and close sales transactions. We performed our review from November 1999 through January 2000 and primarily covered program activities from October 1, 1999, through December 31, 1999. However, to assess some performance aspects, we compared data from current and past periods.

To meet our objectives, we:

- Reviewed information on current program operations, responsibilities, and policies and procedures;
- Assessed the adequacy of the HOC's monitoring of contractors;

- Interviewed HOC staff;
- Reviewed 20 property case files;
- Inspected 20 properties;
- Observed HOC operations; and,
- Analyzed inventory and sales trends.

SURVEY RESULTS

Increased Inventory

The HOC Area-2 is not meeting the program mission of reducing the property inventory. The inventory increased 144 percent from 1,353 properties on April 1, 1999, to 3,306 properties on December 31, 1999. This is largely attributable to Intown's inability to attain an acceptable sales volume. From April 1, 1999, to September 30, 1999, total property sales were 547. For the same period, acquisitions totaled 2,377. Since the HOC took over Area-2 in late September 1999, the inventory level has stabilized somewhat, decreasing about 3 percent from 3,417 properties on October 1, 1999, to 3,306 properties on December 31, 1999. Total sales for the period were 1,170 whereas acquisitions totaled 1,056.

The overall age of the property inventory also increased significantly from 205 properties over 6 months old on April 1, 1999, to 1,336 properties on December 31, 1999, a 552 percent increase. The aged inventory represents 40 percent of total inventory. Again, this is largely due to Intown's inability to sell properties. However, the number of aged properties has continued to increase under the HOC's management. From October 1, 1999, to December 31, 1999, the number of aged properties increased 10 percent from 1,214 to 1,336 properties.

The failure to timely dispose of properties increases holding costs and may reduce marketability. Thus, the return to the insurance fund may be lessened. The HOC should take additional steps to reduce the property inventory, especially the aged properties.

Decreased Revenue

FHA measures revenue losses based on the difference between average sales price and appraised value. It strives to sell properties at or near appraised value to maximize revenue to the mortgage insurance fund. FHA's goal is to sell properties, on average, at 98 percent of appraised value.

Our review of Area-2 property sales showed that revenues declined steadily since October 1999. In October 1999, the average loss was \$8,183 per property and the average sales price was 99 percent of appraised value. For November and December 1999, the average loss increased to \$9,604 and \$10,260 per property, respectively. Average sales prices were 98 and 96 percent of appraised value for the 2 months. This trend continued into January 2000 when the average loss was \$11,343 per property and the average sales price was 94 percent of appraised value.

These recent sales trends may be attributable to sales of aged properties. If so, this supports our conclusion regarding failure to timely dispose of properties. Unless the HOC can develop effective methods to meet the goal of selling properties in about 150 days, it will be difficult to attain a 98 percent return of appraised value.

Properties Not Maintained

To assist with its maintenance and marketing efforts, the HOC contracted with Real Estate Asset Managers (REAMs) to secure and maintain properties. The HOC is responsible for ensuring the REAMs comply with contract requirements. We inspected 20 properties in the Atlanta, Georgia metropolitan area. We found that 13 of the 20 properties were not maintained according to requirements. We found improperly secured properties, interior and exterior debris, health and safety hazards, and other deficiencies. We compared the results of our inspections to recent inspection reports prepared by REAM contractors. We found numerous instances where the contractors did not include deficiencies in their reports.

Failure to secure and maintain properties contributes to the inability to meet the mission of strengthening neighborhoods and communities. Poor property conditions also contribute to performance problems such as decreased marketability, increased holding costs, possible decreased value of surrounding homes, and possible conditions that threaten the health and safety of neighbors and potential buyers. The HOC must ensure that REAMs properly secure and maintain properties.

Untimely Disposition Programs

Handbook 4310.5, REV-2, requires the HOC to review and approve a property disposition program within 3 days of receiving the property appraisal. We reviewed the property case files for seven newly assigned properties. We found the HOC did not comply with requirements for three of the seven cases reviewed. For these cases, HOC approval of the disposition programs ranged from 11 to 20 days following receipt of the appraisal.

The disposition program establishes the sales method and the listing price. If disposition programs are not approved timely, properties cannot be listed timely. As a result, properties may remain in inventory longer which increases the holding costs and reduces the net return to HUD. The HOC should ensure timely preparation and approval of disposition programs.

Incomplete Property Files

Following the initial inspection, REAMs are required to perform subsequent inspections at least every 14 days. The HOC is to maintain the inspection reports in the property files to evidence the inspections and the property conditions. Nine of the 20 property files we reviewed did not contain any subsequent property inspection reports. Staff attributed this to a filing backlog. We did not verify whether the inspections were performed.

We understand that filing may not be a high priority given current operations, but if inspection reports are not in the files, it will be difficult to determine whether REAMs performed the inspections and difficult to assess property conditions.

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We appreciate the cooperation we received during our review. Should you or your staff have any questions, please contact me at (404) 331-3369 or Jerry Kirkland, Assistant District Inspector General for Audit, at (865) 545-4368.

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