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March 31, 2000

Audit Related Memorandum
00-AT-123-0803

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

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

SUBJECT: Interim Report
Atlanta Homeownership Center, Real Estate Owned,
Single Family Property Disposition Program, Area-3

We have completed a survey of the Atlanta Homeownership Center's (HOC) Single Family Property Disposition Program for the HOC jurisdiction known as Area-3. The survey was performed as part of an ongoing national assessment of the performance and success of the Management and Marketing (M&M) contracting initiative. The survey primarily focused on operations of Southeast Alliance of Foreclosure Specialists, LLP (SAFS), a M&M contractor. However, we also performed survey work at the HOC to assess its controls over the contractor.

Our survey identified significant weaknesses in SAFS's operations which warrant additional audit work and immediate corrective action. As such, we have initiated audit work at SAFS. We are providing this interim report to keep you informed, and give you an opportunity to address deficiencies before we issue a final report.

Although we are not currently issuing controlled recommendations regarding the weaknesses cited in this memorandum, we do suggest you take immediate actions to address the weaknesses. Please notify us of any actions taken so that we may address them in our final audit report.

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.

BACKGROUND

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

The mission of FHA's single family property disposition program is to reduce the property inventory in a manner that expands homeownership 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 the contract for Atlanta HOC Area-3 to SAFS. Area-3 consists of properties located in Florida and the Caribbean. SAFS's 5-year contract has an estimated value of $79 million. Its main office is located in Norcross, Georgia.

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 survey 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 over the contractor;
- Interviewed HOC and SAFS officials;
- Reviewed 15 property case files;
- Inspected 23 properties;
- Observed contractor operations; and,
- Analyzed inventory and sales trends.

SUMMARY

Our survey identified weaknesses warranting further audit work. The survey showed that SAFS did not meet the REO mission. In fact, our analysis of inventory and sales trends shows that conditions have worsened significantly since inception of the M&M contract. The primary weaknesses include: decreased revenues; decreased sales to owner occupants; and, properties not maintained according to requirements. Each of these weaknesses directly impacts FHA's property disposition mission.

Also, your Performance Assessments previously identified that SAFS did not perform timely property inspections or review claim forms, HUD-27011, as required by the M&M contract. Our survey confirmed your findings. We also found indications of other weaknesses which require additional audit work. These include ineligible "pass-through" and settlement costs; mortgagee neglect; untimely disposition program reanalysis; lack of inspection of subcontractor repair work; and, inadequate review of sales closing documents.

SURVEY RESULTS

Decreased Revenues

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. According to FHA's Single Family Accounting Management System, SAFS only achieved a 96 percent return of appraised value for properties it sold from June 1, 1999, to December 31, 1999. The average return has steadily declined from 97 percent of appraised value in June 1999 to 93 percent in December 1999. Because SAFS failed to meet the 98 percent goal, the insurance fund lost about $7 million of sales revenue for the period.

Decreased Sales to Owner Occupants

SAFS did not meet the program mission of expanding homeownership opportunities. From April 1, 1999, to December 31, 1999, sales to owner occupants were about 60 percent of total sales. Sales to investors and non profit/government agencies were 25 percent and 15 percent, respectively for the period.

Properties Not Maintained

The M&M contract requires that SAFS maintain properties in a presentable condition. Your Performance Assessments for May through December 1999 show SAFS is not adequately complying with this requirement. From October through December 1999 HOC staff inspected 992 properties. They found 491 properties, or about 50 percent, were in "poor condition." The term "poor condition" is used to describe properties that meet one of the following conditions: (1) not showable or not presentable; (2) debris in or around the property;

(3) not accessible; (4) broken or unsecured doors/windows; (5) signs not posted; (6) hazards; (7) excessive yard growth; or, (8) no contractor property inspection. Our survey results confirm this finding. Our inspection of 23 properties showed that 17, or 74 percent, were in poor condition. We found evidence of vandalism, hazardous conditions, and debris.

Also, we compared the results of our inspections to recent SAFS inspection reports. We found numerous instances where deficiencies were not identified in SAFS's reports.

Failure to properly maintain properties negatively impacts the mission of strengthening neighborhoods and communities. It also will likely impact marketability and resulting sales revenues.

Untimely Property Inspections

The M&M contract requires SAFS to inspect newly assigned properties within 24 hours of acquisition. Your Performance Assessments for October 1999 through December 1999 show SAFS did not comply with this requirement. For October, 46 percent of the files you reviewed showed SAFS did not meet the 24 hour requirement. Our survey results support your findings in this area. SAFS did not meet the 24 hour requirement for 7 of the 8 files we reviewed. Instead, they performed the inspections from 2 to 10 days after assignment.

Inadequate Documentation of Review of Claim Forms

The M&M contract requires SAFS to review all parts of the claim form, HUD-27011. Your Performance Assessments for November and December 1999 show SAFS is not documenting compliance with this requirement. Our survey results confirm this finding. Of the eight applicable case files we reviewed, Part A of the claim form was missing from four files. Of the four files for which Part A was present, none showed evidence of review.

Other Indications of Weaknesses

We also found indications of other weaknesses which require additional audit work. These include:

1) Ineligible "pass through" costs;
2) Ineligible settlement costs;
3) Mortgagee neglect;
4) Untimely disposition program reanalysis;
5) Lack of inspection of subcontracted repairs; and,
6) Inadequate review of sales closing documents.

CONCLUSION

Our survey work showed significant weaknesses in SAFS's operations. These weaknesses may seriously hamper FHA's ability to meet the REO mission. Thus, we have initiated additional audit work at SAFS.

Although your Performance Assessments have shown deficiencies in some of the areas we reviewed, sufficient corrective action does not appear to have been taken to resolve the problems. We suggest you take additional actions to address the specific deficiencies we identified. Our final audit report will address any actions taken.

FHA COMMENTS

We provided a draft of this interim report to you on March 24, 2000, for your review and comments. Your written comments dated March 31, 2000, noted that SAFS has dramatically reduced the holding time of properties in HUD's inventory. Your analysis shows that SAFS reduced the holding time from April 1999 to September 1999 from 170 days to 108 days. This resulted in a $10 million reduction in holding costs. Your comments also state that SAFS complied with contract terms to expand opportunities to owner occupants, nonprofit agencies and government agencies. We included your comments in their entirety as Appendix A of this report.

OIG RESPONSE TO FHA'S COMMENTS

Based on your comments, we deleted the portion of the draft regarding increased property inventory and made other revisions, as needed. However, we do not agree with your analysis regarding SAFS reduction in holding time and resulting reduction of holding costs. According to SAMS data, the average number of days that sold properties were in inventory for the period was 177 days. Thus, SAFS did not reduce the holding time nor achieve a $10 million reduction in holding costs.

We also do not agree with your statements regarding opportunities to owner occupants. The FHA mission is to expand homeownership opportunities. We believe this is best accomplished through sales to owner occupants not through sales to non profit and government organizations who may then resell the properties to owner occupants.

May 3, 2000

MEMORANDUM FOR: Charles E. Gardner, Director, Atlanta Homeownership Center

FROM: Boris Whiteside, Chief, REO Branch II

SUBJECT: Inspector General's Audit of Southeast Alliance of Foreclosure Specialists

We have read the Inspector General's (IG) assessment of Southeast Alliance of Foreclosure Specialists (SFAS) performance regarding the Management and Marketing (M&M) contract for Atlanta Area 3. We would like to offer this response to the deficiencies the IG has noted.

Decreased Revenues

FHA measures revenue losses based on the difference between average sales price and appraised value. While SAFS average from contract inception date (3/29/99) to February 29, 2000 reflects a 96.8% average sales price to appraised value. SAFS has realized a 4.3% increase in the Net Proceeds to HUD from the prior year. Additionally, the Net Proceeds to HUD compared to appraised value for SAFS was 88.6% for this 11 month period compared to HUD's 87.2%. This reflects an increase of 1.4%.

It should also be noted that SAFS has dramatically reduced the holding time of properties in HUD's inventory. When holding time for the period of April 1999 - September 1999 is compared to a similar period in the previous year, SAFS decreased the holding timing of properties in inventory from 170 days to 108 days. This resulted in a 62 day reduction in holding time. This reduction represents substantial savings to the FHA insurance fund.

The combination of the increased net proceeds to HUD of $12,908,000 and the reduction in holding costs (based on the $28 per day holding cost estimate for the Atlanta HOC) of approximately $10,162,000 yields a true monetary gain of $23,070,000 for HUD. This far outweighs the estimated loss noted in the IG's report.

Decreased Sales to Owner Occupants

SAFS has performed in accordance with the terms of their contract to expand the opportunities to owner occupants, non-profits and government agencies. They have held five training seminars for brokers, agents and purchasers with over 1,200 people in attendance. Real Estate Owned feels that sales to non-profits and government agencies should not be counted against SAFS goal of selling to owner occupants since these organizations re-sell to owner occupants. The programs that are often HUD's best example of way in which we help people and neighborhood, such as Officer and Teacher Next Door fall into this category.

Increased Property Inventory

SAFS has met the mission of reducing the property inventory. At the inception of the contract, SAFS was assigned 1,961 properties consisting of the Steps 1-5 inventory for HUD. The total inventory for HUD and contract inception was 3,592. Based on the IG review, SAFS had reduced the inventory to 3,547 at year end. This reduction occurred despite a 12% increase in new acquisitions for the 11 month period which ended on 2/29/200.

It should also be noted that in the SAFS inventory there are properties that cannot be marketed due to title issues, reconveyances, custodials and bad cases. On February 29, 2000 the total of this segment of the inventory was as 460 properties. If adjusted for this unmarketable inventory SAFS sales increased to 87.7% of acquisitions.

We have addressed the areas where we feel SAFS has performed admirably. There are areas the IG named that REO has also noted as areas that need improvement. Since we are in agreement on those, we are not responding to them. We appreciate the opportunity to respond to the IG's report.

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