



Issue Date	June 12, 1996
Audit Case Number	96-BO-123-0001

TO: Edward Bernard, Director, Single Family Housing Division, 1AHS

FROM: William D. Hartnett, District Inspector General, Office of Audit, 1AGA

SUBJECT: Controls Over Real Estate Asset Manager (REAM) Contracts  
Massachusetts State Office

We conducted a limited review of the Massachusetts State Office's, Single Family Housing Division, Production and Real Estate Owned (REO) Branch. The purpose of our review was to determine if the REO has established and implemented adequate internal controls over the performance of Real Estate Asset Manager (REAM) contracts.

The REO needs to develop controls to evaluate REAM contractors' performance to assure the risk relating to HUD-Owned single family properties is sufficiently limited.

We appreciated the cooperation and assistance of your staff in conducting this review.

Within 60 days, please provide us, for each recommendation made in the report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the audit. Should your staff have any questions, please contact our office at (617) 565-5259.

---

# Executive Summary

We performed an audit of the Massachusetts State Office's, Single Family Housing Division, Production and Real Estate Owned (REO) Branch. The audit was limited to a review to determine if the REO had established and implemented adequate internal controls over the performance of REAM contracts for HUD-Owned single family properties.

We concluded that the REO had not established and implemented adequate internal controls to monitor and assess the performance of the REAM contracts. As a result, there is no assurance that the risk to HUD, relating to these properties, is sufficiently limited.

---

## Controls and procedures not implemented

Our audit disclosed that:

- The REO had not developed controls to track the receipt of Initial and Monthly Inspection Reports from the REAMs to assess their performance.
- The REO had not developed controls to track complaints against the REAMs, from their receipt to resolution of the complaint.
- The REO had not developed procedures to communicate and document concerns of unsatisfactory performance to the REAM.
- The REO had not been performing site-visits to the REAM or property locations to monitor the REAM's performance.

## Recommendations

We are making recommendations that require the implementation of controls and procedures to evaluate the performance of REAM contractors and assure that unsatisfactory performance is corrected in a timely fashion.

## Draft report provided

We discussed the finding with you and the REO Branch staff during the audit and provided you a draft report for comment on May 14, 1996. On May 29, 1996, we received comments from the Chief, Single Family Production and REO Branch, which you verbally concurred with on June 5, 1996 and incorporated them in their entirety in the report as Appendix A. The Chief of the REO Branch indicated that he was in agreement with our recommendations and had partially implemented them.

---

# Table of Contents

---

Management Memorandum	i
-----------------------	---

---

Executive Summary	ii
-------------------	----

---

Introduction	1
--------------	---

---

## Finding

Controls Needed to Evaluate REAM	3
----------------------------------	---

---

Follow Up On Prior Audits	13
---------------------------	----

---

## Appendices

A Auditee Comments	15
--------------------	----

B Distribution	17
----------------	----

---

## Abbreviations

FY	Fiscal Year
HUD	Department of Housing and Urban Development
MSI	Management Solutions, Inc.
REAM	Real Estate Asset Manager
REO	Production and Real Estate Owned Branch

---

# Introduction

The Massachusetts State Office's, Single Family Housing Division, Production and Real Estate Owned (REO) Branch, is responsible for the day-to-day property disposition activities for single family HUD-Owned properties.

HUD acquires single family properties (one to four units) as a result of foreclosures of HUD-insured mortgages. Following foreclosure, mortgage lenders have the right to deed the properties to HUD in exchange for the mortgage insurance benefits.

REO's goal is to dispose of acquired single family properties at the earliest possible date and at the highest possible price. While in HUD's possession, HUD contracts with Real Estate Asset Managers (REAM) to manage and oversee the properties while they are in HUD's inventory. REAMs are responsible for the maintenance and management of the property from the time the property is assigned to them until the property is sold. REAMs are required to provide protection and security of the properties through periodic inspections, repairs and general upkeep.

The REO is responsible for monitoring REAM's performance and compliance with HUD requirements.

HUD awarded two contracts (023-92-988 and 023-92-989) to Management Solutions, Inc. (MSI), the former REAM, on December 24, 1991 to perform the duties as the REAM for HUD-Owned properties in eastern and western Massachusetts, respectively. The contracts were for a one-year period and included options for two additional years. HUD executed both options and extended the contract for an additional six months, bringing the termination of the contract to June 30, 1995. MSI was paid \$1.64 Million through February 14, 1996.

MSI submitted a claim for additional compensation on March 24, 1994. At January 12, 1995, the total claim was \$443,809, plus interest, from March 24, 1994. HUD, subsequently, denied the claim. MSI is currently appealing this decision to HUD's Board of Contract Appeals.

Effective July 1, 1995, HUD awarded a new contract for REAM services to Countryside Agency LLC. Through April 29, 1996, Countryside Agency LLC has been paid \$.5 Million.

---

## Audit objective

The objective of the audit was to evaluate REO's controls over the performance of REAM contracts to assure that HUD's risk relating to HUD-Owned single family properties is limited.

## Audit scope and methodology

To accomplish our objective, we:

- Reviewed REO's procedures and controls for monitoring and evaluating REAM performance.
- Reviewed REO and Contracting Division files.

- Interviewed Single Family Division and Contracting Division staff.
- Examined 29 REAM files forwarded by the former REAM contractor to the REO at the conclusion of their contract.
- Inspected 19 HUD-Owned or HUD-held properties.
- Reviewed contracts and program guidelines for the Single Family Disposition Program.

### Audit period

Audit work was performed from July to October 1995 and from February to March 1996. The audit covered the period January 1992 through June 30, 1995. When appropriate, the review was extended to include other periods.

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

## Controls Needed to Evaluate REAM

The REO has not developed controls to assure that the REAM contractor was adequately carrying out their responsibilities under the REAM contract. Despite several "red flags," the REO did not take timely action to require the former REAM contractor to improve their performance. As a result, HUD has little assurance that the REAM contractor was providing the services required under the contract to protect the HUD-Owned properties and HUD's interests.

The contract requires the REAM to provide a number of services and reports. The Initial Inspection Report and the follow-up Monthly Inspection Reports provide evidence to the REO of the condition of the property and that the REAM is providing the services required by the contract. These reports can be used by REO to evaluate the REAM's performance and determine if the REAM is adequately protecting HUD's interests. Some of the information disclosed on these reports include:

- Initial Inspection Report - Shows whether or not the property is occupied, the condition of property, estimated cost of repairs, and whether the property is secured, winterized, boarded up, cleaned of debris, and the lawn is cut. Also, during the initial inspection, the REAM is required to make the property accessible to appraisers and real estate brokers (by installing a lock box or by other means). REO uses this report in developing the disposition recommendation.
- Monthly Inspection Report - Updates the condition of the property each month. Specifically, it indicates whether the lawn is cut, the property is free from debris, is secure and accessible, and the condition of the property identifying any damage or vandalism. REO uses this report to reanalyze and support reductions in the sale price of the property.

Initial Inspection Reports missing or untimely from former REAM

We reviewed 29 of the REAM property files forwarded to the REO at the completion of the former REAM's contract. Our review disclosed that there was no evidence that the initial inspection was performed on 12 of the 29 properties (41 percent) since the Initial Inspection Report was not in the REAM's property files. In addition, only six of the 17 remaining Initial Inspection Reports in the REAM's property files indicated that inspections were performed on

a timely basis. The remaining 11 inspections were performed between five days and 13 months late.

Missing Monthly  
Inspection Reports from  
former REAM

We also found that 336 (75 percent) of the 450 Monthly Inspection Reports, required to be submitted by the former REAM for these 29 properties, were missing from the REAM's files. This was calculated from the date on which the property was assigned to this REAM to the earliest of the date the properties were sold or the contract expiration date.

More striking are the results of an REO review of their own property files, which disclosed an even poorer performance in the submission of inspection reports to HUD by the former REAM. REO's review of 165 property files disclosed that only 30 percent (49 out of 165) contained the Initial Inspection Reports and only 5.4 percent (130 out of 2,409) contained the Monthly Inspection Reports.

REO aware of problem  
for two years

The lack of inspection reports in REO's files dates back to at least the early part of 1993. We were advised by the REO's staff that they had been aware of problem in obtaining the inspection reports (dating back to 1993) from the former REAM and had advised the REAM on numerous occasions over the telephone to submit the required reports. However, the former REAM never substantially improved their submittal of the inspection reports in response to the telephonic requests.

HUD had to extend  
former REAM's contract

The REO did not document nor communicate their concerns with the former REAM's performance, in writing, until November 1994, approximately one month prior to the expiration of the second, and last, option in the REAM's contract. Despite three separate letters to the REAM, in November and December 1994, there was still no substantial improvement by the former REAM. Since HUD had not completed the process of obtaining a new REAM contract, HUD had no alternative but to approve an extension to the former REAM's contract for an additional six months, until June 30, 1995.

Untimely submission of inspection reports by new REAM

The contract with the new REAM required the submission of their Initial Inspection Reports to the REO within 21 days of the July 1, 1995, commencement of the contract, for all properties initially transferred from the former REAM.

Our review of 18 of these initial inspection reports disclosed that:

- 17 of the 18 reports were not received by REO until August 4, 1995, 13 days late. The remaining report was received by the REO on August 23, 1995, 32 days late.
- Six of the inspections were not performed within the 21 day requirement.

The contract with the new REAM also required the submission of Initial Inspection Reports within five days for newly acquired properties assigned to the REAM. Our review of ten newly acquired properties assigned to the new REAM during July 1995 disclosed that:

- Only one report was submitted within the 5-day requirement.
- Four reports were submitted between seven and fifteen days.
- Five reports were submitted between 24 and 28 days.

Untimely submission of monthly reports by new REAM

For the 17 initial inspections performed in July 1995 by the new REAM, for the transferred properties, we obtained the subsequent monthly inspection reports to determine if they were submitted timely, and found that:

- six of the properties were sold in August 1995 and, therefore, did not require an inspection.
- four of the eleven remaining properties were inspected late by the new REAM by five to ten days.



- all eleven of the reports, for the properties inspected, were submitted to the REO from 2 to 20 days late; on average they were ten days late.

Prior audit report disclosed similar conditions

Our prior report (No. 93-BO-123-0002) disclosed that the predecessor to the former REAM was not submitting any monthly inspection reports.

HUD was totally reliant on the REAM's initial inspection to provide assurance that the property was adequately safeguarded and the listing price reflected the condition of the property.

Our prior report also disclosed that when the predecessor REAM was replaced by the former REAM that the REO received both the initial and monthly inspection reports.

Since it appeared that the problem of not receiving inspection reports had been corrected with the replacement of the predecessor REAM and there was a complete change of staff, we did not make a recommendation concerning these reports.

However, the recurrence of this problem clearly shows the need to establish and implement controls to assure that the current and future REAM contractors do not repeat the cycle of the past two REAM contractors of initial compliance followed by non-compliance.

REO not monitoring REAM performance

In addition to not developing procedures and controls to assure the timely submission of inspection reports, the REO has not developed adequate procedures for monitoring the actual performance of the REAMs.

The REO is required to conduct on-site visits to REAM offices within 60-days of awarding new contracts. The purpose of the on-site visit is to determine the frequency of on-site office reviews necessary for proper monitoring.

The REO advised that on-site visits to the REAM offices have not been performed on either the former or current REAMs.

REO not performing property inspections

The REO is also required to perform monthly site inspections of 10 percent of the properties in the inventory. HUD Handbook 4310.5, REV-2, suggests that the 10 percent should, increase as necessary, up to 100 percent, for high-risk REAMS or REAMs whose performance are currently unsatisfactory.

During 1993 and through most of 1994, the REO utilized the services of HUD's Regional Civil Engineer and the Property Disposition Branch's Construction Analyst to perform the property inspections (see additional comments below concerning the results of the Civil Engineer's inspections).

The REO ceased performing property inspections in late 1994, when they lost the services of the Civil Engineer and Construction Analyst, who both opted for early-out retirement in the fall of 1994, and have not performed property inspections since.

Without periodic property inspections, it is impossible to evaluate the performance of the REAMs. The initial and monthly inspection reports merely serve as REAM's documentation of the condition of the property and what actions are necessary to protect and maintain the property.

Property inspections by the REO are necessary, to evaluate the accuracy of the REAM's reporting and the quality of the work being performed by the REAM.

Results of OIG inspections

We physically inspected 19 properties between July 17 and July 20, 1995. This was approximately three weeks after the termination of the former REAM contractor and just about the date the new REAM was responsible for the properties.

Our inspections identified 11 properties (58 percent) that did not have shrubbery trimmed as required by the contract. This was the only condition that we are confident that existed prior to the termination of the former REAM's contract. Since this item is not identified on the monthly inspection reports submitted by the REAMs, the only way the REO can determine compliance is by performing on-site property inspections themselves.

Our inspections also identified the following conditions which could not be positively attributable to the former REAM's performance, since approximately three weeks had elapsed since the contract expired:

- Eleven properties (58 percent) had debris on either the interior or the exterior. Four of the properties, which were properly secured, had debris on the interior which strongly suggests that the former REAM did not properly clean the interior (contract requires property to be broom cleaned).
- Five properties (26 percent) were not properly secured.
- Three properties (16 percent) had graffiti on the exterior.

New REAM disclosed similar conditions

We compared the results of our 19 property inspections to the initial inspection reports submitted by the new REAM for 18 properties (one property had been sold and did not require an inspection by the new REAM). The comparison disclosed that the results of the new REAM's inspections were similar to our inspections. The new REAM's inspection reports identified:

- Nine properties (50 percent) had debris on the interior or exterior. Three of these properties were found to be properly secured, but had debris in the interior, suggesting the former REAM did not properly clean the interior before it was secured.
- Three properties (17 percent) were not properly secured.

- Five properties (28 percent) had graffiti on the interior or exterior.

In addition to the lack of inspection reports being submitted by the former REAM, there were at least two other factors which should have acted as "red flags" to the REO that the former REAM was not adequately performing under their contract:

#### Complaints on poor contractor performance

- 1) The Single Family Housing Specialist advised that, from the time he was assigned to Single Family Property Disposition (predecessor to REO), in early 1993, complaints of poor contractor performance averaged approximately one per day against the former REAM. The majority of the complaints were for inaccessibility to the property from appraisers and real estate brokers, which delays the process of listing and disposing of the properties. While these complaints started at about the time HUD ran out of lock boxes, which relates to property access, they persisted throughout the contract, including after the lock box problem was corrected. Other complaints were for failure to cut lawns, remove debris, and remove snow from pathways.

#### Lack of procedure for tracking complaints

We were advised that the REO handled these complaints the same way they handled the REAM's failure to submit inspection reports, which was to telephone the REAM and relay the complaint. The REO did not have any control system or procedure for documenting and tracking the complaints, the subject of the complaints, who made the complaints, how they were handled, or whether or not they were resolved.

#### Inspection results performed by regional Civil Engineer

- 2) The REO obtained the services of the HUD Regional Civil Engineer to perform inspections of HUD-Owned single family projects as part of their monitoring of REAM's performance. The REO was able to locate and provide us with copies of 22 of his inspection reports, dated between October 1993 and April 1994.

Results of the inspections disclosed:

- Thirteen of the 22 properties (59 percent) did not have lock boxes and, therefore, were not accessible to appraisers and brokers.
- Three of the 22 properties (14 percent) needed the lawns cut.
- Two of the 22 properties (9 percent) needed debris removed from the premises.
- Two of the 22 properties (9 percent) were not secure, allowing unauthorized entry.

As in the other situations, we were advised that the REO handled these deficiencies over the phone without the use of a written control log.

## Summary

In spite of repeated problems with the timeliness and lack of submission of inspection reports by three REAMs including, to a lesser extent, the new REAM, the REO still has not established a system of procedures and controls to monitor the timely submission of the reports, track complaints, or to perform on-site inspections. Without the system for procedures and controls over performance, the REO has little assurance that the REAMs are providing the quality services provided to protect HUD-owned properties and HUD's interests.

We believe that the REO's failure to properly address the performance to the former REAM was primarily due to their focusing on the number one goal of the branch, which was to dispose of the properties. The ability to dispose of properties in a timely manner, however, was impaired by a number of factors in 1993 and 1994, including:

- A chronic staffing problem which was compounded by the lengthy illnesses of two employees.

- The increasing number of acquired properties, (122 in FY 92 to 246 in FY 93 and 328 in FY 94).
- The inability to obtain appraisals in a timely manner.
- Running out of lock boxes, making accessibility to the properties more difficult.

While the REO has properly placed their focus on the job of disposing of the acquired single family properties, they need to establish procedures and controls to properly evaluate REAM performance and to take the necessary corrective action to assure that HUD's interests are being adequately protected.

---

#### Auditee Comments

The Chief, Single Family Production and REO Branch, in response to our draft report, indicated that they were in agreement with the recommendations and had already partially implemented them. See Appendix A for the complete response.

---

#### Recommendations

We recommend that you:

- 1A. Develop and implement a system of procedures and controls to evaluate and document the performance of REAM contractors.
- 1B. Ensure that unsatisfactory performance is communicated, in writing, to the REAM in a timely manner.
- 1C. Develop and implement a log to properly track and control the resolution of complaints, to include periodic review by management.

---

# Follow Up On Prior Audits

On March 19, 1993, the Office of Inspector General issued an internal Audit Report No. 93-BO-123-0002 on the Single Family Disposition Program of the Property Disposition Branch. The report identified significant weaknesses in the Property Disposition Branch's administration of the Single Family Disposition Program. The report contained one finding that included ten recommendations. All recommendations were subsequently closed.

Due to the limited objective of the current audit, we did not follow up on the status of the closed recommendations.

This report does not update any of the recommendations of the prior report. However, the prior report did cite a condition in the finding concerning the failure of a prior REAM to submit inspection reports, which we are citing in the current report. The prior report did not make a recommendation to correct the deficiency since the new REAM at that time (Management Solutions, Inc.) was submitting the required inspection reports during 1992.

The current report stresses the importance of developing and implementing controls to assure that the condition does not continue to repeat itself.

# Auditee Comments



---

# Distribution

Assistant Secretary for Housing - Federal Housing Commissioner, H, (Room 9100) (10)  
Assistant to the Deputy Secretary for Field Management, SDF, (Room 7106)  
Deputy Assistant Secretary for Single Family Housing Programs, HS, (Room 9282) (2)  
Deputy Assistant Secretary for Operations, HO, (Room 9138)  
Inspector General, G (Room 8256)  
Acquisitions Librarian, Library, AS, (Room 8141)  
Audit Liaison Officer, Office of Chief Financial Officer, FOI, (Room 10176)  
Audit Liaison Officer, Assistant to the Deputy Secretary for Field Management, SDF, (Room 7106)  
Audit Liaison Officer, Office of Housing, HF (Room 5132) (4)  
Chief Financial Office, (Room 10164) (2)  
Director, Office of Budget, ARB, Room 3270)  
Director, Office of Accounting Operations, FB (Room 2206)  
Director, Division of Housing Finance Analysis, REF, (Room 8212)  
Director, Division of Policy Development, RPP (Room 8110)  
Director, Office of Finance and Accounting, FB (Room 2206)  
Director, Office of Management and Planning, AMM (Room B-133)  
Deputy Chief Financial Officer for Operations, (Room 10166) (2)  
Director, Office of Asset Management and Disposition, HMM, (Room 6160) (2)  
Director, Office of Housing Budgets and Field Resources, HOB, (Room 9206)  
Single Family Housing Programs, HS, (Room 9282)  
Special Assistant, Office of Public Affairs, (Room 10136)  
Secretary Representative, 1AS  
Director, Office of Housing, 1AH  
Field Comptroller, Illinois, State Office, 5AF

Associate Director US GAO (2)  
Union Plaza Building 2, Suite 150  
820 1st Street NE  
Washington, DC 20002  
Attn: Jacquelyn Williams-Bridgers