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FARMERS HOME ADMINISTRATION
(RURAL HOUSING PROGRAM OPERATIONS)

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HEARINGS

BEFORE A

SUBCOMMITTEE OF THE
COMMITTEE ON
GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES

NINETY-THIRD CONGRESS

FIRST SESSION

JUNE 5, 6, AND 7, 1973

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FARMERS HOME ADMINISTRATION
(RURAL HOUSING PROGRAM OPERATIONS)

TUESDAY, JUNE 5, 1973

HOUSE OF REPRESENTATIVES,
INTERGOVERNMENTAL RELATIONS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:10 a.m., in room 2247, Rayburn House Office Building, Hon. L. H. Fountain (chairman of the subcommittee) presiding.

Present: Representatives L. H. Fountain, Bill Alexander, Clarence J. Brown of Ohio, and Guy Vander Jagt.

Also present: James R. Naughton, counsel, and Richard Thompson, minority staff member, Committee on Government Operations.

Mr. FOUNTAIN. The subcommittee will come to order, and the record will show that a quorum is present.

Under the Rules of the House of Representatives the Committee on Government Operations has responsibility for examining the operation of Government activities at all levels with respect to economy and efficiency. This responsibility, insofar as it relates to the Department of Agriculture and certain other departments and agencies, has been assigned by the committee to its Intergovernmental Relations Subcommittee.

In accordance with that assignment, the subcommittee is examining today operations of the Farmers Home Administration relating to housing. I think that I can speak for my colleagues on the subcommittee, particularly those who represent large numbers of rural residents, as I do, when I take note of the significant and valuable contribution which the rural housing program has made to the quality of life in nonurban areas. Because of the program, I think it is fair to say that hundreds of thousands of families, both farmers and nonfarmers living in rural areas, are now realizing the benefits of adequate housing. It is our hope that these hearings will help strengthen the program by improving the manner in which it is administered.

We are particularly concerned with the effectiveness of procedures designed to insure that the quality of material and workmanship in FHA-financed housing is satisfactory and that the borrower has a decent, safe house for the price he must pay. We will try to put information on the record for the benefit of the Congress and the agency, and those down the line who serve the agency, which will help us do a better job to eliminate such problems as conflicts of interest which seem to occur at all levels of Government in one way, shape or form.

In preparation for the hearing, the subcommittee requested that the Farmers Home Administration prepare a written response to a number of rather detailed questions concerning the agency's housing operations. That response has been supplied and will be made a part of the record. I might say at this point that FHA personnel were very cooperative in providing this material. For myself, and on behalf of the subcommittee, I would like to express our appreciation for this assistance.

It is my hope that the availability of this written material will make it possible for us to make an adequate report in a considerably shorter time than otherwise might be possible.

[NOTE.—The material referred to appears in app. 1.]

Mr. FOUNTAIN. Our witnesses today are from the national office of the Farmers Home Administration. Tomorrow we expect to have additional witnesses from FHA field offices in Texas, Arkansas, and South Carolina. In addition, we expect to take testimony from Mr. Lee Harr who is associated with the television station KGBT in Harlingen, Tex. Mr. Harr was responsible for the production of a documentary film concerning FHA operations in Cameron County, Tex.

Without further ado, Mr. Elliott, you may want to introduce those you have on your staff, and thereafter proceed with your statement.

STATEMENT OF FRANK B. ELLIOTT, ACTING ADMINISTRATOR, FARMERS HOME ADMINISTRATION; ACCOMPANIED BY JAMES J. SCOTT, AUDITOR, OFFICE OF THE INSPECTOR GENERAL; R. STANLEY HARSH, OFFICE OF THE GENERAL COUNSEL; JOSEPH R. HANSON, ACTING DEPUTY ADMINISTRATOR, PROGRAM OPERATIONS; JAMES F. NEVILLE, ASSISTANT ADMINISTRATOR; AND LOUIS D. MALOTKY, DEPUTY ASSISTANT ADMINISTRATOR, RURAL HOUSING

Mr. ELLIOTT. It is my pleasure, Mr. Chairman, and I would like to introduce them. Because of my relative newness to the agency, and in my acting capacity, I might misunderstand some of the questions. So we will orchestrate it. On my right is Mr. Jim Scott, who is with our Office of the Inspector General; Mr. Stanley Harsh, the Office of the General Counsel; Mr. Joseph Hanson, on my left, is the Acting Chief of Program Operations which includes the housing program as well as community and other programs. Mr. Jim Neville is the head of our housing programs, and Mr. Malotky is his able assistant. Behind me, I have Mr. Denton, from HUD, whom you may wish to corroborate various answers, along with ours; Mr. Nestle, to the rear, is in charge of our planning and evaluations. I think that is enough.

Mr. FOUNTAIN. It looks like you are well backed up here this morning.

Mr. ELLIOTT. We expect a number of questions, in the number of areas, that you are covering. In order to do justice to your committee, we thought that we would bring everyone that could answer your questions factually.

Mr. FOUNTAIN. We hate to have to bring all of you here—call any of you, for that matter—but there always comes a time when we have

to check into these matters for the benefit of the Congress and all others affected, and we appreciate your coming. As I have said before, particularly in view of the short period of time we have, I do not want you to hesitate to designate the one whom you feel is prepared to answer questions, as may be propounded by the subcommittee.

We are going to be limited in time because of the heavy floor calendar, so I do not know how long we will be able to proceed each day.

You may now proceed.

Mr. ELLIOTT. I am prepared to either read this statement or, if your time is of value and you would like, I can submit it for the record, but I will proceed in the manner that you would like.

Mr. FOUNTAIN. You may just go ahead and read your statement.

Mr. ELLIOTT. Mr. Chairman, members of the committee, I appreciate the opportunity to appear before this committee to discuss the operation of the rural housing program in the Department of Agriculture. This program is designed to provide housing credit in rural areas for families who are unable to obtain home mortgage credit from other sources.

The Congress first enacted special housing legislation for rural families when it included a farm housing section as title V of the Housing Act of 1949. Loans were initially authorized only to farmers, but the law has been amended to permit making rural housing loans to nonfarmers for dwellings located in the open country and in small rural towns with not more than 10,000 population. Other significant changes have been made in the Department's housing program to better adapt it to the housing needs of rural America. They include authorizations to make—

Loans for rental and cooperative housing;

Loans and grants for farm labor housing;

Loans to nonprofit organizations to buy land and develop it into building sites for low- and moderate-income families; and

Technical assistance grants for self-help housing.

Another significant change occurred in fiscal year 1966 when the program was placed largely on the insured basis. The Farmers Home Administration originates and insures loans and services loan accounts and security property. Loans are made with funds advanced to borrowers out of the rural housing insurance fund.

After the loans are closed, the notes are sold to private investors and insured at the time of sale. Our agency, through its loan programs, has the capacity to bring investment capital from big cities to rural areas. The flow of this type of loan capital to the credit deficit areas in the country is essential in providing the people who live there an opportunity to have adequate housing and related community facilities.

There has been a substantial increase in the volume of loan activity. The highest volume of loans made prior to enactment of the loan insurance authorization was $185.7 million in fiscal 1963. The amount authorized for the current fiscal year is slightly more than $2 billion. This will enable the Farmers Home Administration to finance homes for about 130,000 families in rural areas this year.

The committee may be interested in knowing that the total level of activity and responsibility of the FHA has increased sharply in recent years. For example, on June 30, 1968, we had 383,000 outstanding accounts with a principal balance of $4.8 billion. Four years later on

June 30, 1972, we had 636,000 outstanding accounts with a principal balance of $9.6 billion. By June 30 of this year, we estimate that the amount outstanding will increase by another $2 billion.

Associated with the delivery of credit is counseling service to families and to developers who want to build homes for the market we serve. The organizational structure of the agency is well adapted to this type of credit delivery service. It is a direct line agency with some 1,750 offices to serve families in rural communities. Briefly, the Farmers Home Administration has three administrative levels; namely, the national, State, and county offices. The focal point for delivery of the agency's services is the local county office. County office personnel receive and process applications for homeownership loans, determine the applicant's eligibility, counsel families, make appraisals, review plans and specifications, inspect construction, and service loans. Loans for multifamily housing are reviewed and approved at the State office level. Some larger, more complex loans require prior review by the national office.

The function of the State offices is to provide program supervision and management guidance to our county offices.

The national office is responsible for the establishment of policies and procedures and giving administrative direction to all phases of the programs for which the Farmers Home Administration is responsible.

Financial and program accounting, reporting, computer services and support services to field offices are centered in the FHA National Finance Office in St. Louis, Mo. This office also handles the sale and the repurchase of insured notes.

The largest part of our housing program is in section 502—loans for adequate single family housing. Under this program loans may be made to low- and moderate-income families at subsidized interest rates. The current basic interest rate is 7¼ percent. Under the subsidized program, the interest rate may be reduced to as low as 1 percent, depending on the size of family, its income, and the amount of the loan. At present, this subsidized loan program has been suspended. I will comment more about this later in the statement.

We also make loans to finance rental housing for elderly and low- and moderate-income families. This program serves families in small towns, especially senior citizens and young families who are just establishing households.

Small home repair loans for shelter housing are available to owner-occupants for minor repairs to homes. These loans are made to very low-income families whose dwellings are badly in need of repair to remove hazards to the health and safety of the family and the community. Loans are used for purposes such as roofing repairs, putting in screens, providing adequate water and waste disposal systems, and making the home structurally sound.

Other programs are farm labor housing loans and technical assistance grants to qualified organizations to pay administrative and supervisory costs in connection with mutual self-help housing loans for building sites.

To date almost 700,000 families have received rural housing loans from the Farmers Home Administration. This has been only a small beginning toward meeting the market for adequate housing in rural areas

Historically, rural housing has been inferior to city housing. This is still true. In 1970 there were 20.4 million occupied homes in those rural areas served by the Farmers Home Administration. Of these, 12.6 percent or about 2.6 million lacked complete plumbing. This is only a partial measure of the need for better housing in rural areas. Additional demand for homes will develop from:

The elderly who now live in rural areas or who want to move there;

Newly formed families who want to live in rural areas;

Industrial development in rural communities;

Families who move from one location to another to seek employment or more favorable place to live;

The replacement of homes that are lost or damaged as a result of fire or natural disasters.

During recent years our housing program has been in a period of rapid growth. In addition, the area of service was increased to include rural places up to 10,000 population. To handle the increased volume of housing loans, we made a concerted effort to improve the efficiency of our available staff. For example, we:

Introduced the use of conditional commitments to encourage builders and developers to participate more actively in the production of housing;

Put into effect a system under which most of the borrowers make their payments directly to the FHA Central Finance Office in St. Louis;

Authorized the use of commercial credit reports;

Introduced a method for packaging applications under which builders, developers, real estate agents, and others may assemble factual information about the house and the applicant. The judgment decisions such as the determination of eligibility and appraisal of the property are made by the Farmers Home Administration;

We have made more extensive use of our computer to improve the types of reports to State and National offices, reduce the workload at county office level, and improve the service to borrowers in all aspects;

Consolidated forms whenever practicable;

Continued to improve our working relationship with the private sector, especially members of the building trades and the financial community.

This period of rapid growth also admittedly has brought with it some problems. I understand that the committee is thoroughly familiar with the problems reported by the General Accounting Office and the Office of Inspector General. I will not enumerate them but I would like to mention some of the actions we have taken to strengthen the administration of our housing program. They include:

Issuing comprehensive guidelines for building sites and subdivision development;

Adopting HUD's minimum property standards for uniformity;

Requiring FHA inspection during the eleventh month of warranty period;

Putting into effect suspension and debarment procedures for contractors, builders, and realtors;

Issuing a procedure for handling construction complaints;

Establishing a technical services division at the national office and strengthening State office technical skills;

Establishing an operational review and evaluation system;

Working more closely with State and local health or sanitation officials and other Federal agency staffs such as the Soil Conservation Service to utilize technical information available through these sources;

Establishing a National Training Center at Norman, Okla., and strengthening other national and State office training efforts;

Increasing the emphasis on employee conduct and activities or actual conflicts of interests; and

Emphasizing the need to work closely with delinquent and problem case borrowers.

We have provided the committee a list of the major problems we have encountered and the specific corrective actions we have taken. This information is included in our response to question number 12 in the list of questions submitted to us by your committee.

In closing I would like to comment briefly on the suspension of new commitments on subsidized interest credits as of close of business on January 8, 1973. This action, which resulted in some additional administrative problems, was part of a governmentwide suspension of new commitments for subsidized housing to provide time for a study to explore the basic question of what role the Federal Government should play in housing and housing finance. The evaluation of existing programs is underway. The Farmers Home Administration and others in the Department of Agriculture are involved in this study and will participate in an evaluation of the broad housing issues to be considered. Particular attention will be given to the housing needs of rural families.

The following are specific actions we took in connection with the suspension of new commitments for subsidized housing loans.

On January 8, 1973, FHA notified its field staff by telegram that after that date county and State offices could not approve farm labor housing loans and grants, rental and cooperative housing loans, and section 502 homeownership loans that involved interest credit. An exception was made for homeownership loans to families participating in mutual self-help projects.

Subsequent decisions, similar to the steps taken with respect to HUD programs by Secretary Lynn, resulted in modifications of the original notice. All of these actions were taken to do the best we could to draw the suspension line at the most equitable point for each program. These actions included:

Restoration of the nonsubsidized rental housing program:

Extension of authority to make housing loans with interest credits to families to buy homes built by builders who had received written or verbal commitments from the Farmers Home Administration for the homes before January 9, 1973. In case of a verbal commitment for a home to be sold to a rural housing borrower at less than full interest, construction of the home must have been started and footings poured before January 9;

Making loans with interest credits to families who applied before January 9, 1973, and owned or had selected a house or site or had been found to be eligible by the Farmers Home Administration before that date;

Completion of applications for farm labor housing loans and grants for which written commitments were given before January 9 by the national or State office;

Authorized processing of applications that involve loans with interest credits for rental housing for elderly and others for which either written or verbal commitments had been made before January 9;

Authorized making loans with interest credits to families whose homes are being built or repaired under special manpower;

Training programs.

These actions in connection with interest credit loans, together with the programs that are being continued on a nonsubsidized basis, will provide for a substantial level of activity while the comprehensive evaluation is being made.

Mr. Chairman, this completes my formal statement.

I shall be glad to answer any questions the committee may have about our housing program.

Mr. FOUNTAIN. Thank you very much, Mr. Elliott.

I note that in your statement you say you understand that the committee is thoroughly familiar with the problems reported by the General Accounting Office and Office of the Inspector General. I might say that the staff members may be, or one or two members of the subcommittee, but I am afraid that most of us are not. That is one of the reasons for this hearing.

In the interest of time, we will place the report of the Office of the Inspector General in the record, and that should cover quite a bit of territory.

Mr. ELLIOTT. Yes, sir.

[The report referred to appears in app. 2.]

Mr. FOUNTAIN. Before I proceed with my line of questioning and yield to other members, are you in a position to tell us which of the recommendations beginning on page 5 of your Inspector General's report were put into effect either in their present form or in a modified form or are now in the process of being put into effect?

I understand this report goes back to 1971.

Mr. ELLIOTT. I will make this statement in a general manner, sir.

I have the intention while I am in my current acting position to act on all recommendations presented to correct the program deficiencies. Now, we can deal with each on its own and, if I may, then Mr. Scott could go over them and we can come directly to them.

Mr. FOUNTAIN. We may get back to that. I simply want to ask that general question at this time.

Mr. ELLIOTT. And, to be specific, we intend to follow the recommendations and make the necessary corrections of the deficiencies which are within our power to do so.

Mr. FOUNTAIN. Are there any new recommendations in the December 1972 GAO report?

Has either the Office of the Inspector General or the General Accounting Office made significant recommendations for changes in the administration of the rural housing programs with which FHA disagrees?

Mr. ELLIOTT. I think Mr. Hanson can best answer that.

Mr. FOUNTAIN. If so, will you give us the details?

I might say the committee, by asking these questions, is taking no position one way or the other on these items. We are not in a position to do so yet.

Mr. HANSON. I am not familiar with any recommendation with which we could disagree. I would like to refer the question to Mr. Neville, who is more familiar with these issues.

Mr. NEVILLE. I don't have the report presently before me, but, if my reflection is correct, in reviewing the report and going over it with the representatives of GAO in the conference that we had, basically we have no disagreement with the suggestions that they have made.

Could we give you a copy of this report, or do you have it?

Mr. NAUGHTON. We have it.

Mr. FOUNTAIN. What about the Inspector General's report? Are there any of the recommendations with which you disagree?

Mr. ELLIOTT. No, sir, not at this time.

Mr. NEVILLE. Basically, no, we do not.

Mr. ELLIOTT. In the case of the OIG report, we agree with the objections and recommendations and have developed an organization proposal to meet all the points that were raised.

Mr. FOUNTAIN. Did you find there were any modifications or changes submitted by them——

Mr. ELLIOTT. We will clarify it for the record.

[See app. 3.]

Mr. FOUNTAIN. Do I understand that these recommendations have been or are being put into effect at the present time?

Mr. ELLIOTT. We are reviewing each one of them. We intend to take corrective actions as defined by both GAO and by our Office of the Inspector General.

Mr. NAUGHTON. Could you, in supplying your answer for the record, first indicate if there are any recommendations of GAO or OIG which are of significance?

Mr. ELLIOTT. Right.

Mr. NAUGHTON. And second, for any of those recommendations which are not completely in effect as of the present time, would you indicate what the progress is and when you anticipate that the recommendation would be carried completely out?

Mr. ELLIOTT. I will be delighted to do so, and give you both the action and the timetable.

[See app. 3.]

Mr. FOUNTAIN. Mr. Elliott, as I said, all the members of the committee, including the chairman are not familiar with all the problems we have. Last night I went through the report of the Office of the Inspector General, and I must confess that a lot of the situations there were quite revealing, as I am sure they must have been to you. I have also been through the GAO report. I don't want you to attempt to go into all of them but I think it would be helpful to illustrate the nature and extent of the problems which you did find.

I wonder if you would give us the benefit of what you discovered as the most serious problems that currently face you in the administration of the rural housing program, in your judgment?

Mr. ELLIOTT. Well, may I make a general observation there? These loans are made at the local levels and with the rapid increase in the program, we need to find administrative ways to accomplish our responsibilities within the resources allocated to my agency. As I quickly scan this in item 3 of the Inspector General's report, they indicate they would like to see an increase in numbers of personnel and tech-

nical capability. Personnel resources are allocated to me by the Secretary of Agriculture. I must make those resources do the job necessary as opposed to asking for additional resources both in money and manpower. So the major problem then confronting us is to find the necessary management ways of getting things done within those resources, and that is my major administrative problem. We intend to stay within our resource limitation and still achieve the program objectives.

The second major problem in the nature of management is the continued development of individuals to enable them to perform their duties under the expansion of the program from its rural origins and farmer programs. The employees' ability to extend themselves to the increasing sophistications of new loanmaking is a challenge in both training and upgrading of our personnel in order to be able to administer the additional loans and complexities of those loans.

Those are two major management problems.

Last, but not least, of course, is in the selection of personnel to perform the duties. To keep to a minimum the oversight, deficiencies, and personnel problems that do arise in a program which has expanded considerably, we motivate the individuals to both integrity and accomplishment. In general, those are the three areas that we have to deal with and are dealing with. If we are successful in these accomplishments, the program can be accommodated and the rural areas can be serviced.

Mr. FOUNTAIN. I think you have certainly, in substance, adequately described your management problems.

I wonder if you would give us a description now of some of the problems which you found, such as those set forth in the Inspector General's report. I don't expect you to go into all of the little details, but I think you can generally describe the nature of the problems.

Mr. ELLIOTT. That I would be glad to do.

Mr. FOUNTAIN. Feel free to have any of your staff supplement your reply.

Mr. ELLIOTT. In answering your question 12, we dealt with a list of serious problems and you may wish to refer to it as I give the highlights.

As you are all aware, it has come not only to our attention but also to a wide area of other interested people, that some loans were made to families who found themselves with inadequate waste disposal systems. We have taken corrective actions, and are continuing to do so. We will deal with each problem on an individual case basis.

We have also had delays in processing the applications as the result of having responsibilities for a greatly increased housing program with resources that were not necessarily adequate to cope with this increase.

Now, I can enumerate the corrective actions taken. However, if it serves your purposes, we will just cover the serious problems.

Mr. FOUNTAIN. That is what we need to know. Some of the other members of the committee may not have had a chance to read all the materials that our staff secured for us.

Mr. ELLIOTT. The staff has done an excellent and thorough job, I can assure you. I hate to admit my deficiencies, but they have been teaching me as we move along.

There is another area in which we had serious problems. We do receive complaints about making loans to families whose credit needs could have been met by other lenders. This requires a particular kind of judgment—that is, again, a judgment at the county level based on the financial data provided. In those cases, we generally rely on the County Supervisor's judgment.

We have also received criticisms about discriminatory treatment of minority groups. I believe that there has been a continuous and honest effort to overcome this particular bias. However, it will continue to arise in one form or the other, either consciously or subconsciously.

We also receive questions about delinquencies. We have some problems with a slightly increasing delinquency level. Frankly, as an outsider coming to this organization and having seen some real losses in the financial world in New York, this agency has one of the more commendable records in making loans and getting repayment. Principal writeoffs of only six one-hundredths of 1 percent of principal advances for insured building loans is amazing. Also, property acquisitions by the Government to date of about 3 per 1,000 of total loans made is a remarkable achievement. It probably speaks well for the kinds of people to whom we are lending money.

Mr. BROWN. May I ask a question?

Mr. FOUNTAIN. Yes.

Mr. BROWN. In terms of Government acquisitions, when a house is defaulted upon, what is your procedure? Do you put it on the market, or does the Government—when you say Government acquisitions, are you talking about the Government then taking possession of it?

Mr. NEVILLE. That is right, sir.

Mr. BROWN. What is right?

Mr. NEVILLE. That we take possession of it. It becomes part of the inventory through foreclosures or through assignments.

Mr. FOUNTAIN. You foreclose the mortgage?

Mr. NEVILLE. Yes, also we get assignments.

Mr. BROWN. The phrase you used was "Government acquisitions."

Mr. ELLIOTT. Yes, sir.

Mr. BROWN. Foreclosures and acquisitions—those are interchangeable terms?

Mr. NEVILLE. That is right because they help Farmers Home Administration acquire the property.

Mr. BROWN. At that point then what does the Government do with the property?

Mr. NEVILLE. It liquidates the properties through the sale of the property to eligible borrowers, or, if an eligible borrower cannot be found, then to a noneligible one.

Mr. BROWN. Suppose the house has been damaged or mistreated, or suppose the house is a couple or 3 years old and the house has been pretty badly banged up by the previous owners—previous mortgagees?

Mr. NEVILLE. No, there are no mortgagees. We are the mortgagee.

Mr. BROWN. Or the mortgagor.

Let us say that I have not taken care of that house. I have not met my obligations to you, you repossess—or say that I have taken good care of it, you repossess it and it sits idle for 6 months and during that 6 months it is vandalized. How quickly do you move to try to get somebody else to buy it?

Mr. NEVILLE. The first thing we do, once we get control over the property, is to put it into a resalable condition. This might require repairs. After completion, the local county supervisor would try to sell the property as soon as possible.

Mr. BROWN. He acts as a realtor.

Mr. NEVILLE. Yes, sir. He acts in behalf of the Federal Government.

Mr. BROWN. Do you ever engage in real estate?

Mr. NEVILLE. Not up to this time, sir, but we are considering doing that.

Mr. BROWN. For what reason?

Mr. NEVILLE. We think it would assist us in selling properties. Somebody would be engaged on a full-time basis. Our county supervisor has a multitude of other duties to perform.

Mr. BROWN. Mr. Chairman, the reason I asked the question is because I have had complaints that the FHA rehabs houses and they sit in a rural area and become quickly vandalized again, and are not moved quickly on the market. The result is that the Government puts money in two and three times.

Mr. ELLIOTT. Mr. Congressman, you are correct.

As I pointed out, we are trying to find management solutions to just these kinds of problems and, as Mr. Neville indicated, we are considering using realtors to handle the resale of Government-acquired properties.

Mr. BROWN. Is that an administrative decision?

What I am asking, how does the law speak to that, or have you just chosen not to do that in the past?

Mr. NEVILLE. With the inventory we had, it really was not a significant problem. We have in inventory, according to the last figure I have in mind, about 600 properties nationally. This didn't constitute a problem. It could be handled in the ordinary course of business. But in order to prepare ourselves, because of the large volume of business we have had in recent years, and to get set to handle them in the event we should acquire substantial numbers of properties, we are now instituting new procedures. They are being developed for publication in the Federal Register. Soon, they will be in effect.

Mr. ALEXANDER. Would the Chairman yield for one question on that point?

Mr. FOUNTAIN. Yes.

Mr. ALEXANDER. Well, in response to counsel's questions to the Farmers Home Administration, as to question No. 6, I believe you say that the Farmers Home Administration requests annual appropriations to restore losses to the fund and these amounts are then available for loan making. The 1974 appropriation request for this item, $89,170,000.

Now, my question to you is, sir, does that mean that the losses in the housing program, which is this appropriation, would total in full amount of the $89,170,000, or is this a figure representative of some other loss within the program?

Mr. NEVILLE. I would be glad to answer that.

This $89,170,000 is a deficit and not a loss. The deficit is the result of the interest credits which we have allowed borrowers. It is to pay the deficit between the interest paid on sold notes and the interest rates being collected from the borrowers. At one time the interest on the sale of the note was in excess of what we were receiving in interest

from the borrower. The third aspect is the loss owing to property liquidation, which is the smallest amount. I cannot give you that figure now. The total of all three equals $89,170,000.

Mr. ALEXANDER. Thank you, Mr. Chairman.

Mr. ELLIOTT. Mr. Chairman, Congressman Brown had a question relating to the legal aspects of being able to use realtors for the resale of Government-acquired properties. I would like for Mr. Harsh to answer.

Mr. HARSH. I want to say, Mr. Brown, that some of the vandalism that you spoke of is due to causes outside of the capability of the agency. It is due to the difficult legal process in the liquidation of some of our loans. That is, even after the borrower is delinquent and we attempt to obtain possession of the house, we do this through a variety of ways, judicial foreclosures, nonjudicial foreclosures and other means. Some of these take a great deal of time. That is true even where there has been an abandonment of the property. Consequently it is during this period——

Mr. BROWN. Why should it take time when there is vandalism?

Mr. HARSH. Well, the statute, or the court calendar, requiring judicial foreclosures, require notice, and many of these courts are behind in their work. Until we get a transfer of title, we simply cannot take possession of the property. It is a problem that exists that we are working at in many various ways.

Mr. BROWN. Does that mean you also cannot take action to protect the property?

Mr. HARSH. Probably we cannot take adequate protection.

Now, we have done a number of things in this line. I know the Farmers Home Administration has utilized neighbors to try to watch over the property even with payments of various kinds, but it simply is not adequate. Many instances have been reported to the local law enforcement officers, and there is a general reluctance, I would say, on their part to provide the kind of protection that these properties would need.

I know the Administration is looking at a Federal nonjudicial foreclosure statute that would expedite this foreclosure and to minimize the very type of loss that you are mentioning.

Mr. BROWN. With reference to the authority for using realtors——

Mr. HARSH. I can only give you a tentative opinion at this time.

I believe adequate authority exists, but I will be glad to verify that if you would like.

Mr. ELLIOTT. The opinion that we now have is that it is administratively allowable. Prior to this time we had felt that we could deal with this within the agency without going to realtors. We are now taking necessary action to utilize the realtors, because we have been unable to cope with the problem as an agency. Does that answer your questions?

[The following statement was subsequently provided:]

AUTHORITY OF FHA TO UTILIZE PRIVATE ENTERPRISE REALTORS IN MAKING DISPOSITION OF FORECLOSED PROPERTIES

That part of the Housing Act of 1949, as amended, which applies is stated as follows:

Title V, section 510, 42 U.S.C. 1480—Administrative Powers of the Secretary.

In carrying out the provisions of this subchapter, the Secretary shall have the power to:

"(e) bid for and purchase at any foreclosure or other sale or otherwise to acquire the property pledged or mortgaged to secure a loan or other indebtedness owing under this subchapter, to accept title to any property so purchased or acquired, to operate or lease such property for such period as may be necessary or advisable, to protect the interest of the United States therein and to sell or otherwise dispose of the property so purchased or acquired by such terms and for such considerations as the Secretary shall determine to be reasonable and to make loans as provided herein to provide adequate farm dwellings and buildings for the purchasers of such property ;"

As can be seen, there is no prohibition in the law to the use of private enterprise realtors in disposing of foreclosed properties.

Present FHA regulations do not provide for use of such arrangements. Such has not been provided heretofore since the need has not been demonstrated for such. Now that there appears to be a volume of foreclosures which might make it feasible to advocate the use of private enterprise realtors there is in the drafting stage a proposed regulation which would address itself to the use of this procedural method if in the judgment of the State director such is deemed to be the most feasible way to consumate the disposal of such properties. This proposed FmHA instruction will be 465.2. It has been reviewed by the Office of the General Counsel. Paragraph E, "Use of Realtors to Sell Acquired Rural Housing Property," on page 34 sets forth the proposed procedure as follows:

E. Use of Realtors to sell acquired rural housing property.—If the county supervisor has been unable to sell acquired property in accordance with paragraphs VI, C, or D, he may submit to the State director a detailed report of his efforts to sell the property and request authority to offer it through realtors. The State director may authorize the use of realtors to sell acquired property only if the county supervisor has made a diligent effort to sell such property and the State director determines that the property cannot be sold under reasonable terms by FHA personnel.

(1) Selection of realtors: If the State director authorizes the use of realtors, the County Supervisor will give public notice that FHA has certain properties for sale and that realtors are invited to participate in selling the property. The notice is to be inserted in newspapers circulating in the primary market area in which the property is located and will read substantially as follows:

The Farmers Home Administration has for sale the following properties:

(1) Ten unit rental complex located at 125 Main Street, Anytown, Va.

(2) Home located 3 miles west of Anytown, Va.

Licensed realtors who are interested in listing these properties should contact the Farmers Home Administration County Office at _____ for detailed information before _____.

(2) Conditions:

(*a*) The property will be handled by realtors on an open listing basis. Any licensed realtors who customarily handle real estate in the area in which the property is located will be given an opportunity to list and attempt to sell the property.

(*b*) All realtors granted authority to sell acquired rural housing property will sign form FHA ———, "Agreement for Sale of RH Property." They will be informed of any redemption rights applicable to the property. The county supervisor is authorized to sign form FHA ———, "Agreement for Sale of Rural Housing Property."

(*c*) Once authorization is received to use realtors and the, "Agreement for Sale of Rural Housing Property," has been signed, FHA officials will discontinue any attempts to sell the property but will inform prospective buyers of the names of all realtors who have signed agreements.

(*d*) The property will be listed for a period not to exceed 90 days from the date of first public notice. This period may be extended, if at the end of the 90 days, it appears that a contract for sale can be obtained within 30 days. All agreements with realtors will terminate on the same date.

(*e*) The fee for selling the property may not exceed the cost normally charged in the area for similar services. In the event the property is not sold, there will be no charge to FHA for the services.

(*f*) The property will be listed for its present market value as determined by the State director. No offer from any prospective purchaser for less than the listed price will be accepted.

(*g*) Property suitable for FHA programs will be offered for sale for (a) cash, or (b) cash or terms in accordance with paragraph VI, D of this Instruction if the purchaser is not an eligible applicant, or (c) terms in accordance with paragraph VI, C of this Instruction if the purchaser is an eligible applicant.

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(*h*) Properties not suitable for FHA programs will be offered for sale for (a) cash, or (b) cash and terms in accordance with paragraph VI, D.

(*i*) In order to determine priority when offers from prospective buyers are submitted by realtors, each offer will be considered in the order received in the county office and either accepted or rejected in that order. Each offer will be reviewed for compliance with the listed price, terms of sale, and qualifications of the buyer if the sale is to be on the basis of a credit sale to an applicant eligible for an FHA loan. Those offers not qualifying will be rejected and returned immediately.

(*j*) Any realtor fees resulting from a sale to an ineligible applicant will be paid from proceeds of the sale. Such fees resulting from a sale to an eligible applicant will be paid by processing SF 1034. The cost will be charged to the RHIF. Payment to a realtor will not be made until the transaction is closed.

(*k*) Any downpayment collected from a prospective purchaser by a realtor, will not be accepted by the county supervisor prior to the closing of the transaction. Any such moneys collected must be returned to the prospective purchaser if the offer he submits is not accepted or if he applies as an eligible applicant and is determined to be not eligible for the requested loan. If, however, an offer is accepted and the prospective purchaser refuses to close the transaction, the Farmers Home Administration will not negotiate or intercede in negotiations between the realtor and the prospective purchaser concerning the disposition of funds paid as a downpayment.

Mr. BROWN. Yes.

I think the factual answer, and I must say that I think a factual answer may be helpful—is the agency of these houses—in other words, the ones that you have that have not been foreclosed, what is the life before they are then put back and picked up again?

Mr. ELLIOTT. I understand your question, and I will supply it for the record.

[NOTE.—No response supplied at time of printing.]

Mr. FOUNTAIN. I think, also, what you are saying, is that even if a house is abandoned because a man decides he is going to give up his equity, the payments are small, he has to put so much down, he is dissatisfied with the house which is cracked and the walls are warped and the roof is leaking—like the situation was in so many of these cases—you still have to go through the regular legal process to dispose of it.

Mr. NEVILLE. To acquire the title. But in the interim period we can do some caretaking.

Mr. FOUNTAIN. But as far as actual possession and title, you still have to go through the legal process?

Mr. NEVILLE. We still have to go through the regular legal process.

Mr. FOUNTAIN. Mr. Naughton.

Mr. NAUGHTON. I believe in response to Mr. Brown's question that you indicated that the acquisition rate is 3 per 1 thousand.

Mr. ELLIOTT. That is historical.

Mr. NAUGHTON. And that would consist of both foreclosures and voluntary transfers, where the borrower would decide he has had enough and wants to leave and sign over whatever equity he may have or any rights he has to the house.

Mr. ELLIOTT. Right.

Mr. NAUGHTON. You also have transfer procedures, do you not, where in a situation a borrower cannot make it and wants to leave, you try to transfer that house to a new eligible borrower?

Mr. ELLIOTT. Right.

Mr. NAUGHTON. That does not show up as an acquisition or delinquency or anything else?

Mr. ELLIOTT. Correct. The house is continued to be used for purposes of taking care of families living in it. So that is not an acquisition.

Mr. NAUGHTON. Do you feel you have had adequate information on the occurrence of abandonments or vacancies from other causes?

In other words, are your procedures such that an immediate alert is called when a county office becomes aware that a house has been abandoned or is likely to be vacant?

Mr. HANSON. I would like to comment.

I think we have had some problems in this area, but it is a local problem with the local county supervisor and his communications with the neighbors or with whoever happened to live in the area. I know that there have been some cases where they have not known that a house was abandoned for maybe a few months.

I am not sure that I know the answer to this problem, but this happens. This definitely happens.

Mr. NAUGHTON. Do you have any figures as to the amount of your losses from vandalism or deterioration in cases of abandonment or other vacancies?

Mr. HANSON. We do not have specific figures. Actually, they are very low.

Jim, would you want to comment?

Mr. NEVILLE. No; I do not have cost figures, but we will try to get them for you.

[See app. 4.]

Mr. NEVILLE. Due to the few acquisitions that we have, the costs involved as far as the Government is concerned would not be substantial.

Mr. NAUGHTON. I think the statement was made——

Mr. NEVILLE. We have a figure of about $4½ million cumulatively. That is subject to correction.

Mr. BROWN. What is that figure?

Mr. NEVILLE. Loss on properties acquired.

Mr. BROWN. Loss due to——

Mr. NEVILLE. $4½ million.

Mr. ELLIOTT. Let me see if I can bring this into focus. That $4½ million is to repair and rehabilitate acquired houses. In other words, to put them back on the market.

Mr. BROWN. How do you make the distinction between vandalism? Suppose a house is left in good shape and a man—as the chairman pointed out—leaves because it was badly constructed in the first instance and it just simply is falling apart, how is that distinction made in that $4½ million?

Mr. NEVILLE. Let us see if we cannot bring this into a little different type focus.

You are bringing into being the fact that the house was poorly constructed, and the person abandoned it for that particular reason. We have established very definitely in the last 2 years a procedure for handling construction deficiencies in houses. It is an equitable approach, both as far as the borrower is concerned and the builders involved. Our county supervisor, if there is a difference of opinion with respect to whether there is a deficiency in construction, will go out and resolve it. Not all deficiencies are the fault of the builder.

Some of them occur because the homeowner doesn't maintain the property properly.

We do ask the builder, if we judge that it is his responsibility, to make the corrections, and we follow up to see that he does. We also have a warranty in connection with that particular piece of property. We have instituted a new procedure which calls for us to make an inspection in the 11th month of the warranty period.

Mr. BROWN. The 11th month of construction?

Mr. NEVILLE. The start of the warranty period is when the occupancy occurs.

During this period of time, if there were construction deficiencies, we would expect them to be taken care of by the builder, if they were his responsibility. Incidents of abandonment because of poor construction have not come to my attention, nor do they seem to be a basis for abandonment.

Usually, what I find is that abandonments primarily are due to marital difficulties, unemployment, and the debts of the borrowers. Some just leave when they have no way of meeting all their obligations.

Some might be avoided if they sat down with our county supervisors. We could probably work out an arrangement with them to alleviate the situation for a short period of time so that they could get on their feet. There would not be the absolute need for leaving it. This is one of the reasons that we feel that there is an absolute and continuing need for counseling.

Mr. BROWN. It seems to me you have three points of concern about the physical condition of the house. One is, was it built right in the first place and did it deteriorate through no fault of the occupant. I would feel that you could determine whether the house was built right in the first place by an inspection——

Mr. NEVILLE. We do.

Mr. BROWN [continuing]. Following its construction and prior to its occupancy, and this is the 11th-month inspection. If it is going to deteriorate, it seems to me it would be deteriorating in that time period.

The second point is that the 11th-month inspection also should make some determination as to whether the people are treating the house properly or whether they live in it like animals. Then the third point is that once you know the house is abandoned, it seems to me it should be inspected promptly to determine whether the house has been badly treated by its occupants, then would be vandalized later on to somebody from the outside without respect to either the builder or the occupant in the first instance.

Mr. NEVILLE. In the original instances, we make three inspections of the property. By law, a staff employee is required to make inspections. During the course of construction, they are made at the pouring of the footings, when it is framed in, and the final upon completion. In addition, we have the 11th-month inspection.

Mr. BROWN. That 11th-month inspection reports only on builder failures, or does that report on occupants' mistreatment?

Mr. NEVILLE. I also mentioned that we have counseling. Our county supervisors are obligated to tell the occupants what he has not been

doing with respect to caring for the property and how it should be cared for. This is part of our continuing counseling service.

We also have this situation. When notice of a default in payment is received by the county supervisor, the property is inspected to see what condition it is in. These inspections continue on a periodic basis as long as the default exists. Thus, we have a knowledge of what is transpiring with respect to the specific properties.

Mr. FOUNTAIN. One of the problems, as pointed out in the Inspector General's report, is the monitoring of the field operations and reporting program accomplishments.

How far along have you gotten in setting up a monitoring system so that you know what is going on down at the local and State levels; that is, whether or not they are doing their jobs adequately?

Mr. HANSON. This is an ongoing problem, of course.

The staff has just recently completed what we refer to as a servicing instruction on housing loans. This will be a big step forward for us in doing a better job of monitoring. Specifically, how far along are we, I think the instructions are about ready for process in the Federal Register now, are they not, Jim?

Mr. NEVILLE. Very close to it.

Mr. HANSON. They are not in the field yet.

Mr. FOUNTAIN. Mr. Alexander, before I proceed with questions concerning growth of the program, would you like to ask some questions?

Mr. ALEXANDER. Thank you, Mr. Chairman.

I, too, am concerned about the question of abandonment.

In referring to the OIG and GAO reports, both of these reports included comments on the faulty quality of housing built or sold under the FHA programs. In connection with this, GAO stated that it inspected 121 houses in 8 States, which had been provided under the USDA administered section 235 or 502 subsidy programs, and found that over 50 percent—I repeat, 50 percent—of these houses had defects.

Now, these included defects resulting from poor workmanship or material, and significant defects relating to health, safety, and livability.

Now, the OIG report, based on studies in six States, including Puerto Rico, also identified "a significant number of construction defects and/or inspection irregularities."

In referring to a GAO report that was done in Arkansas, "Out of 92 borrowers interviewed in 5 counties, 35 complained of defects.

Is this contrary to what you are saying? Do you deny, Mr. Elliott, that the GAO report, the facts in this report, or are you saying——

Mr. ELLIOTT. To the contrary, I accept them as a factual basis for making administrative corrections.

Mr. ALEXANDER. I see.

Mr. ELLIOTT. There is certainly no denial of the facts.

Mr. ALEXANDER. Then do you not think that this poor workmanship that is referred to here contributes to abandonment? Or are you saying that it is only part of the problem, but that owner abuse is the other part of the problem?

Mr. ELLIOTT. I am taking the facts, as presented by the OIG and GAO in order to make better administrative procedures apply.

I don't think, in any case, Mr. Congressman, we are in the posture that you are suggesting now. If abandonment was for bad workman-

ship, we think we have procedures to minimize or limit that as a reason for abandonment. If other abandonments are happening for other reasons, we are seeking to make more rapid foreclosures and to put the houses in proper repair through the use of maintenance funds as necessary and place them back on the market as quickly as possible in order that they will be providing housing for rural residents.

Mr. ALEXANDER. Well, going one step further, Mr. Chairman, I personally interviewed some of these 53 people in Arkansas who complained of deficiencies in their homes. I don't know whether some of them abandoned their houses or not, but one of their most common complaints was they could not obtain any sort of action from the Farmers Home Administration after a complaint had been filed. In many cases, the complaint was lodged with the Farmers Home Administration prior to closing the house. In other words, notice from the prospective borrower was given to FHA in advance of purchase, and in many cases, these admonitions were ignored, and borrowers were advised to go ahead and sign up and get in the house, and FHA will try to take care of it later.

My question to you is, do your rules and regulations that you have now promulgated take this into account and try to guard against procedures of this type in the future?

Mr. ELLIOTT. Mr. Neville, do they?

Mr. NEVILLE. They certainly will help, but you cannot overcome everything.

I would like to make this observation. We are not aware of such situations, nor has it been reported to me by any borrower that they had indicated to the county supervisor that they had deficiencies prior to the time of closing, and they went ahead and closed the loan and then did not have the deficiencies corrected. Had I known of such a situation, I will assure you that it would have been handled promptly.

Mr. ALEXANDER. Well, Mr. Neville, if the chairman would yield one question further. On the previous organizational structure of the Farmers Home Administration, as I understand it, the States pretty well determined their own policies as related to these matters and the national office, though it has attempted to provide leadership in policies, just didn't seem to quite penetrate the State offices, is that true or untrue?

Mr. NEVILLE. Well, I think that probably you can find that situation in every organization where it takes a period of time to have new thoughts and new ideas sink in.

Mr. ALEXANDER. Yes, sir.

Mr. NEVILLE. And, also, we got into a situation where we were developing rapidly as far as housing was concerned, and in view of the rapid development, I think there were many oversights that took place.

Mr. ALEXANDER. In other words, that was in 1960, and in 1973 you increased in volume. How much?

Mr. NEVILLE. I don't know, but dollarwise we went from about $138 million into the billion-dollar category.

Mr. ALEXANDER. Well, for future reference to me as a legislator in the U.S. Congress, I would like to prevent these types of things from happening in the future.

Could you explain to me how it was that the U.S. Government was funding a program of this magnitude without the proper national leadership and guidance to safeguard the taxpayers' money that was spent on the projects of this type?

Mr. ELLIOTT. May I answer that question, please?

Mr. ALEXANDER. Yes, sir.

Mr. ELLIOTT. In answer to your original question, nationwide we increased in the past 5 years 156 percent. This program was developing from a base of farm experience of Farmers Home personnel without the sophisticated knowledge of building practices, building codes, and requirements. It is therefore quite possible that they were not trained and qualified to absorb this additional burden as rapidly as it was placed upon them.

Now, on the matter of national leadership, two areas must be considered to assure that we do not continue to have this situation. One, administratively we must take corrective action both in personnel matters as well as procedural. The other is to step back with the HUD Housing Policy Task Force study to see just what we have done during this rapid expansion and what we should do better in housing in general. I agree with you absolutely. It is incumbent upon us to take the necessary actions to assure this program is properly administered.

Mr. ALEXANDER. But for future reference, should the U.S. Congress have oversight hearings of the administrator of a program to determine in its own judgment whether or not regulations have been promulgated which safeguard the taxpayers' money?

Mr. ELLIOTT. Yes, sir, by all means.

Mr. ALEXANDER. I would only say, Mr. Elliott, Mr. Chairman, we should be ready to increase our staff size up here a hundredfold if we are to provide this type of oversight in every program that we fund here.

Mr. ELLIOTT. I will leave that to your judgment, gentlemen.

Mr. FOUNTAIN. I think what Mr. Alexander is pointing out is that it is absolutely impossible for Congress, with its legislative committees and investigative committees—the Committee on Government Operations being the primary one in the House—to maintain oversight, except in a spot check way, over the many agencies under its jurisdiction with respect to efficiency and economy. It is just absolutely impossible.

That is why the Congress has to depend upon responsible management at the top. As I read this report of the Inspector General——

Mr. FUQUA. I have a question.

Mr. FOUNTAIN. I will get back to you and yield.

As I examine it, it seems to me—and I am one who believes in local initiative and local incentives and decentralization to whatever extent is reasonable and proper and appropriate, even though sometimes I find it can be overdone—that these reports reveal to a large extent too much reliance by Washington on the State offices and local offices to carry these jobs out without having adequate supervision.

Mr. ELLIOTT. Let me deal with both questions. If you would like to interpose your question now——

Mr. FUQUA. No, please go ahead.

Mr. ELLIOTT. The need for the Congress to maintain oversight of the administration of any of FHA programs is understandable. The feasi-

bility of Congress to maintain continuing oversights regarding the many agencies under its jurisdiction would be, as you pointed out, impossible.

We have continually provided you with anything in terms of necessary information from the Inspector General, who in fact, is available to you to accomplish your responsibility to that degree. In addition, the FHA Administrator stands accountable to the Congress for the use of public funds.

Mr. FOUNTAIN. We appreciate that attitude.

Mr. ELLIOTT. Concerning your question of the local and State abilities of the FHA employees to perform their functions, Washington has real restrictions as to its ability to cover all matters in detail. The General Accounting Office does keep an oversight on us.

We do use the Office of the Inspector General to keep watch over our activities. Also, we have to depend upon our troops in the field to accomplish the mission. Headquarters cannot do the fighting. Very simply stated, the problem, as pointed out initially, is to make sure all our procedures and management systems are amenable for the people in the field to do their jobs, and that we select the kind of people who can do the job or select out those who cannot.

As to relying on decentralized operations, I know of no other way to do it.

Mr. FOUNTAIN. I understand that, but let me give you an example, and then I will yield to Mr. Fuqua.

I have had a number of people who have said to me that one contractor gets all the work in this area, and these complaints are common.

What kind of examination do you make to see whether or not the field is competitive and that other contractors are offered opportunities to build these homes?

Mr. ELLIOTT. Our procedures should deal with equal opportunities and capabilities of anybody who can competitively bid but I am not familiar with the details.

Mr. NEVILLE. There is absolutely no restriction on who can participate in our program. The question really arises as to what information we pass on to industry of the availability of this type of financing for producing housing in rural areas.

In some jurisdictions a greater effort is made to educate the builders in the community as to what should be done and what kind of market exists.

I am not aware of any particular priority given to any contractor to produce—the market is wide open to any man who is a builder and who will produce for us.

Now, we do require a builder to submit applications and apply for conditional commitments. Until recently we went along with oral commitments in many situations which permitted them to build. The number participating in building in the rural communities is limited. The volume builders are located in suburban and urban areas. Consequently, few are participating. Some are much more active than others. Others do not want to get beyond the father-and-son type of builder. But, in no way do we select. If it is a bid situation, it is put out to a public bid or negotiated between the homeowner and the individual builder.

Mr. ALEXANDER. Mr. Chairman, would you yield for one more question on that particular point, sir?

Mr. FOUNTAIN. Yes.

Mr. ALEXANDER. I am pleased to know that the Farmers Home Administration has that national policy. But, I can take you into every single community in my congressional district—I have 21 counties—and I can find at least one builder that does not believe that. In fact, the charges of favoritism for builders within the Farmers Home Administration structure persist even though we have promulgated these recent regulations which say that competition shall be there and that everyone shall have the opportunity to bid on it. I can parade witnesses in here all day long that will refute that statement.

Whether or not the policy has changed—I hope it has—but I certainly know that the policy for years when I first heard of the complaints of favoritism and in-house favoritism within the Farmers Home Administration——

Mr. ELLIOTT. If those allegations are a fact and I accept them as a fact, I would like to deal with them on a regular Office of the Inspector General investigation. If I find collusion or any conflicts of interest on the part of individuals, we will deal with them.

Mr. ALEXANDER. Thank you, sir.

Mr. SCOTT. As Mr. Neville expressed, there have been complaints in recent years, and there are still complaints that individuals or certain contractors get the preponderance of the business.

We in the Office of the Inspector General have investigated these and some of them have been substantiated, but the majority of these complaints are washed out. FHA is financing modest houses, and some of these people that wanted to participate wanted either to use substandard materials or shell houses or they wanted to go the other route and build more expensive houses than FHA could finance.

Mr. ALEXANDER. I would take issue with you on that point but we do not have the time to discuss it further.

Mr. NEVILLE. One of the things that I have done, because of the shortage of builders in rural areas, is to publicize the fact that there is an excellent opportunity for builders to get in and start producing housing for rural America in rural communities. We know there is a shortage of builders there.

Mr. ALEXANDER. We all agree to the need.

Mr. NEVILLE. Right, sir, no question.

Mr. FOUNTAIN. Mr. Fuqua.

Mr. FUQUA. First of all, let me say that our State office in Florida has been very cooperative with my office. However, I think that we have all heard complaints from other parts of the country. The programs are administered differently in the several States because of the various capabilities and interests of the administrators, but in Florida they have been very cooperative with me. Let me state that.

Mr. Neville, in your responsibility as head of the rural housing program what procedures have you developed to make sure that you effectively address consumer housing complaints?

What are your investigative procedures? Do you monitor your State administrators handling these programs? Do you talk to any of these people or witness the procedure by which they operate?

Mr. NEVILLE. Primarily the oversight aspect of the operation is conducted by OIG and GAO. Our program and technical service staffs are sent out periodically or as a result of a complaint to see whether it is justified or not. We have done this on numerous occasions in the last couple of years.

I, myself, visit projects and look at housing. I returned from Colorado last week. While there, I went into housing under construction and visited some homes that were already completed. I have done the same thing in Illinois. I have asked people whether they were contented and satisfied with the construction.

Mr. FUQUA. Has that just been recently or was that the practice 3 or 4 years ago?

Mr. NEVILLE. Well, I have only been with the organization a little over 2 years.

Mr. FUQUA. I see.

Mr. NEVILLE. Since that period of time we have initiated many steps to assure better construction. For instance, we have adopted the HUD minimum property requirements. We had minimum requirements before, but they were not universally known nor accepted by the building trade. We put those into effect to attract into the building program in rural America builders who were conversant with those particular requirements and could produce housing in volume.

We have established a construction complaint procedure. We have even gone further than that. We may employ suspension or debarment.

Mr. FUQUA. Is the person who buys a home aware of this mechanism for making construction complaints?

Mr. NEVILLE. He should be if our County Supervisor is giving proper counseling. County Supervisors should not only do that, but most of them go through the house with the purchaser prior to the closing.

Mr. FUQUA. But what about when the County Supervisor is not carrying out his responsibility? We have had some problems with this, although the State office has been very cooperative in adjusting these deficiencies. How does a person know where to go? Presently, the consumer calls his congressman or somebody and then we are on the firing line.

I was just wondering if the Department is aware of some of these complaints, of which some are legitimate and some not legitimate?

Mr. NEVILLE. I have had people call me on the telephone and ask about a complaint that they couldn't get reconciled. I have picked up the telephone and called the director and asked him to give me a report within 48 hours explaining the situation so that I could communicate with the individual who lodged the complaint with me. In most instances I would say that the complainant was justified.

Some offices were dilatory in getting after the builder to do it promptly, and usually the reply from the builder would be, "Well, I am too busy. I am going to do it, but I haven't gotten around to doing it yet."

You can only accept that type of deferment for a limited period of time. It cannot go on too long.

Mr. HANSON. Could I add to that?

Mr. FUQUA. Certainly.

Mr. HANSON. I want to be sure that we all understand that this agency does not ignore its State organizations. Not through the

years—and I have been with the agency for about 4 years here in Washington—but I know that even prior to that, the agency has operated in the 1,700-plus county offices through the 42 State offices, they have specialists on their staff for housing, community programs and farmer programs. They have district supervisors in each State and through our review system, for about the last 3 years now, the district supervisors have been required to review the entire loan program in their districts once a year. All delinquent loans are reviewed with the County Supervisor. He makes regular calls in the county offices.

People from this office in all programs visit the various State offices a couple of times a year, and many of them go out in the country and visit the county offices, and often visit the borrowers, but even that, of course, makes it impossible for us to personally see it will—at the present time we must have 600,000 to 700,000 housing borrowers, let alone the community borrowers, and farmer borrowers.

All I want to say is that I hope we don't get the impression here that we are not paying attention to our people out there, we think we have good contacts.

Mr. FUQUA. I am sure you are conscientious. I do think you should step up your efforts.

Mr. HANSON. This obviously is true.

Mr. FUQUA. When we have called these problems to the attention of the State office, they have been corrected, but many times they should have been corrected or discovered before that. A case in point is that of a man who applied for a disaster loan in August for damages caused by Hurricane Agnes. However, he just got his check the other day after I had to call the State Director to expedite the processing of this application.

Mr. ELLIOTT. May I reply to that, Mr. Congressman?

Mr. FUQUA. Yes.

Mr. ELLIOTT. First, I am concerned that you would have to share the firing line with our agency.

Mr. FUQUA. That is part of our job.

Mr. ELLIOTT. We try to correct such problems through procedure changes and other efforts. I personally believe that in recent years there has been a very strong and sincere endeavor to solve many of the problems being discussed here today.

I am dedicated to the effort of correcting these outstanding issues.

That you should have to become involved, I consider regrettable. This organization should be responsive at the local level without requiring your assistance.

Mr. FUQUA. This happens in many agencies of the Government not just FHA.

Mr. FOUNTAIN. How long have you been with the agency?

Mr. ELLIOTT. I have been with the agency since March 20, 1973.

Mr. FOUNTAIN. I think the record should show that you have been there just a short time.

Mr. ELLIOTT. I would also like the record to show that I am quite impressed with their dedication and accomplishments to date. They have brought housing to the rural areas. Rural Virginia, the area that I know best, would never have progressed as far as it has without their efforts. I cannot speak for other States, although I've had assignments in rural areas in other States. While I am familiar with their problems

in trying to "catch up" with the new and varied occurring developments within the FHA programs, I think the intent of the Congress is being accomplished, notwithstanding the mistakes.

Mr. BROWN. I would concur with that. I am interested in determining where the muscle is located that wags the tail on this dog. If somebody wants to provide himself housing, does the FHA seek out potential buyers?

Mr. NEVILLE. Not usually.

Mr. BROWN. So, let us say that he goes to the savings and loan first and asks that he would like to build a house. They say we cannot handle you because you are not economically within our area of activity. What does he do? Do they send him to the Farmers Home Administration or does he first go to the builder, or, in fact, is he sought out by the builder?

Mr. NEVILLE. It is a combination of all of them. In some areas it is the savings and loan. When they examine the credit capability of the borrower, they will realize that he cannot make the 10-percent downpayment. They may say that they cannot make the loan. They may refer him to the Farmers Home Administration.

Mr. BROWN. Does he have his house plan and builder at this point?

What I am getting to is this, it seems to me that some builders may very well make a business of going out after the guy who is going to be a Farmers Home Administration client and has the house plan or things all arranged, the deal packaged up, and then finds the client, and says, "Let's go down together to the Farmers Home Administration and get this thing worked out."

How often does that happen?

Mr. NEVILLE. That's typical of the way that it happens. The builder is in the business of building homes to sell and make money.

Mr. BROWN. So the builder brings them in hand and hand to the Farmers Home Administration after the potential buyer has checked with the savings and loan and found out that he could not get a loan in the first place.

Now, I am sure that this satisfies the social feelings and the social accomplishments of the Farmers Home Administration. We have so much money, so many loans that we can guarantee, and here is this builder bringing these people here and he is helping me do my job of bringing rural housing to the rural areas.

The relationship builds up between the Farmers Home Administration and the builder. Basically that is if you have a builder, that he could decide he is going to use that Federal program to keep himself and his construction activity business.

Is that a fair statement?

Mr. NEVILLE. Right, sir.

Mr. BROWN. Do you make some special efforts then to caution your people in the field against too close a relationship with the builder and to make sure that they have the opportunity to meet with the client at some time when the builder is not present so that they can say, now you have these rights of complaints in case the building contractor has taken advantage of your good nature and has built it badly and so forth and so on.

Is that clarification or that sort of point of insistence made to your administrators in the field?

Mr. NEVILLE. I cannot vouch for that fact, but our supervisors should do precisely what you are saying.

Mr. BROWN. In view of the fact, however, that the builder is the muscle that wags the tail on this dog, I think, more than anything else, you should.

Mr. NEVILLE. Well, I cannot vouch for that as a fact. An alert county supervisor, when an applicant is brought in, would talk to the purchaser because we have to determine his eligibility and his capability of purchasing a home. We have also to determine whether that home is suitable and adequate for that particular family.

Mr. BROWN. But by that time, you see, he has been sold the house, the financing and a lot of other things, by the builder, and what I am trying to suggest, at some place along the line the local administrator should separate the client from the builder so that the relationship is independent, with the local administrator and the client, and is as strong as perhaps it is with the builder.

I just get a vision here of the builder being the guy who is manipulating this whole process, perhaps including the county supervisor.

Mr. NEVILLE. Just like a salesman who is selling life insurance for a company. He goes out to find an individual to whom he can sell a policy. So, he talks with him and endeavors to sell him a policy in his particular company, not in somebody else's company.

Mr. ELLIOTT. Could I comment on that?

How does an FHA client like that ever find out he can get a house or that FHA is his only source of financing for his house? Banks and various people who would not service him refer him to Farmers Home. The builder also refers him to the Farmers Home Administration. In addition, we have an ongoing program that disseminates information to rural communities concerning the kinds of services available to individuals and others through the Farmers Home Administration.

Last, but not least, disciplining our supervisors specifically to the fact that they shall not be in close relationships with a builder or with a bank or with anyone else when these issues arise. There are cases, as you say, Mr. Congressman, and they have to be ferreted out and dealt with as malfeasance on the part of the county supervisor.

Mr. BROWN. Considering the client that you are servicing, it occurs to me that his relationship is not first with his banker or savings and loan. He probably doesn't operate in that sphere as naturally as some of the rest of us who may be at some of the higher income levels.

Mr. ELLIOTT. I would not agree with that observation. Builders, for example, play an extra role.

Mr. BROWN. So, early in the game—and I am talking about the small community—he locally goes to the local lumber company or somebody that he thinks knows something about building, and he wants to know how much it is going to cost to build his house, buy his own house. The person he may wind up with, either because he initiates this as the client looking for a house, or initiated it because the builder is looking for a market for his service and his products.

I am not criticizing that because it seems to me that that is what has helped succeed in bringing rural housing into the rural areas where you are dealing on the basis of one and one rather than a large group of housing facilities. But it does occur to me that it puts the

builder in this Federal program in the position of control over the masterminding driver's seat, and, again, is the muscle that wags the tail.

The builder is the one that is bringing all this together and making it work to a greater extent than we might recognize otherwise, and at that point you have really got the possibility of some problems here with reference to the local administrator unless the local administrator is particularly alert to those possibilities. If the builder is also sitting there with the client, does the local administrator ever present alternatives to him?

Mr. ELLIOTT. Let me answer the two parts of your question with the part of the problem that we have.

Initially, as you are well aware, in many of the rural areas, there was not construction capital available. One effort is to bring construction capital into the rural area, and that is point 1. Point 2, as to the question of control of the property by the builder, in the instance that you find the borrower and the builder working together with the Farmers Home Administration County Supervisor to get the job done, there could be a question. If such a question or allegation is substantiated then we should be doing something about it.

I can submit for the record that we have taken individual actions where allegations were provable, either criminal or personal, and in two cases of builders where collusion was observed, we have instituted, in fact, effectuated the debarment of them from the program. So, in effect, we are trying to administer the program properly within a free enterprise system.

Mr. BROWN. I am not against the free enterprise system, and I am for the builder going out and doing this.

But I am telling you this because not so many years ago my wife and I had a builder take us through a house. There were stakes out in the ground, and as we went through the house we went through two stakes, and that was the front door. After we spent half an hour there, we were laying out everything and had everything arranged until we realized that it wasn't quite what we wanted.

I think that your administrators ought to be particularly cautioned to be very careful of the builders who are making this program all possible by getting out there and looking for business and bringing your clients in, because that is where some of your problems may be springing from.

Mr. ELLIOTT. I accept your good advice, we will put in the record our instructions to the field supervisors with respect to the issues brought forth.

[See app. 5.]

Mr. BROWN. Instructions you now have?

Mr. ELLIOTT. If they prove inadequate in your judgment, we are certainly willing to address this point more definitely.

Mr. FOUNTAIN. We will get back tomorrow with some more details concerning deficiencies.

Mr. NAUGHTON. Have you found any instances of situations in which it has appeared or there is evidence that State or local officials have actually given preference to contractors as opposed to the legitimate interests of the borrower?

Mr. ELLIOTT. May I pass this over to Mr. Scott?

Mr. SCOTT. There have been some instances of this.

Mr. NAUGHTON. I believe that we will discuss that type of situation with respect to South Carolina tomorrow.

Mr. FOUNTAIN. Mr. Elliott, FHA has provided a brief history of the Farmers Home Administration and its predecessor agencies, which originated in the 1930's.

Would you say that the primary function of FHA and its predecessor agencies through at least the midsixties was to provide necessary credit for agricultural purposes?

Mr. ELLIOTT. Yes, sir, I would say it dealt with farmer problems and farm needs for credit where it could not be obtained elsewhere.

Mr. FOUNTAIN. Is it true that during that period of time expenditures for housing purposes did not amount to as much as 20 percent to 25 percent of total expenditures during any one year?

Mr. ELLIOTT. That would be correct.

Mr. FOUNTAIN. Through 1965 did the total expenditures by FHA for all programs amount to as much as a billion dollars a year?

Mr. ELLIOTT. No, sir.

Mr. FOUNTAIN. FHA's figures show total annual expenditures were just over a hundred million dollars in 1946 and reached about $800 million in 1965. These figures represent loan volume plus administrative costs, and the cost to the taxpayers would be substantially less. Is that right?

After 1965 were there increases in the total FHA expenditures through the appropriations process?

Mr. NEVILLE. The volume of business, particularly housing started to increase at that period of time.

Mr. FOUNTAIN. I have figures indicating that the 1972 total is $2.8 billion. Is that right?

Mr. NEVILLE. That's right.

Mr. FOUNTAIN. What is the current total for housing only?

Mr. NEVILLE. For housing, just $2 billion plus for this current fiscal year.

Mr. ELLIOTT. For the total program it is in the magnitude of $3.4 billion with housing being about $2.1.

Mr. FOUNTAIN. How much of that is agricultural programs?

Could you supply that for the record?

Mr. ELLIOTT. Yes, sir.

Mr. FOUNTAIN. Then how much is the administrative cost?

Mr. ELLIOTT. We'll provide that for the record.

[See following pages.]

Mr. FOUNTAIN. Has the percentage of the total FHA expenditures involving housing programs increased substantially in the past few years?

Mr. NEVILLE. Yes, sir, it has.

Mr. FOUNTAIN. I wonder if you could give us the approximate percentage.

Mr. NEVILLE. It is probably about 58 percent of the total funds available for the Farmers Home Administration.

Mr. FOUNTAIN. Prior to 1967 it never exceeded 25 percent?

Mr. NEVILLE. That is correct, sir.

Mr. FOUNTAIN. How much of FHA's expenditures represents a net cost to the taxpayers and how much is expected to eventually come back through repayment of loans, interest payments, and so forth?

Mr. NEVILLE. We sincerely hope that all the dollars will come back, money loaned for housing purposes will be repaid.

Mr. HANSON. We do not have the exact figures. I think that the budget is right at a $110 million for this program, this total program.

Mr. FOUNTAIN. Would you provide us with the details for the record?

Mr. ELLIOTT. Yes, sir.

[The following information was subsequently provided:]

Estimated program levels, fiscal year 1973

[Dollars in thousands]

	1973 current estimate
Rural housing programs:	
Interest credit housing loans	$842,000
Noninterest credit housing loans	1,016,000
Subtotal	1,858,000
Rural rental housing loans	138,000
Farm labor housing loans	10,000
Farm labor housing grants	2,176
Rural housing site loans	5,900
Mutual and self-help housing grants	3,729
Very low-income housing loans	10,000
Total, rural housing	2,027,805
Farmer programs	1,674,500
Community programs	469,539
Total, FmHA program level	4,171,844
Administrative funds	129,612

Of the rural housing funds shown above there were $30 million housing loan funds used by the farmer programs during the 1973 fiscal year. These funds were used for farm dwellings and essential farm service buildings.

For the estimated amount of net cost to the taxpayer and amounts expected to eventually come back through the repayment of loans and interest payments. Known costs are considered in the following:

Of the $1.618 billion obligated for housing during fiscal year 1972, about $8 million was for grants and will not be repaid. Further, losses from foreclosures could approach 0.1 percent or about $1.5 million. It is estimated that interest subsidy costs related to 1973 loans will be about $300 million. This will be partially offset by about $30 million of net interest revenue on those loans made at 7.25 percent. Combining the above figures produces a net cost of $279.5 million for the 1973 housing program.

Other nonsubsidized loans made in the year are expected to be repaid with interest at 7.25 percent.

Mr. FOUNTAIN. I believe you stated that the major share of FHA housing activities consists of single family home loans.

About what percentage of FHA's total expenditures for housing programs consists of such loans?

Mr. NEVILLE. You mean obligated, or made available for them?

Mr. FOUNTAIN. Yes.

Mr. NEVILLE. It is probably 95 percent.

Mr. FOUNTAIN. 95 percent?

Mr. NEVILLE. Yes, sir. It is the biggest portion of our applications. Our next largest is the multifamily, which will run about $138 million this year.

Mr. FOUNTAIN. To what extent are Federal subsidies involved directly or indirectly in section 502 loans; both for moderate income loans and when interest credit loans are involved?

Mr. NEVILLE. Where moderate income loans are concerned, the interest rate we established in the last couple of years was 7½ percent. That interest rate was about a point and an eighth above what

we were paying for money borrowed from the Treasury; consequently, we were making money on that.

The exact dollar amount for total subsidies for last year involved about $665 per house, overall.

Mr. NAUGHTON. This $665 a house, would that involve only interest credit loans?

Mr. NEVILLE. That is right

Mr. NAUGHTON. Do you have a figure as to the approximate amount you would estimate that would constitute a subsidy, if there is any, in a moderate income loan?

Mr. NEVILLE. There is no subsidy in moderate income loans because the interest rate we are receiving is higher than that which we are paying for the money that we are borrowing.

However, because of the change in the money market that has occurred in the last few weeks in the sale of our notes, we may incur a deficit between seven and a quarter and what we will have to pay for money on the open market.

Mr. NAUGHTON. In other words, based on what you pay for money and the interest rate you charge for loans, you may come out ahead or you may come out behind depending upon the fluctuations in the money market and the interest rates.

Do you maintain the interest rate at a fairly stable level on moderate income loans?

Mr. NEVILLE. In the last couple of years we have entered into agreements with HUD and decided that the interest rates for both agencies, since we are both dealing with housing, the rates should be more or less uniform. So we established ours at 7¼ percent and their interest rate is 7 percent plus one-half of 1 percent mortgage premium.

Mr. NAUGHTON. Do you raise your rates when the cost of money goes up, or do you try to maintain a stable——

Mr. NEVILLE. That question will come up soon because we establish the interest rate annually, before July 1. We will give it very serious consideration as to whether the interest rate should be raised.

Mr. NAUGHTON. Up until fairly recently, the 7¼ percent was enough to pay the cost of the loans?

Mr. NEVILLE. During the period of time that I have been here the 7¼ percent appeared to be adequate.

Mr. NAUGHTON. But $665 per house would be your estimate of the subsidy?

Mr. NEVILLE. Yes. The average interest rate would be about 2.8 percent on an interest credit loan.

Mr. FOUNTAIN. I would like to ask just a few questions now concerning the differences between the FHA and HUD programs.

The Department of Housing and Urban Development has a very extensive program for homeownership loans. In your judgment, Mr. Elliott—and I see that you have been learning pretty fast in a short period of time—what are the major differences between the FHA and the HUD programs, particularly with respect to the geographic areas in which the programs operate and the methods used?

Mr. ELLIOTT. Mr. Neville will answer that. He previously was with HUD and came with FHA a little over 2 years ago.

Mr. NEVILLE. We are limited to the geographical area of 10,000 people. The HUD, Federal Housing Administration, if I recall correctly, has the authority to make and insure loans anyplace in the United States.

The program operation is basically the same. We follow similar subdivision requirements. We have the same minimum property requirements. We both look to see that the borrower has repayment capability for the loan. However, the Federal Housing Administration borrowers have expenses that ours do not have. For instance, they have application fees and commitment fees. They also have to pay points. The purchase of a house financed under section 235 is more expensive than the purchase of the identical property under section 502.

Mr. FOUNTAIN. What limitations, if any, are there on the extent to which the Farmers Home Administration can make loans in or near urban areas?

Mr. NEVILLE. We have certain legal and administrative limitations.

Mr. FOUNTAIN. Much was said about this in the Inspector General's report.

Mr. NEVILLE. When the areas are delineated, you will find that we are coming closer to urban areas in some instances because our county supervisors have drawn the line too close to the urban areas. Some lines should have been out where it is more rural in character.

We have endeavored to correct those situations. People have appealed to Washington, to be included in a rural area. We have analyzed some situations close to urban communities. In 2½ years, I don't think we have approved one. We have general guidelines and instructions. The county supervisors determine whether the area is or is not rural. It is his judgment. As indicated in the report, there can be differences of opinion. We think that we have obtained more uniformity. About 2 years ago, regulations were issued which brought the State offices into the determination to secure uniformity within the State. There is a specific delineation around each place with 10,000 or more population. County supervisors make their recommendations to the State office where it is received. The lines are then finally affirmed.

Mr. FOUNTAIN. Is it uniform at this time, or does that depend upon your urban areas?

Mr. NEVILLE. It will vary. What is rural in relationship to Washington, and what is rural in relationship to small towns, are two different things. The State offices have introduced uniformity within a State.

Mr. FOUNTAIN. The limitation is imposed at the local level, but is worked out in conjunction with the State levels?

Mr. NEVILLE. There are guidelines in the regulation.

Mr. FOUNTAIN. Could you give just some examples of your guidelines, or will you supply those for the record?

Mr. NEVILLE. We will give you the definitions.

[See app. 6.]

Mr. NAUGHTON. Are the State offices required to follow guidelines?

Mr. NEVILLE. They certainly are.

Mr. NAUGHTON. Although the State may determine what is an urban area?

Mr. NEVILLE. They just make it with respect to the rural area.

Mr. NAUGHTON. Do they have to do that in exact accordance with the guidelines that are laid down from Washington?

Mr. NEVILLE. Sometimes it is a matter of judgment, and I could say they are not too close. Some areas are really a borderline situation.

Mr. FOUNTAIN. You may find a metropolitan area in a small town has extended all in one direction, but 3 or 4 miles the other way they

haven't done a thing and are unwilling to do it, and this might well be a rural area.

Mr. NEVILLE. In El Paso at one time, we were out in a rural area. The city limits were extended, and we were included within the city of El Paso.

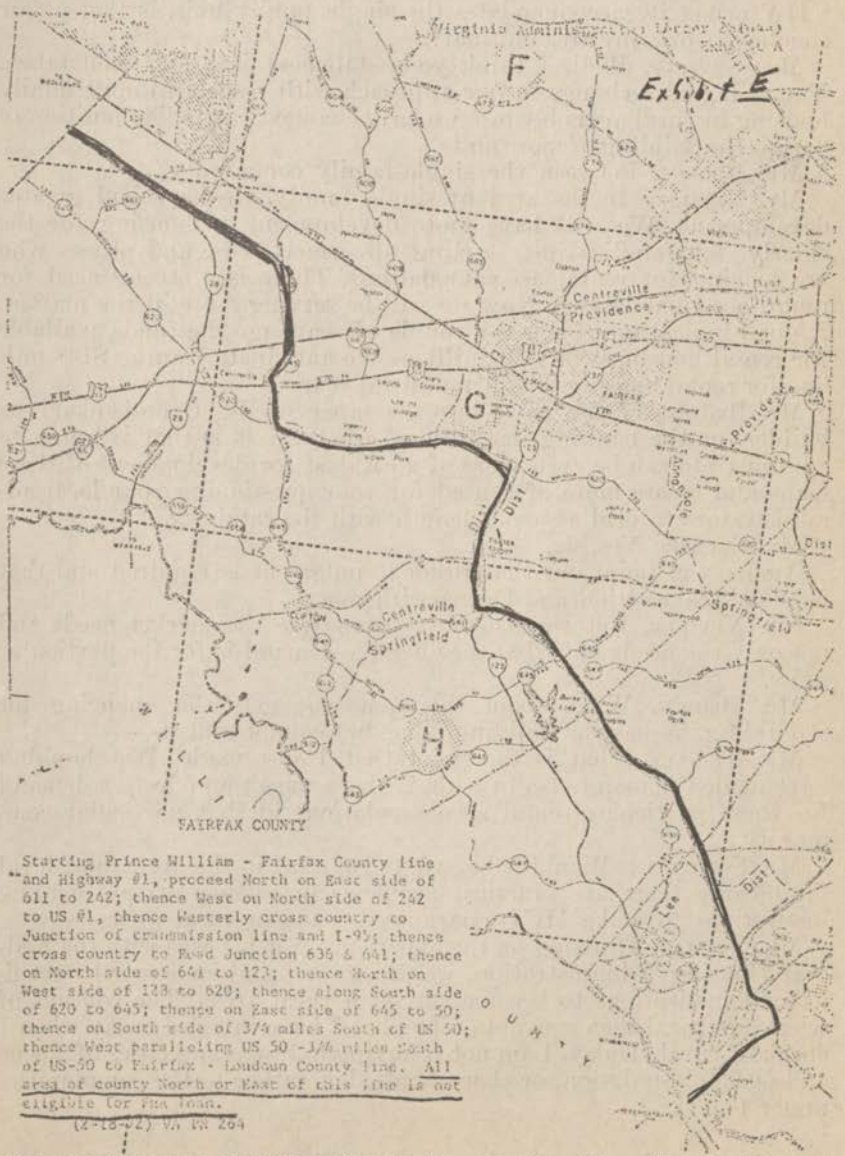
Mr. NAUGHTON. Do you happen to know where the rural area for your program is in Fairfax County, Va.?

Mr. NEVILLE. I don't know just exactly.

Mr. NAUGHTON. Perhaps you could supply that for the record?

Mr. NEVILLE. Yes, sir, I will.

[The following information was provided for the record:]



Map showing areas of Fairfax County, Va., considered "rural" under Farmers Home Administration programs

Mr. NAUGHTON. I am just wondering how close to Washington in Fairfax——

Mr. NEVILLE. Two years ago a case came up. It was handled through our Virginia office. They pointed out that there were some remote areas of Fairfax County that were considered rural, but if that is true today, I don't know.

Mr. FOUNTAIN. Does the Federal Housing Administration have authority to make loans in any jurisdiction? Can HUD guarantee loans in rural areas?

Mr. BROWN. Mr. Chairman, it is my understanding that HUD operates in the multifamily housing field in the rural area, and the FHA primarily accommodates the single family unit, is that a fair conclusion, or is my area unusual?

Mr. NEVILLE. Well, I think your statement is pretty well taken. You will find a change in our approach with respect to multifamily housing in rural areas because we have changed our policy position to permit the building of more units.

Mr. BROWN. Between the single-family community?

Mr. NEVILLE. In the area of single family, we have had greater development. We will have more development of housing for the elderly, for families just starting up—newlyweds, and others who are looking for rental accommodations. There is a strong need for rental accommodations. Now we will be serving more of the market. A good indication of this is a couple of years ago the funds available for rental housing were $21 million. We anticipate loaning $138 million for rental housing this current fiscal year.

Mr. BROWN. If you move into that area, wouldn't the banker, the builder, or the banking institutions, whatever it is that is going to administrate can be even more of a catalyst for development of these loans and create more of a need for your questioning your local administrators to deal at arm's length with the catalyst?

Mr. ELLIOTT. Yes, sir.

Again, you point out that prudent judgment is required and that we should take action, and I agree with you.

Mr. NEVILLE. But we also have to analyze the market needs and not only the needs but what the effective demand is for the particular units.

Mr. BROWN. What about the man who gets the financing for a building, he has the building done, but cannot rent it——

Mr. NEVILLE. That is the point that I just made. We shouldn't have made the loan to begin with, if there wasn't an effective demand for those particular rental accommodations in that particular community.

Mr. FOUNTAIN. Would it be safe to say that in the absence of legal limitations, there are practical problems in getting private lending institutions to make HUD-guaranteed loans in rural areas——

Mr. NEVILLE. Drawing on the experience, when I was with the Federal Housing Administration, we did go out and endeavor to get financial institutions to become active in rural areas. The concept of what was rural then was not quite what I have in mind today when I speak of rural. Today, I am not referring to towns and cities of 25,000 and 50,000 population, or thereabouts, but rather to the communities under 10,000.

Mr. FOUNTAIN. We still call that rural down my way. I think the largest town we have is about 40,000 in my congressional district.

Mr. ELLIOTT. Right, sir.

Mr. FOUNTAIN. In your judgment, what are the major advantages or disadvantages of FHA methods of making direct loans, compared with HUD methods of guaranteed loans by private lenders?

Mr. NEVILLE. If we look at the entire area in which we are doing business, it is absolutely essential to have the Farmers Home Administration in there making direct loans for many reasons. There is a shortage of mortgage credit in rural communities. Financial institutions in the rural communities are limited as to funds for these types of investments. Again, they can make more money with what funds they have on short-term investments, consumer financing, financing cars, and so forth. Small financial institutions have a reluctance to invest in a long-term obligation. Thus, there is an absolute necessity for the Farmers Home Administration to be there.

Mr. ELLIOTT. I would like to enlarge upon that.

I am sure you are aware that the Rural Development Act authorizes the use of guaranteed loans. To the extent financial institutions in local rural areas will accept guaranteed loans, we intend to use that authorization.

Mr. FOUNTAIN. In this connection, I am told a GAO report compared a number of FHA homes in Georgia with similar homes financed through HUD guaranteed loans, and concluded that the homebuyers under the HUD program paid from 2.3 percent to 18.7 percent more than homebuyers under the FHA program. Are you familiar with that report or do you have any comment on it?

Mr. ELLIOTT. I think that HUD would have to answer that——

Mr. FOUNTAIN. This was the GAO report.

Mr. ELLIOTT. Yes, I believe my answer as to why the differences between the percentages——

Mr. FOUNTAIN. I think he gave some of the answers awhile ago.

Mr. NEVILLE. I do not have any knowledge of that particular report. I have not read it.

Mr. FUQUA. Was the comparison of similar loans or average HUD loans made because they are making loans to people in higher income brackets than—these were designed for people of low income.

Mr. NAUGHTON. This is a report that was recently made to the House Committee on Banking and Currency and we can get you a copy. The report took a number of dwellings that were similar and made an analysis of the various costs to the borrower under each type of financing plan. Of course, they have indications of savings to the borrower that could represent a subsidized item that is not subsidized under the other programs.

Mr. FOUNTAIN. More expensive homes being built, too.

Approximately, how large a staff does the Farmers Home Administration have?

Mr. ELLIOTT. I will answer that question.

In fiscal year 1973 we were authorized 7,554 full-time employees.

Mr. FOUNTAIN. How many of them are agricultural specialists? How many are housing specialists?

Mr. ELLIOTT. That is a good question. May I supply that for the record?

Mr. FOUNTAIN. Would anybody like to guess at that?

Mr. HANSON. Mr. Chairman, I would like to say that most of our county supervisors are agriculturally oriented, and most of them are agricultural specialists. However, they also administer housing programs at the local level. We have them in the State level and national levels in addition.

Mr. FOUNTAIN. Is one of the reasons that you are trying to give more training because of the report of the Office of Inspector General?

Mr. BROWN. Could we also ask you to bring, Mr. Chairman, if you think it appropriate, how they are dispersed geographically among the States?

Mr. ELLIOTT. We can supply that.

[See app. 7.]

Mr. FOUNTAIN. These housing specialists are specially qualified?

Mr. NEVILLE. Most of the training is on-the-job training, sir.

Mr. FOUNTAIN. How long is that?

Mr. NEVILLE. That is a variable situation.

Mr. FOUNTAIN. This is something that they do on their own?

Mr. NEVILLE. They come in as assistant supervisors. They are trained in a particular specialty in which there is a need. There is continuous training from the State staff in the particular specialty.

Mr. FOUNTAIN. Do you have an adequate number of properly qualified inspectors?

Mr. ELLIOTT. I will answer that. Apparently not.

Mr. FOUNTAIN. What are you doing specifically in that area?

Mr. ELLIOTT. We have now established a training school in Oklahoma. We are trying to educate our people in various aspects of the program, including inspections. We do hire temporary inspectors in the field when it is necessary. The point you made is that we have to improve our inspections. The competence for making credible inspections can be learned at this school.

Mr. FOUNTAIN. I have a constituent who was a HUD appraiser for a long time. I don't want to quote him, he said that he thought it was a good program, but some of the inspectors just happen to have some close friends. It is pathetic some of the houses that they have inspected and approved for these people to live in.

Mr. FUQUA. Mr. Elliott, what retraining programs do you have? Are you updating the local supervisors and orienting them to housing programs and other problems with which the Farmers Home Administration program deals?

Mr. NEVILLE. Let me say this, that beginning last year we started formally educating our people. Prior to that time, we ran a pilot operation in Pennsylvania. We included all county and assistant county supervisors to judge the effect the training program would have. It was only a 2-day session. We have observed the results carefully so the benefits could be evaluated. There are indications that it was a very successful endeavor. With the curriculum developed, we started training the housing chiefs, explaining the new programs, policies, sanitary requirements, inspections, and other structural aspects of the program so that the participants could, in turn, train their staffs. The program is continuing in Oklahoma. Housing specialists, architects, and engineers were briefed in architectural requirements and land development and planning.

The next phase will include new employees who are assistant community supervisors and lack knowledge. They will be trained in appraisals, credit analysis, and inspections.

Mr. FUQUA. A retraining program?

Mr. NEVILLE. A retraining program, but it will include new employees.

Mr. FUQUA. The gentleman to Oklahoma this year——

Mr. NEVILLE. Well, we had a long way to go the first time. The situation would depend upon what is needed and in what areas the deficiencies show up.

Mr. FOUNTAIN. How much larger is your current housing program in terms of expenditures than the program was say 10 or 12 years ago?

Mr. NEVILLE. Around nine times higher than in 1960.

Mr. FOUNTAIN. How does the number of housing specialists that you now have compare with the number you had 10 or 12 years ago?

Mr. NEVILLE. I have no way of really answering that question, sir.

Mr. FOUNTAIN. You have trouble determining who is a housing specialist?

Mr. NEVILLE. Right. Yes, sir. We have trouble qualifying people for that particular discipline. If you wish, we will try to get that for you.

Mr. FOUNTAIN. If it would not take a lot of unnecessary trouble, I thought if you had that information——

Mr. MALOTKY. I would assume that housing specialists also include architects and engineers. Ten years ago we had one architect and one engineer at the national level. Today we have a larger technical staff. We have architects on some of the State staffs to back up our county supervisors. We couldn't have one in every county office.

Mr. FOUNTAIN. Is it true that the Office of Management and Budget has ordered a substantial reduction in the number of FHA employees.

Mr. ELLIOTT. Let me turn that around a little bit.

The Secretary of Agriculture receives certain allocations. The manpower is distributed and the Farmers Home Administration receives its share of that. In terms of manpower—and I think I gave you the figures—we intend to work within our authorized ceiling and under the guidelines of the Secretary of Agriculture.

Mr. FOUNTAIN. Do you think you will be able to work with them?

Mr. ELLIOTT. Yes, sir. We are developing systems and ways to work within all of the resources allocated to us.

Mr. FOUNTAIN. Was FHA consulted in advance about these cuts?

Mr. ELLIOTT. It was discussed back and forth. I was on the other side of the coin at the time, and I will assure you that when you start to cut personnel resources, nobody is satisfied. We all took our cuts across the board, including the Farmers Home Administration. We will make every effort to take the necessary management actions that will permit us to work within our resources.

Mr. FOUNTAIN. When you——

Mr. ELLIOTT. We have these resources the Secretary, based on his priority, allocated to FHA. We accept these allocations.

Mr. FOUNTAIN. Can you give any figures, or if you cannot, will you supply them for the record, indicating how many employees will be eliminated by the cuts which you are taking?

Mr. ELLIOTT. We are trying to do this by attrition.

[The following statement was subsequently provided:]

NUMBER OF FMHA EMPLOYEES TO BE ELIMINATED DUE TO ANTICIPATED PERSONNEL CUTBACKS

FmHA anticipates the loss of approximately 750 positions from a present ceiling of 7,354, due to the fiscal year 1974 personnel cutbacks. Even though the present agencywide yearly turnover rate is approximately 13 percent, it is mostly in the clerical positions. This will require shifts in many professional and technical positions to fill the vacated clerical jobs resulting in an overall loss of employees in all occupational series. Studies are now underway to determine the most appropriate methods to maintain the highest possible program levels under the ceiling restrictions.

Mr. BROWN. Relating to the percent of money—I guess money is the way to get at the factor in terms of things like that. You administer disaster loans and that kind of thing in the areas covered under the availability of programs in nonhousing programs over the past several years—if you could benchmark years as opposed—the point I am trying to get at, but I don't know how to ask the question to elicit the answer that I want. It seems to me that there have been a lot of farm programs of an emergency nature and so forth which are administered by the Farmers Home Administration. They have come into being when a disaster is declared—the Farmers Home Administration gets the administrative responsibility of that, do you understand what I am saying?

Mr. ELLIOTT. Yes, sir, I do.

Mr. BROWN. What percentage of the increase has been there versus the——

Mr. ELLIOTT. I understand your question, and I will supply it for the record.

[The following data was provided:]

FmHA EMERGENCY FARM AND RURAL HOUSING LOANS DURING RECENT YEARS—EMERGENCY LOAN PROGRAM LEVELS, FISCAL YEARS 1970-73

[Dollars in thousands]

	Farm	Housing	Total
1970	$89,430	$4,450	$93,880
1971	127,636	4,962	132,598
1972	108,912	2,032	110,944
1973 (as of June 15, 1973)	523,229	[1] 7,557	

[1] As of May 31, 1973.

Mr. BROWN. What is the definition of a community program?

Mr. ELLIOTT. Water and waste programs. In the coming year, under the Rural Development Act, this may include other community facilities.

Mr. FOUNTAIN. Mr. Vander Jagt.

Mr. VANDER JAGT. Thank you very much, Mr. Chairman.

You mentioned in your statement the temporary suspension of providing backing up new commitments so that a study could be conducted erasing all the other agencies and departments of Government that relate to housing.

How active is FHA as a participant in that study?

Mr. ELLIOTT. Quite active. As a matter of fact, we have been able to cooperate on every one of the study group teams. We have State directors who are personally involved on two of them. We have county and State people on the teams and we taught—if I may tease Mr. Denton—the original study group to spell the word rural.

Mr. VANDER JAGT. As we look at the rural housing needs in this House study, are we looking at only the needs for today or are we projecting for the future?

Mr. ELLIOTT. It is all-encompassing. It goes out to year 2000 or so. I can supply that for the record; I am not sure of the projections. They are looking into future urban-rural migrations and patterns of the population as they are foreseeable. All of those factors will be placed into historical perspective to determine which direction we should be going.

Mr. VANDER JAGT. Thank you, very much.

Thank you, Mr. Chairman.

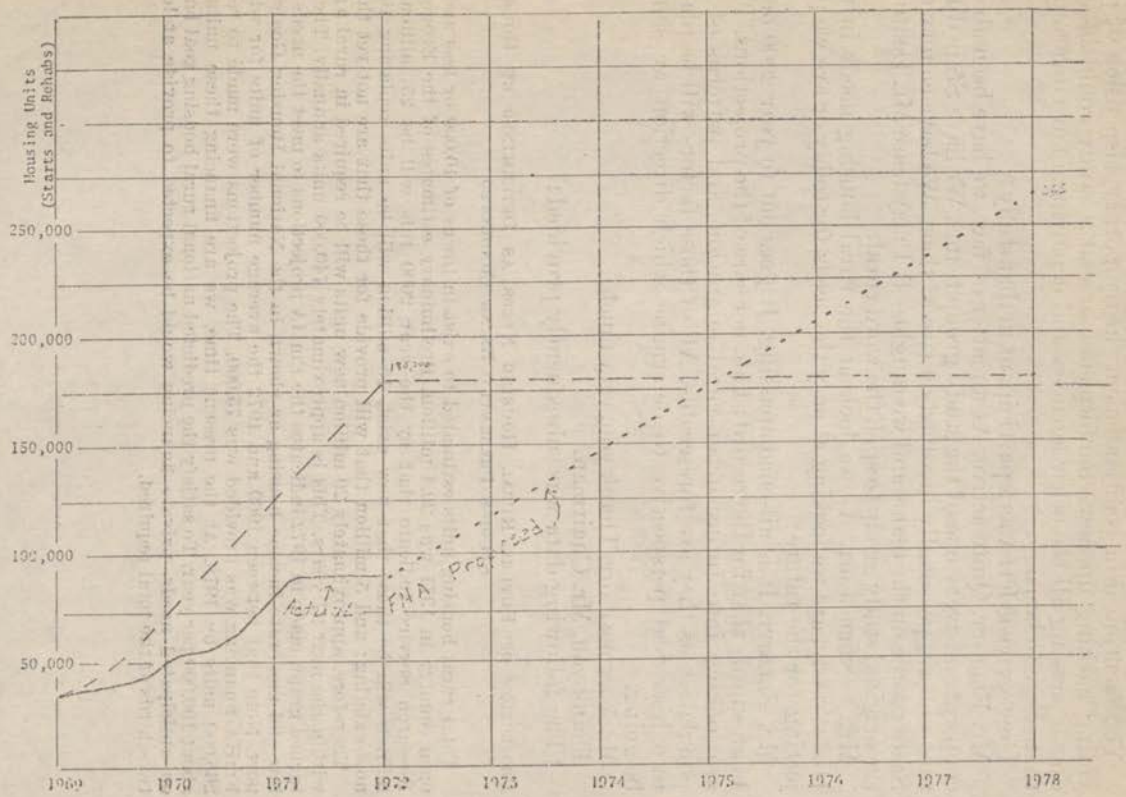
[The following data was subsequently provided:]

PROJECTION OF FUTURE RURAL HOUSING NEEDS AS DETERMINED BY HOUSING STUDIES PRESENTLY BEING CONDUCTED

Total rural housing units estimated to exist in towns of 10,000 or less and in open country in 1971 was 20.4 million. Preliminary estimates of the Economic Research Service indicate that by the year 2000 this will be 25 million; 5 million will be those that now exist, 15 million will be units replacing those now existing; and 5 million that will provide for those that are not yet there.

Therefore, approximately 20 million new units will be required in rural areas within the next 27 years. This is approximately 740,000 units annually. The attached graph made in 1972 indicates the FmHA projections to meet the needs for low and moderate income housing as shown in the National Housing Goals report. Note that between 1969 and 1972 the average number of units for which FmHA financing was provided was 75,000. The projections were made to reach 265,000 units by 1978. At the present time, we are financing these units at about 100,000 per year. To satisfy the predicted national rural housing goal based on anticipated needs, private financing would be expected to provide at least two-thirds of the total required.

USDA Portion of the National Housing Goals (Sales & Rental Units 1.5 million)
As Specified in Table IX of the Second Annual Housing Report



Mr. FOUNTAIN. We are going to recess at this time until 10 o'clock tomorrow morning, but at 9:30 in the morning we are going to show a movie.

Mr. NAUGHTON. If the arrangements for the projector and screen work out, we will have about a half-hour documentary film on Cameron County, Tex. I am sorry part of the sound track may be missing but I think that it will still be useful.

In the event that you want to be sure that arrangements have worked, you can contact the subcommittee office.

Mr. ELLIOTT. We will plan to be here at 9:30 a.m., tomorrow, sir.

Mr. FOUNTAIN. The subcommittee stands in recess until tomorrow morning.

[Whereupon, at 12:26 p.m., the subcommittee adjourned, to reconvene at 10 a.m., Wednesday, June 6, 1973.]

FARMERS HOME ADMINISTRATION
(RURAL HOUSING PROGRAM OPERATIONS)

WEDNESDAY, JUNE 6, 1973

HOUSE OF REPRESENTATIVES,
INTERGOVERNMENTAL RELATIONS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10 a.m., in room 2247 Rayburn House Office Building, Hon L. H. Fountain (chairman of the subcommittee) presiding.

Present: Representatives L. H. Fountain, Don Fuqua, Bill Alexander, Guy Vander Jagt, and John H. Buchanan, Jr.

Also present: James R. Naughton, counsel, and Richard Thompson, minority staff member, Committee on Government Operations.

Mr. FOUNTAIN. Let the committee come to order, and let the record show that a quorum is present.

First I want to thank Congressman Alexander of the subcommittee and his legislative assistant, Miss Dorothy Thomas, for narrating the Cameron County, Tex., TV documentary that you just observed a few minutes ago. She did a beautiful job. I am sorry we did not have a recording of everything that transpired.

While I am on that subject, I would like to thank Mr. Lee Harr, news director of television KGBT, Harlingen, Tex., who is with us to give us the benefit of any additional information that we may need.

I hope as many representatives of FHA as possible were here to view it.

Mr. Elliott, I note that you and a number of your group were here during the showing of this televised program. You viewed the documentary a few minutes ago. Is there anything in it that you have any reason to regard as inaccurate or misleading? What comments do you have upon this particular documentary?

STATEMENT OF FRANK B. ELLIOTT; ACCOMPANIED BY JAMES J. SCOTT; R. STANLEY HARSH, JOSEPH R. HANSON, AND JAMES F. NEVILLE—Resumed

Mr. ELLIOTT. I accepted it as sufficient evidence for us to take corrective action.

I would like to make the record clear that we recognize in the Farmers Home Administration that we have made mistakes. The evidence in Cameron County, as shown by the people in that area, is sufficient for us to take corrective action against the faults and deficiencies in the construction.

It is also sufficient to say that our people need training and they must be trained to better accomplish the job. We are doing that.

To say that we have not made mistakes in not only Cameron County but in other areas would be hiding from the truth. We intend to and will correct all the deficiencies within the Farmers Home Administration's power. As I told you yesterday, we take very seriously the helpful criticism of your committee, the Office of Inspector General, and the General Accounting Office.

We will also be in continuing contact with your counsel, Mr. Naughton, to keep you informed, on a monthly basis, of the actions we are taking to correct the mistakes in personnel selection, personnel training and performance, as well as the corrective actions taken against construction faults and deficiencies.

We have no excuses, frankly, sir, on what has transpired. We took on a program with people of other skills and experiences. They, in turn, took on the program and adapted, in many cases, excellently. The point is, the program is working to a great degree. The needs of the people in the rural area are being served.

I regret deeply that any mistakes have been made. Those made will be corrected.

I would like very much to thank the committee and also the television station in Texas, as well as other critics of our program, for bringing these mistakes to our attention. I hope with your oversight, as you do with the old mule, you get our attention, because that 2 by 4 smarts, and we are appreciative of that kind of interest.

With that, I am prepared to answer any questions.

We have here today people from field offices that have been involved in some of the more critical aspects of the program where mistakes have been made. We are prepared at this time to answer any questions that you have, sir, or to have them answered.

I have asked them to please deal with fact, because other than that, it would be to the disadvantage of the program and the people involved in it. If at any time we are failing to be responsive, sir, if you could direct the question back to me, I will see that we are fully responsive.

Mr. FOUNTAIN. Thank you very much for your comment.

I am sure that the subcommittee appreciates your attitude, which, I think, is a splendid one. In fact, I think if more of our administrators started out and continued with that attitude, more of our programs would be better administered.

For the record, I would like to also say I hope no one, including the press, gets the impression that in any of these investigations we like to bring these agencies up here for the purpose of embarrassing them. That is not our purpose at all.

What we are trying to do is record facts that will be helpful to those who are actually engaged in the process of administering these programs, and also to give to the Congress, in record form, the benefit of what we are able to bring out, so that if additional legislation is necessary, the Congress can take the appropriate action.

We are concerned because these programs are important. Notwithstanding all the deficiencies that may have been revealed as a result of the investigation by the Inspector General and others and as indicated by the transcript of the television program, I am satisfied that the vast majority of the money has been wisely spent.

We are concerned because we support the program. We think it is one of the finest ways of rehabilitating and helping rural America—you might say, providing an open-door invitation for people who live in the cities to go out into rural areas and take advantage of some clean, free, unpolluted air, and to enjoy the conveniences of rural life. I can tell you, if you have not lived in the country, you do not really appreciate it until you do. I grew up in the country and when I leave here, I am going back to the country. When I say country, I mean a real small community.

We do appreciate your attitude and the dedicated, sincere way that you are going about your job.

Mr. Fuqua, would you like to make any comment?

Mr. FUQUA. Just to echo what you have said, this is a fine program and I can cite many fine homes that have been constructed under this program. Just because we find a few rotten apples, it does not mean the whole barrel is spoiled.

We are trying to be constructive and to help you and help the taxpayer who, after all, is footing the bill.

We appreciate your attitude, Mr. Elliott. As the chairman said, I wish we had more public servants with your attitude.

Mr. FOUNTAIN. When and how did the national office and the Texas State office first learn of the irregularities in Cameron County?

Mr. ELLIOTT. I will have to orchestrate this, sir, due to my ignorance. Mr. Neville, would you take the national office?

Mr. NEVILLE. The first indication I got, I believe, was a petition referred to us to be answered dealing with complaints. As is customary on matters of that kind, we will refer them to the State office to look into the matter, because we have no absolute knowledge of what is going on. There is too much activity.

I also understand that about the same time our State office received a copy of the petition. I believe it came from the Congressman representing that particular district. That was the first indication that there was some trouble with respect to construction.

Mr. FOUNTAIN. I wonder if you would tell us what significant actions were taken by the FHA after you received the petition to investigate this situation? Give us the dates, if you can, in chronological order, of what transpired.

Mr. NEVILLE. I may not be able to give it to you precisely, but I can give it to you in general.

Mr. FOUNTAIN. Please do that.

Mr. NEVILLE. After Mr. Futch, State director, had an opportunity to look into the situation, it appeared from all the evidence that there were a number of problems relating to construction. In a telephone conference with Mr. Futch, we agreed that the best thing to do was to suspend our packaging operation, because the office was being inundated with applications.

Our staff in the local office was not capable of processing them in an orderly and proper manner. The best thing to do was to suspend packaging until such time as the office got on its feet and could handle it in a responsible manner. That was No. 1.

I advised them to make sure that the market conditions there were studied to be sure that we were not going to overbuild the community. If there were indications that it was being overbuilt, to refrain from

issuing any conditional commitments. However, if an individual came to us to build a home for himself, he was the market. We should handle that particular case and process it. If he were eligible, we should make the loan.

I also counseled him to reorganize the office and to push reorganization as fast as possible and to get some experienced personnel into the office and to guide and direct them; to interview the borrowers and to determine the accuracy of their complaints, so that an appropriate list could be prepared and we could determine whether it was the builder's responsibility to undertake the repairs that were necessary; and to secure the builder's cooperation, because it was needed under the circumstances so that justifiable corrections could be made.

What I did not want to occur there, was the builder to withdraw from the project and just throw his hands up and tell us to forget it, that he did not want anything to do with it. In such event, we would be in a real pickle. It could involve the development of subsequent loans which the people could not afford to repay, and matters of that kind. The borrowers might well bring legal action on a warranty which would be very extensive and protracted.

He was also advised to impress upon the builder the necessity of going forward, and getting the corrections made as soon as possible and to ameliorate the people that were involved.

Mr. FOUNTAIN. What significant irregularities did your investigation disclose?

Mr. NEVILLE. Primarily, construction deficiencies. There were indications, as the film showed, that some of these were easily corrected. They should be corrected regardless of how one felt about it. The best thing to do was to get a competent staff to work with the builder, inspect the houses and see that the work was taken performed.

If we ran into a situation where it would take additional funds to rectify the deficiencies, we would handle those cases on an individual basis. That has not happened, up to this time.

So as it stands right now, the project is going forward. As I understand it, most of the corrections have been made, except in about three or four instances. There seems to be a difference of opinion between the homeowner and the builder and a reluctance on the part of the homeowner to let the builder correct the conditions that exist. That frequently happens. One of these days, we will just have to sit down with both of them and see if we can reconcile their differences and bring those matters to a conclusion.

At the present time, it is my understanding that we have about five houses in inventory. Of that five, three of them are vacant. I believe the two occupants are there pending their sale.

At this particular date, we have not reinstituted the volume operation in that county in Texas. There are delinquencies there. There are 79 properties that are delinquent, out of a possible 138. However, those delinquencies are gradually coming down. It seemed that many of the people got the impression that they should not make their mortgage payments. Some way or another the word was passed along to them, to not make their payments and just forget about them.

People in low-income categories, with limited funds available, find other needs for that particular money, and get into financial trouble very rapidly. But we have worked out arrangements with all of them. I believe within a period of a year, we will have them all current.

Mr. FOUNTAIN. What percentage of the irregularities that were disclosed involved failure to follow FHA regulations?

Mr. NEVILLE. From a percentage point of view, I could not give that to you. I did not analyze it from that point of view.

I believe our Texas boys might be able to give you that information.

Mr. ELLIOTT. We have Mr. John Barnes, who is our assistant State director, with us.

Mr. FOUNTAIN. Mr. Barnes, will you respond to that question?

Mr. BARNES. I believe, sir, that less than 10 percent of them would involve any deviation from prescribed procedures. Most of the criticisms that we had were based upon incompletions inside the house.

As you recall in the film, there were three dwellings that showed some bad mortar and brick. Those were in three places, at the entrance of one door.

But I believe that not more than 10 percent of them would be due to actual failing to follow the plans and specifications.

Mr. FUQUA. Mr. Chairman?

Mr. FOUNTAIN. Mr. Fuqua.

Mr. FUQUA. How long has Mr. Barnes been in his present position?

Mr. BARNES. Since September 1, 1967, sir.

Mr. FUQUA. So this occurred during the time that you were the State director?

Mr. BARNES. It surely did.

Mr. FUQUA. Thank you.

Mr. ELLIOTT. Sir, it should be noted that when this petition was brought to the attention of the State director, he immediately requested the Office of Inspector General for an inspection and that was the result.

Mr. FOUNTAIN. What about the relations between the contractor and the supervisor? Were there any indications of irregularities there, or violations of the regulations?

Mr. BARNES. It appeared so, yes, sir.

Mr. ELLIOTT. If you would turn to your question 13——

Mr. ALEXANDER. Mr. Chairman?

Mr. FOUNTAIN. Mr. Alexander.

Mr. ALEXANDER. Mr. Barnes, your answer to that question was, I believe, in the affirmative, that there were some violations of the regulations by the contractors. Is that correct?

Mr. BARNES. Sir, only the failure to follow plans and specifications specifically.

Mr. FOUNTAIN. I think I asked him if there were irregularities between the contractor and the supervisor, and he said there were.

Mr. BARNES. It appeared so, sir.

Mr. ALEXANDER. I was just asking for some delineation of that statement, for my own definition.

Mr. Barnes, what were the irregularities due to? For what reason did you discover the irregularities to have occurred?

Mr. BARNES. Generally, sir, it appeared to us that there was an oversight on the part of the county supervisor. It was a failure, sir, to follow specifically the plans and specifications as were submitted. The failure to examine those.

Mr. ALEXANDER. You did have regulations in the State of Texas to require that supervisor to follow a procedure that would avoid those mistakes, had he followed that procedure?

Mr. BARNES. Yes.

Mr. ALEXANDER. May I ask, Mr. Barnes, what corrective action you took, both within your organizational structure and with reference to the particular supervisor involved?

Mr. BARNES. First of all, people were sent into the area from the State staff, pointing out any deficiencies that we thought existed. Then, soon after, the OIG report came in, the county supervisor was reduced in grade and removed from that position. The present—or the current county office clerk at that time retired. The building inspector, who was on a temporary appointment, was not reassigned; he was terminated. That, sir, is the extent of the action taken by our office.

Mr. ALEXANDER. Thank you, Mr. Barnes.

Mr. FUQUA. Mr. Chairman?

Mr. FOUNTAIN. Mr. Fuqua.

Mr. FUQUA. Mr. Barnes, do you think that was an adequate disciplinary action or should there have been other action taken?

Mr. BARNES. We felt, at the time, sir, that that was the appropriate action. Yes, sir.

Mr. FUQUA. Thank you, Mr. Chairman.

Mr. FOUNTAIN. How much emphasis is placed in the State office, not just in Texas but throughout the country, Mr. Elliott, in emphasizing to the supervisor the necessity of having the best contractors available that are willing to undertake these projects, and in being sure of their integrity and that they have good reputations as builders?

Mr. ELLIOTT. Our instructions are clear to the point that you select qualified contractors. I guess the simple fact is, there is some evidence that we have not in the past followed the instructions.

Mr. FOUNTAIN. I am just wondering how much emphasis is placed—in addition to sending out regulations—on educational programs. Are there conferences?

Mr. ELLIOTT. We have national office conferences. The State directors, with their county people, participate in State conferences. We have an educational program now when these deficiencies became apparent. We are endeavoring to educate our lowest level of county supervisors to their responsibilities and have them follow the necessary instructions and procedures.

The fact is, in some cases, we have not selected sufficient capability in the construction industry.

Mr. FOUNTAIN. What are your requirements concerning the financial responsibility of contractors?

Mr. NEVILLE. We really have no requirements for financial responsibility. For instance, if he is building under a conditional commitment, we have no financial obligations at all in those particular transactions. The contractor is the one who has the money on the line. We inspect to determine if the house is built in accordance with approved plans and specifications. We approve the buyer of the house.

However, in some situations we require a bond arrangement where the individual and a contractor get together to build a house. We indicate to the borrower that it would be well for him to bond the contract for completion. On the multifamily housing projects, we do require a bond over $60,000, or an equivalent, like a letter of credit or something of this kind, to assure completion. In those instances we are advancing

construction money during the progress of the job. We want to see that the Government's position is protected.

Mr. FOUNTAIN. I asked that question because I was thinking of the man that buys a home. On the basis of what I have been told at various times, I sense the feeling on the part of some contractors, that the buyer should not show concern. He is getting a long term loan; his monthly payments are low, so what is he complaining about? He is living in a house.

I am concerned that that attitude might be present in the minds of some of the supervisors, too.

Here is a man with no income except what he gets by the month. In many cases, he just makes enough to be able to apply for a loan to build a house. He certainly is not in a position, financially, to make any repairs or to make corrections.

If he has a contractor who is financially irresponsible, even though a good carpenter—and sometimes a good carpenter can still make mistakes—and the inspector approves him, the homeowner can do nothing about it, can he?

Mr. NEVILLE. No, sir. If a contractor does not have responsibility, financial responsibility, even under the warranty, there is no way that he can recover.

There is one action that we could take. We could suspend him. We would not be doing business with him until such time as he returned and rectified the condition that he created.

Mr. FOUNTAIN. There is no requirement that he himself be able to finance the complete construction of that particular home, or those particular homes, except in your cluster situation, before you make your payment?

Mr. NEVILLE. Yes. If it is a conditional commitment, certainly he has to get the money locally. We do not advance any money on single family homes under these circumstances.

Mr. FOUNTAIN. You do not?

Mr. NEVILLE. No, sir. Only when there is an owner-contractor involved. We will advance the money in those situations, where we find a weak contractor, financially weak, in order to help him over a rough spot. We get receipted bills for the material that is put in place. We only advance on the basis of receipted bills. When the time comes for final closing of the loan, we have a rundown of title to the date of closing.

With the receipted bills in hand, we feel confident that the bills have been paid. It may very well be that a little chicanery could go on behind your back, and someone file a lien at some later date.

Mr. FOUNTAIN. How much money do you withhold until the house is accepted by the owner?

Mr. NEVILLE. Usually we withhold 25 percent.

Mr. FOUNTAIN. One of the essential things is that the inspector do a pretty good job of inspecting and not release the contractor and turn it over to the owner until the job is completed. Is that not right?

Mr. NEVILLE. That is right, sir. It is a turnkey job at the time of closing.

Mr. FOUNTAIN. Mr. Naughton.

Mr. NAUGHTON. Mr. Barnes, I believe you estimated only about 10 percent of the construction defects were actually in violation of regulations—where plans and specifications were not complied with.

Would it not be accurate to say that a good deal more than 10 percent, perhaps even 85 or 90 percent, of the deficiencies that occurred were allowed to occur and payment made, because the inspections were not conducted in a proper and adequate manner as your regulations call for?

In other words, do your regulations not provide that deficiencies such as have been demonstrated in these homes should be ascertained by the inspector, by his making a proper inspection at the proper time and refusing to accept that house?

While perhaps only 10 percent of the deficiencies involved a failure to follow the plans and specifications, would it be accurate to say that the bulk of these deficiencies should have been caught and not allowed to occur on accepted homes, if your inspectors had been properly trained and had followed the regulations?

Mr. BARNES. Yes, sir; I would agree to that.

Mr. NAUGHTON. Is the contractor involved in this situation still doing business under FHA programs?

Mr. BARNES. No, sir.

Mr. NAUGHTON. Has he been debarred?

Mr. BARNES. No, sir. He has been informally suspended, not formally.

Mr. NEVILLE. That is a very fine distinction that Mr. Barnes has made. The reason we have not suspended the contractor is because he is still correcting the oversights and the deficiencies.

Mr. FOUNTAIN. This is the contractor?

Mr. NEVILLE. The contractor. We feel that if he continues with that attitude and assumes his responsibility, and makes the people happy, we do not have a basis to suspend him.

As far as new business is concerned, we are not entertaining any applications for him.

Mr. NAUGHTON. Do you feel that you have sufficient contact with the borrowers involved here and sufficient knowledge of their feelings in the matter to be able to say that most of them are satisfied with the corrective action that has been taken?

Mr. NEVILLE. I will have to give that question to somebody else.

Mr. HANSON. According to the May 15, 1973, figures, of the 16 borrowers cited in the OIG report, three cited cases remain unsettled. Here is where—the statement has been previously made by Mr. Barnes—inability to obtain cooperation of the families is cited as a primary reason why the deficiencies have not been corrected. Seven homes were satisfactorily repaired, and six were acquired by the Government.

Mr. NAUGHTON. Were there other borrowers that were not included in the OIG report that might have complaints that have not been satisfied?

Mr. HANSON. I suspect that is correct.

Mr. BARNES. There could be, sir, but we are not aware of them.

Mr. NAUGHTON. So you have no knowledge, then, of whether or not any deficencies or complaints that were not described in the OIG report have been taken care of?

Mr. BARNES. May I make this statement?

Accompanied by one of the staff members from the housing section in the State office and the Congressman from that district, we

were on tour down there last Thursday, June 1. We not only contacted people whose names appeared in the OIG report, but also we contacted people at random that were living in homes that were financed by Farmers Home Administration.

These contacts did not reveal to us any additional people that were dissatisfied with their homes. On the other hand, they were pleased and happy with the homes that they had.

Does that answer your question, sir?

Mr. NAUGHTON. Yes.

Mr. FOUNTAIN. Do you, on the State level, ever spot check or just go down and make a check with the owner of the house without your supervisor along, just to see if he was satisfied, if he had any complaints? Not that they are always legitimate complaints. Do you do that sort of thing?

Mr. BARNES. No, sir, Mr. Chairman, not in the manner that you placed it. But we select, when we go into a county office, we will always contact the district supervisor and pick a county supervisor up to accompany us. We frequently will select those individuals that we want to visit, not leaving it up to the county supervisor to take us to the good ones, in case he would be inclined to do that. We make those selections ourselves, members from the State staff, as well as myself and the State director.

Mr. FOUNTAIN. You do not pick an area to send a couple of fellows down to say hello to these people to ask them if they are satisfied; if they have any difficulties?

You know, a lot of people will not complain. They will go ahead and put up with something for the very reason that the contractor sometimes refuses to do the work. He says, they are not paying much. The taxpayers are providing the money over a long period of time, so why worry about it? A lot of people will not complain because they themselves realize they are not making large loans.

Mr. HANSON. I am sure some of this spot-checking is being done throughout the country. However, there is not a systematic procedure for it at this time.

Mr. FOUNTAIN. Do you think it would be a good idea?

Mr. HANSON. It sounds excellent.

Mr. ELLIOTT. Yes, sir.

Mr. FOUNTAIN. Do you have the staff at the present time to do that sort of thing?

Mr. ELLIOTT. Mr. Chairman, we have the staff to do it.

Mr. FOUNTAIN. In other words, you agree with the idea that you cannot handle this situation by regulations and correspondence, and just hope that everything is working out on the basis of that?

Mr. ELLIOTT. I spent 28 years in the military. I found that regulations and procedures are meaningless; unless a man walks on the spot, he cannot be sure of the results.

Again, I say we should have spot-checks, and we should have them on the national level as well.

Mr. FOUNTAIN. Mr. Naughton?

Mr. NAUGHTON. Mr. Elliott, with respect to the relationship between the former county supervisor and the contractor in this case—there is considerable evidence of a rather cozy relationship, if you want to call it that—engaging in recreational activities together, things of that

kind. Regardless of whether there was any law violation, it appears that this is the kind of situation that would create the appearance of a conflict of interest.

Have you taken action to stress to people in positions of responsibility in the field that they are not only to avoid actual conflicts of interest, but to bend over backwards to not give the appearance?

Mr. ELLIOTT. Yes, sir, we have. This problem will continue to exist as long as the human race exists, but they have been instructed to lean over backwards to avoid any conflict of interest. It is always very difficult to discipline this sort of thing, as you all well know from your own experiences.

On the other hand, they have been admonished, instructed, and cautioned to make extremely sure that they do not find themselves subject to discharge.

Mr. FOUNTAIN. Are there any guidelines as to what might be considered a conflict of interest, say for Mr. Barnes as State director, or for a supervisor?

Mr. ELLIOTT. Not to my knowledge. I am relatively new, but I can assure you that we will put out a guideline, if one is not already available.

Mr. FOUNTAIN. I realize you cannot be unreasonable. You cannot put people in prison so they cannot associate with one another.

It seems to me that there must be some way of at least referring to some specific items that obviously would be considered conflicts of interest or would raise suspicion.

Mr. ELLIOTT. May I ask Mr. Harsh to speak to that point?

Mr. HARSH. Chairman Fountain, we do have many Department guidelines on conflicts of interest, specific instances. Whether they cover the exact situation here in sufficient detail that would be helpful, I do not know.

Mr. FOUNTAIN. For example, I think it would be a serious mistake for a supervisor and a contractor to buddy around a lot, party a lot, things of that kind. They could be perfectly independent of each other when it comes to business, but nobody would believe it.

Mr. ELLIOTT. Mr. Neville has a point.

Mr. NEVILLE. We have general instructions, Mr. Congressman, in our FHA regulations of 207.1, dealing with conflicts of interest. As instructions are written, you cannot cover every situation. I cannot recall whether we tell them not to associate with a contractor. That is very difficult, because they are the ones you are doing business with regularly.

Mr. FOUNTAIN. Mr. Scott?

Mr. SCOTT. If I could respond to this: The FHA instructions do prohibit business transactions between employees with borrowers, suppliers of building materials, and doing business with them. Once a year there is a printed reminder that comes from the USDA Office of Personnel, which goes to every employee, again pointing out the necessity to refrain even from the appearance of a conflict of interest.

In addition to this, the district supervisor is required in his annual evaluation of performance to discuss the conflict of interest situation with each employee.

Mr. FOUNTAIN. What were some of the significant conflicts of interest that you discovered in the course of your investigation that came out in the 1971 report?

Mr. SCOTT. County office employees doing business with borrowers—buying and selling land, et cetera.

Mr. FUQUA. Could you briefly cite some examples?

Mr. SCOTT. Real estate transactions.

Mr. FUQUA. They were not just selling chickens and eggs?

Mr. SCOTT. No, sir. We are talking about buying and selling land, buying and selling building supplies, that sort of thing.

Mr. FUQUA. This was the county supervisor?

Mr. SCOTT. Yes, sir.

Mr. FUQUA. With whom was he engaged in the real estate transactions?

Mr. SCOTT. He was engaged with borrowers. We found other examples where county committeemen, who certified applicants as eligible to receive loans, were also selling the land on which this applicant would build a house. In some cases, the committeemen were building, or their children were building, the houses.

Mr. FUQUA. Dealing with the supervisor and the borrower, was this under the low-income housing program or the general program for farmers?

Mr. SCOTT. At that time we were dealing primarily in the section 502 house without a subsidy, without interest credit. So we are talking primarily about unsubsidized housing.

Mr. FUQUA. I was wondering how they could deal in real estate and be eligible for the 235 program.

Mr. SCOTT. We have since found that a number of people had been made interest-credit loans, where they were able to pay full interest.

Mr. ALEXANDER. Would the gentleman yield on that point?

Mr. FUQUA. Yes.

Mr. ALEXANDER. Mr. Scott, do you have a report of those findings to which you referred at this point? Has it been made part of the record?

Mr. SCOTT. Yes.

Mr. ALEXANDER. Thank you.

Mr. ELLIOTT. Mr. Chairman, in direct response to your question, the former Administrator, Mr. Jim Smith's letter of January 13, 1972, in reply to the Inspector General, points out that the FHA orientation training program for new employees, and so forth, deals with this whole problem of conflict of interest and deals with it in specifics.

I believe you have it as a matter of record.

Mr. FUQUA. Does it show what disposition was made of this as far as any disciplinary action is concerned?

Mr. ELLIOTT. Yes, sir. You will notice in the back here we have a series of people that we have taken actions against for various administrative reasons. We can make it a matter of record, if you do not have it. It shows on all the actions that we have taken administratively, as well as any criminal situations that occurred.

Mr. FUQUA. Mr. Scott, have you followed up to make sure that action has been taken on each of these cases?

Mr. SCOTT. If I could explain the OIG system of followup. At the national level, we only follow up on recommendations to the national office. All other recommendations are handled by our regional offices, of which we have seven. We have followed up on the actions the national office took on 6171-2-H. However, we have not followed up as to each incident or allegation of a conflict of interest.

Mr. FUQUA. Maybe Mr. Barnes could answer the question. We are now speaking of the Texas operation.

Mr. BARNES. I do not believe so.

Mr. ELLIOTT. We are speaking in general.

Mr. FUQUA. Excuse me then.

Mr. FOUNTAIN. Did you find examples of conflicts of interest between county supervisors and the contractors?

Mr. SCOTT. During the 6171–2–H report, sir, we were under great stress to complete the job and get the report out. So what we did was make a quick inquiry into it and then refer to it for investigation after the situation was over. So in most of these cases, we did not do enough to prove or disprove the allegation.

But among other complaints that we had where the contractors were doing business or getting favors from the county supervisor, that bribery was involved. We had allegations that a particular insurance company was getting all the business because the spouse of the insurance agent worked in the county office.

Mr. FOUNTAIN. Were there any complaints or evidence of kickbacks?

Mr. SCOTT. There were some complaints of kickbacks, but we did not, at the time, run those down.

Mr. FOUNTAIN. They are very hard to establish.

Mr. ALEXANDER. Will the gentleman yield?

Mr. FOUNTAIN. Yes.

Mr. ALEXANDER. Was other action taken to follow up on the alleged kickbacks?

Mr. SCOTT. Yes, each complaint was made the subject of an investigation, but these were performed in our regions.

Mr. ALEXANDER. Was the investigation conducted by the Farmers Home Administration?

Mr. SCOTT. No, sir; by the Office of the Inspector General.

Mr. ALEXANDER. Do you have reports in your office of those investigations that are compiled in a complete file?

Mr. SCOTT. No, sir.

Mr. ALEXANDER. Mr. Scott, I know all of us have personnel deficiencies, notwithstanding the statement of the Administrator a minute ago.

But, are you satisfied that complete action has been taken by the Office of the Inspector General to fully investigate all of the alleged kickbacks that have been reported to your agency?

Mr. SCOTT. Mr. Congressman, I will have to yield here to my investigative counterpart, since I do not have the knowledge to give you a factual answer.

Mr. ALEXANDER. I would be pleased to receive an answer from anyone present.

Mr. SCOTT. Mr. Evins.

Mr. FOUNTAIN. Could you give me your full name?

Mr. EVINS. James J. Evins. I am a Supervisory Special Agent, Office of the Inspector General, Headquarters, General Investigations.

In response to Mr. Alexander's question, each region has the responsibility to follow through on what we call nonsignificant cases. We follow through here in Washington on the cases that are declared to be significant.

We try to insure in each case that the agency takes the action and they are required to report back to us in 60 days upon any action taken on a particular finding in a particular investigation.

I believe your committee has been supplied with various investigation reports that include some of the matters that are being discussed by Mr. Scott.

Mr. ALEXANDER. Mr. Chairman, would the gentleman yield for further questions?

Mr. FOUNTAIN. Go ahead.

Mr. ALEXANDER. Has this committee been supplied with copies of all allegations that have been made on significant cases?

Mr. EVINS. I was not working in that particular section at that time.

Mr. ALEXANDER. You do not know?

Mr. EVINS. I cannot answer that.

Mr. ALEXANDER. Mr. Scott?

Mr. SCOTT. Mr. Congressman, I think I can answer that. I have been provided a list of the investigation reports that the committee received. It is only a very short list, so I can assure you that you have not received copies of all significant investigations.

Mr. ALEXANDER. One further question, Mr. Chairman.

Mr. Evins, are you satisfied in your own mind that complete action has been taken by the Office of the Inspector General to fully and completely investigate all the allegations that have been reported to your office?

Mr. EVINS. In my own mind, I would say, no.

Mr. ALEXANDER. Thank you very much, Mr. Evins.

Mr. FOUNTAIN. Would you like to explain that?

Mr. EVINS. I cannot speak for each allegation that may come out from each particular region. I can only state my own experience.

I was formerly in region 5 as a supervisory special agent. There are many allegations that we get. We get allegations from any one of different sources. The majority of our investigation requests come from the agency itself. Some of our investigations emanate from the various audits. They are referrals by the audit division. We get complaints from Congressmen. We get complaints from individuals.

To sit here and tell you that we have satisfactorily investigated each and every complaint we receive I believe would be presumptuous on my part. I do not believe we have, nor do I believe any other investigative agency has, either. But I believe that we make a genuine attempt to investigate legitimate complaints. They are evaluated by experienced investigators, and we make an attempt to do the proper thing. This is our business, investigations.

Mr. FOUNTAIN. Mr. Naughton?

Mr. NAUGHTON. Mr. Alexander, I might mention we have not received copies of all investigative reports. We have received a summary of all significant conflict of interest cases and things of that kind.

Mr. ALEXANDER. There is no need to pursue it any further, Mr. Chairman.

Thank you.

Mr. FOUNTAIN. Mr. Naughton?

Mr. NAUGHTON. On this question of conflict of interest, what percentage of the loans originate through packages where a contractor brings a borrower in the office?

Mr. NEVILLE. I would say—and this is a rough estimate—that probably 90 percent of our business today is builder originated, meaning that they themselves prepare the packages or have individuals package the applications for them for submission to the individual offices.

Mr. NAUGHTON. I was going to ask you how you handle it if a borrower or potential borrower comes in and asks if you can recommend a contractor for him. But it appears that apparently 90 percent of the borrowers are brought in by the contractor.

Mr. NEVILLE. The question, I believe, was what percentage of our business is done by packagers. That does not mean that they have the borrower in hand. What they are doing is packaging the application for submission to us. It includes plans, specifications, et cetera. Subsequently, they interest the borrower in the purchase of the house. It could be simultaneously.

Mr. NAUGHTON. Do some of the borrowers come into the county office and get referred to packagers?

Mr. NEVILLE. Let me say this could happen. Individuals will come into county offices looking for a loan and will want to know whether they are financially capable of receiving a loan.

We counsel them with respect to it. The borrower may also ask whether we know anyone who is building houses, or where he could get a house, or what help we can give him.

I think it is within the purview of our county supervisor's authority to indicate by way of help who the person is that is building houses in his area, or that such a gentleman is in the contracting business, so the borrower may consider him with respect to having a house built.

It is done by way of cooperation and trying to be helpful. This undoubtedly is done.

Mr. NAUGHTON. I can see where that might be quite useful. But there might be a fine line there. At what point would you cross it, where, instead of being helpful to the borrower by giving him information on resources that are available, you get over to a situation where the county office might be recommending a favorite contractor, or the borrower might get that impression.

How do you manage that so you can be helpful without either giving or giving the appearance of a recommendation or favoritism to a specified builder?

Mr. SCOTT. Mr. Neville, if you will yield to me, I think I can answer that.

Each county office is required to have a list of approved contractors that are doing business within that county office unit.

Mr. FUQUA. What are the criteria for approval?

Mr. SCOTT. They have indicated an interest—I am not sure. Maybe Mr. Barnes can answer this, whether the State office has to pass on a contractor or not.

Mr. BARNES. They do not, sir.

Mr. SCOTT. It is my impression that it is a very loose arrangement, that if a contractor—a man comes in and says, I want to build houses, and he has a pretty good general reputation in the community, in the county, he is approved.

Mr. FUQUA. Regardless of his reputation, he may be an honest man but a poor builder.

Mr. SCOTT. It is my impression that it is a very loose arrangement.

Mr. NEVILLE. I do not think Mr. Scott means approved in the sense that we put our stamp of approval on his competency, not by a long shot. What it really means is, a list of persons engaged in this particular endeavor for a livelihood——

Mr. FUQUA. That they have expressed an interest or have been known to be reputable builders of single family units?

Mr. NEVILLE. If I moved into a community and decided to make it my home, and I was going into the contracting business, I would visit Farmers Home Administration and inform them that I was in the contracting business, and would be working in a particular area, and furnish them some general background information on myself.

Mr. FUQUA. That was the point I wanted to make. There is no automatic stamp of approval?

Mr. NEVILLE. There is no stamp of approval, no, sir.

Mr. FOUNTAIN. I gather from what Mr. Scott said, they do not necessarily say that they are in the contracting business, but that they are interested in building houses, so you put them on the list. Then the average person comes in and asks for the names of some contractors. I would imagine that a borrower would think that you would not put the contractor's name down if you did not think he was competent.

That is why I think that is very important that the qualifications of contractors to build be inquired into.

Mr. ELLIOTT. Mr. Chairman, you have made an excellent point. I will take that under advisement immediately.

Mr. NAUGHTON. It seems to me that there are two areas that are a proper matter of concern. One, does the prospective contractor have the fiscal ability to carry out his commitments. This perhaps could be determined by a Dun & Bradstreet report.

Mr. FUQUA. Some of these people do not have Dun & Bradstreet reports. An example is a very good builder in my hometown who is a minister and builds homes with his family in his spare time. He is a very good builder and builds homes of this type, I am sure you will not get a D. & B. on him.

Mr. NAUGHTON. Perhaps that should be stated as the responsibility to carry out commitments.

Mr. FUQUA. I would not want to see any regulations, Mr. Elliott, that would preclude anyone from that type of activity.

Mr. ELLIOTT. I am sensitive to that. In Red Hill, Va., a rural area that I am familiar with, they do have family contractors. They do honest and able work.

I think the point that both of you have brought into focus is, have we sufficiently assured ourselves of the qualifications of those people that are on the "approved list"? I think that needs attention. The minister that you spoke of would qualify as approved, as well as a family of father and son that does excellent work.

I certainly will take it under advisement. Your point is extremely well made.

Mr. NAUGHTON. This might be helpful in a negative sense, at least, that you would assure yourself of not getting any known bad apples.

Mr. ELLIOTT. You do have a very interesting problem that should

be brought to the committee's attention. The problem of getting qualified construction capability in many rural areas where it is currently nonexistent. Where the risk of coming into that kind of business in terms of the profit or loss that they expect to take is a major consideration. You have to bring them in and, once you get them in, you have to try to keep them there, if they are qualified.

There is a real need, and Farmers Home has brought to many rural areas construction competence that heretofore has not existed.

Mr. FUQUA. I do not mean to belabor the point, but I think Mr. Barnes made a good point awhile ago, and maybe this is what Mr. Scott is referring to. You may blacklist, if you want to refer to it that way, a contractor that you have had trouble with who trys to cut corners, and does poor quality work. So in approvals per se, you do not guarantee that this man will do a perfect job, but you probably do not approve those who you know have a history of poor performance.

Mr. SCOTT. One further point on this, in answer to Mr. Naughton's earlier question about the county supervisor referring an applicant that was himself an individual contractor. The county offices don't go overboard. They say we cannot tell you who to select, but here is a list of contractors doing business in the county. We encourage you to get three bids.

You may have noticed in the film this morning that it was said in a critical way that some of them had been required to get three bids, and they did not want three bids. They wanted one. But actually, what the county office was trying to do was protect the interest of the applicant to get the best bid for the house the man wants to build.

Mr. FOUNTAIN. Would it be rather difficult for a potential borrower who has not gotten his loan approved to get a contractor to actually give him a bid?

Mr. SCOTT. No, sir.

Mr. FOUNTAIN. No contractor is going to take the time and trouble to bid unless he knows the borrower is going to get a loan, is he?

Mr. NEVILLE. His time is valuable. They want to ascertain that the money will be there when the work is done. That is why so many contractors will not bid on jobs, because the amount of time spent on bidding is unproductive. If someone underbids them by $5, $10, or $15, they may lose the contract.

When they entertain a job, they're looking to see if the borrower, particularly in our cases, is the one who will be financed by Farmers Home before they become involved too deeply. It is a good business approach. Without doing that, they would be doing charitable work and not earning a livelihood for themselves.

Mr. FOUNTAIN. As important and helpful as it is to the borrower, I just wonder, when you tell somebody to get three bids, if he could if he has not had his loan approved.

Mr. NEVILLE. He should have his loan approved first.

Mr. FOUNTAIN. Mr. Naughton.

Mr. NAUGHTON. Going back to an area that we discussed a few minutes ago, does the Office of the Inspector General keep track of action taken with respect to investigations which indicate a need for criminal or civil action?

Mr. SCOTT. Yes. However, I think I should defer to Mr. Evins and let him explain that.

Mr. FOUNTAIN. Mr. Evins.

Mr. EVINS. Yes. In each case an investigation report, of which you have before you, an investigation report goes to the addressee. Also, copies go to the Office of General Counsel, who consider the matter for possible criminal prosecution.

The action addressee is generally advised that within 60 days to please reply on any action taken by his office. This generally would apply in some cases, either to fiscal action, personnel action, or any other matter. In some cases, a personnel action is delayed until the ruling is received from the Office of General Counsel.

The Office of General Counsel will in some cases, if a criminal act has occurred, refer the matter to the U.S. Attorney where there will be further deliberation concerning possible criminal action against the subjects or persons involved in the investigation.

All the time, after this investigation report is issued, we follow that case and keep it in open status until it is closed. If the agency—in this particular case, of course, we are dealing with all the agencies of the Department of Agriculture, not just FHA—makes a determination that the Office of the Inspector General does not think is valid, we can, and sometimes do, challenge the agency on the adequacy of the action taken.

Now, actually we are not in the position to tell the agency that you should fire this man. We cannot do that. The agency has a responsibility to run its own operation, but we do monitor those activities, and we follow them until the case is closed.

This involves the closing of the financial matters, and in some cases, FHA personnel have certain fiscal responsibility. This matter is also referred. If the fiscal matters are closed, the criminal matters are closed and the personnel matters are closed, we close the case.

Mr. NAUGHTON. The Office of the Inspector General reports directly to the Secretary, do you not?

Mr. EVINS. That is right.

Mr. NAUGHTON. You are not investigating your own bosses, except inasmuch as the Secretary would have overall responsibility for all programs.

Mr. EVINS. That is correct.

Mr. NAUGHTON. That change was made about the time the committee was involved in a rather extensive investigation of operations of Billy Sol Estes. Perhaps he deserves most of the credit, although he was not trying to do it.

The chairman will recall at that time each operating agency of the Department had its own staff of auditors or investigators, and they reported directly to the man that was responsible for the particular programs that they were investigating. I am sure it must have been a matter of some concern to the investigator, who knew for sure that his boss was going to read that report but was never sure it would get to the Secretary.

Mr. EVINS. That is correct. There were 12 different investigative and/or audit agencies within the Department at the time of the creation of the Office of the Inspector General. I was formerly with Compliance and Investigation Division, ASCS, which worked on the *Estes* case.

In this particular instance, the Deputy Administrator was in the direct chain of command and the matter involved reporting to this chain of command. That brought forth this same problem that you are talking about.

Mr. ELLIOTT. Mr. Chairman, while these occurrences might refer to the State of Texas, I would like to suggest that our Inspector General does report to the Secretary. We in the line operations and administrators of programs, of which you have oversight, are responsive to these investigations and are held accountable.

In that regard, I think it is an important institution, having lived with an Inspector General most of my adult life. I find they keep you honest, and if they do not, they find facts for the Secretary to take proper action.

Mr. FOUNTAIN. Let me ask you this. After they have submitted a written report, such as 6171, of which we have a copy, is there an opportunity afforded to sit down and discuss matters.

Has that been done?

Mr. SCOTT. Yes, sir. We have had numerous consultations with FHA at the highest levels, both during and after the period when this review was made, and FHA has taken substantial action on our recommendations, although they did not always agree with what we recommended. But we are pretty well satisfied.

Mr. NAUGHTON. You are satisfied with the action that they have taken and are taking with the recommendations you have made?

Mr. SCOTT. Yes. Some of the actions that they still have not taken were mainly because of budgetary restrictions. They are willing, but it takes money and manpower to make changes.

Mr. NAUGHTON. Your files on an investigative report, then, would reflect not only the information disclosed by the report itself, but the administrative and/or civil or criminal legal action that was taken as a result of the report?

Mr. SCOTT. Yes.

Mr. NAUGHTON. Have there been any instances in which an inordinate amount of time, in your opinion, has been required to bring about a disposition of civil or criminal action against a builder or contractor resulting from the facts disclosed in a report?

Mr. SCOTT. I would have to defer to Mr. Evins again, because I do not know.

Mr. EVINS. There are occasions, of course, when each investigator would like to see an investigation matter resolved quickly. Every investigator and each investigative agency is constantly faced with delays in each step of the way—first with the Office of the General Counsel that has to evaluate the legal matter; the U.S. attorney. Their business is very heavy at the time, and sometimes agricultural cases take sort of a back seat to some of the more glamorous things like bank robberies and other matters.

On these occasions we follow through and make pretty hard requests on the Office of General Counsel. We write them letters; we call them; we ask them to take good offices with the U.S. attorney. We sometimes contact the U.S. attorneys directly in order to make some resolution on some of these criminal matters.

On the administrative matters, I think some of the gentlemen here from the Farmers Home Administration will tell you that they

have been contacted many times concerning personnel action on cases that are reported by the Office of the Inspector General.

I would like to make one point here. There seems to be a little confusion insofar as what the Office of Inspector General does concerning audits and investigations. In investigations we cannot make recommendations based on the investigation itself. We have to retain our objectivity. For us to make recommendations in an investigation report would destroy the objectivity. However, when we do find a significant condition and possibly an administrative condition that needs further action, an audit report can be prepared from some of the information developed during the investigation.

So what I am trying to say is, in order to retain our objectivity on the investigative side, we attempt to refrain from making any recommendations to the agency itself on the basis of the investigation. On the letter of transmittal to the action addressee we might make some note that a situation exists under some circumstances that the addressee should pay some attention to.

Mr. FOUNTAIN. What you are saying is that you do not make a recommendation as to the specific action that should be taken against anyone or more individuals?

Mr. EVINS. That is correct.

Mr. FOUNTAIN. You do find the facts?

Mr. EVINS. Yes.

Mr. FOUNTAIN. All the facts are made available?

Mr. EVINS. Yes.

Mr. FOUNTAIN. You do make recommendations for the improvement of administrative procedures, or recommendations that would help improve the administrative procedures?

Mr. EVINS. Yes; with the Office of the Inspector General. They will make that recommendation. The investigative part will not make that recommendation. That would be on the audit side.

Mr. NAUGHTON. The auditors will normally go in and review the administration of the program, and it is their function to make recommendations as to the improvements that they think should be made?

Mr. EVINS. Yes.

Mr. NAUGHTON. On the investigative side, where you have facts that could lead to a possible criminal action, the investigator's job is simply to report the facts and not decide on his level whether or not a criminal prosecution should be made?

Mr. EVINS. That is correct. A special agent is not empowered to make recommendations to the agency official. When they do, they generally get in trouble.

Mr. NAUGHTON. Mr. Gehley of the General Accounting Office who has been helping us in this investigation has given me the name of a case that allegedly has been pending for approximately 2 years. After the hearings, I will give it to you. Perhaps for the record you could indicate what has caused it to take so long.

Mr. EVINS. I would be happy to.

[See app. 8.]

Mr. FOUNTAIN. Mr. Buchanan.

Mr. BUCHANAN. Mr. Chairman, I have no questions concerning this area. I am an urban area member, so I do not have a lot of dealings with the Farmers Home Administration.

I will say I am familiar with your work in my own State.

Mr. Administrator, I would like to compliment you. I am sure everywhere in a large agency, and when you have as big a job to do as you do, that there are some problems here and there. But I really commend to you the competence and the dedication of Mr. Garrett and those working with him in Alabama. They are working hard to do a good job for the people.

Mr. ELLIOTT. Thank you, sir. If you had been here previously, the chairman would have had you moved into a rural area for a better way of life.

Mr. FOUNTAIN. We are hoping to get some of these city slickers yet.

Mr. BUCHANAN. Let me say, Mr. Chairman, I used to spend every summer on the farm, and I do not think I could disagree unless you make the single exception of the city of Birmingham. I would say country living is better except for that one exception.

Mr. FOUNTAIN. I would like to ask Mr. Lee Harr to take a seat at the witness table so I can ask him several questions about the documentary he made.

Mr. Harr, as I stated, you are the news director of the television station KGBT, Harlingen, Tex. We appreciate your presence here and your making this film available to us.

I would like to ask you three questions. The other members may have some, too.

Would you like to add any comments concerning the situation described in your documentary and in the discussion today?

Is there anything that you can add?

Mr. HARR. No, sir. Of course, this documentary did result in a lawsuit, and there was other information that came out during my investigation of certain people and other situations later on. This was basically the information.

Mr. FOUNTAIN. I wonder if you can give me a brief description of how you came to do the TV documentary that we have seen, and what happened after you started working on it.

Mr. HARR. I was given a copy of a petition.

Mr. FOUNTAIN. Signed by a lot of people?

Mr. HARR. Signed by a lot of these people.

Mr. FOUNTAIN. And addresed to the FHA office?

Mr. HARR. It was addressed, I believe, to the Senators and Congressmen from that area.

Mr. FOUNTAIN. That quite often happens.

Mr. HARR. This was, however, after a number of complaints had been filed with the local office, and also there had been letters written to the State office; and finally they did begin the business of getting a petition to the Congressmen and Senators.

Mr. FOUNTAIN. Do you personally have information as to the extent to which the borrowers' legitimate complaints about construction defects have resulted in corrective action?

Mr. HARR. I do not know how much has resulted in corrective action. There have been reports that there has been some corrective action taken. However, it is also my understanding that there are still a lot of people that are in the process of getting attorneys and are turning their houses back. In fact, I talked to one lady last week who said she had gone to Legal Aid for help with about 10 or 12 additional

homeowners. Also, Mr. Moore, who is quoted in the film, told me that he had three or four calls, people wanting to know what they should do at this point.

The county office, I believe, admits to having three or four cases that are unsettled. In addition, one thing I forgot, the people in the tax office at city hall at Port Isabel said that there are a number of people there that have given up, primarily had given up. They do not believe there is anything that can be done, and they are willing to turn their homes back or whatever.

In a lot of cases there are a lot of people who are not able to make their payments. At the same time, I know that these people that have gone to legal aid—I know most of them—in the past 3 months when this thing started, are fairly reliable type people.

Mr. FOUNTAIN. Are there any questions from the members of the committee?

Mr. Fuqua?

Mr. FUQUA. Thank you, Mr. Chairman.

Mr. Harr, did you go to the Farmers Home Administration and talk with them prior to going out and doing your documentary?

Mr. HARR. Yes, I did.

Mr. FUQUA. Were they cooperative?

Mr. HARR. They were more cooperative before the documentary than after.

Mr. FUQUA. Did they try to impede you?

Mr. HARR. We had some misinformation, yes.

Mr. FUQUA. From the county level?

Mr. HARR. Yes.

Mr. FUQUA. Since you have made the documentary, with the cooperation of the people shown in the film this morning, have any of them related to you any reprisals or intimidating tactics? I do not mean intimidating in the way of having their lives threatened or anything.

Mr. HARR. A lot of the people that owned their homes felt that they had been misled. So many people bought their house representing high offers of FHA which really did not. They felt intimidated in that way. In fact, they were really suspicious. If anybody comes to their door now and says, "Let me talk to you about the problems you have," they are terribly suspicious.

Mr. FUQUA. To your knowledge, did anyone from FHA go out threatening to foreclose on them for helping you with your investigation?

Mr. HARR. Yes. We have gotten reports that some of these people have been threatened—that they did stand a chance of losing their homes.

Mr. FUQUA. Because of cooperating with you, or because they were not making their payments?

Mr. HARR. Because of making complaints to me. Yes, sir.

Mr. FUQUA. Could you enlighten us as to who allegedly made these remarks to the cooperating homeowners?

Mr. HARR. This has been 18 months ago. I do have information in my files.

Mr. FOUNTAIN. We would not want you to guess at it.

Mr. FUQUA. I would not want you to impugn the integrity of some innocent person.

That was all I had, Mr. Chairman.

Mr. NEVILLE. May I make an observation? We would appreciate it if the gentleman would furnish us the names of those, so we can check into it further to ascertain precisely what the situation is, even though it has been 18 months?

Mr. FUQUA. The gentleman could refer to his notes, if he is agreeable.

Mr. HARR. Yes.

Mr. ELLIOTT. Certainly, such an allegation, if it is provable, should be investigated immediately. I would not want it to be in the record, because we could prejudice the judicial process. However, I certainly would solicit anything that would assist us in checking out the allegations.

Mr. FOUNTAIN. Did your interviews with these people satisfy you that they thought they were really dealing primarily with the FHA rather than the contractor?

Mr. HARR. Yes.

Mr. FOUNTAIN. FHA lends the money; the contractor does the work. Of course, from that point on FHA helps direct and supervise, but any lawsuit that the borrower may have is against the contractor, not the FHA. FHA just makes the money available.

Do you think a lot of them thought that this was something the FHA was responsible for?

Mr. HARR. They thought the Government was responsible, not necessarily FHA.

Mr. FOUNTAIN. That they were dealing with the Government?

Mr. HARR. They were dealing with the Government. And they were told in a lot of cases that the Government does not approve of this or it does approve of that.

Mr. FOUNTAIN. I found that to be the feeling of a lot of people, and you have to explain it to them. I talked to one man who said he was not going to make any payments; just let the Government sue him.

The point is, you do not have a contract with the Government other than your loan. Your contract is with the contractor.

Mr. ELLIOTT. The point is well made, Mr. Chairman.

Mr. FOUNTAIN. If the public is getting the impression that it is dealing with the Government, then you have to do some educational work, it seems to me, to let them know just what the situation is.

Mr. ELLIOTT. Yes, sir.

Mr. FOUNTAIN. You have to improve that image.

Mr. ALEXANDER. May I ask one question of Mr. Harr?

Mr. FOUNTAIN. Yes.

Mr. ALEXANDER. I want to thank you for your good citizenship for loaning me your film that you took in Harlingen. That is on my tape that I supplied. The committee did not have any funds to do it, so I thought I would just get that point in since we are all referring to the budget administrator.

Mr. FOUNTAIN. In that connection, Mr. Alexander, I might say before you came in this morning I thanked you and your staff, but I did not realize that you bought the film. We thank you for that.

Mr. ALEXANDER. All I ask is that I get it back.

Mr. Harr, would it be fair to conclude from your endeavors and your statements here today that the people to whom you refer in

your investigation and in your statements have been disillusioned by the activities of the Farmers Home Administration and have lost faith in their Government?

Mr. HARR. I would say that they are certainly suspicious.

Mr. ALEXANDER. Thank you very much.

Mr. FOUNTAIN. Mr. Vander Jagt.

Mr. VANDER JAGT. Mr. Chairman, I have no questions of the producer of the film, other than to thank him. I do have questions of the other witnesses.

Mr. FOUNTAIN. Yes, sir.

Mr. VANDER JAGT. I would like to focus on some problems that have arisen in my experience in Michigan. I would like to say first, however, that my experience with the FHA program in Michigan indicates that they have done an outstanding job there. Under the current leadership in Michigan, cooperation is exemplary. In general, I am very pleased with the work. The program has done a great deal for the people.

I would like to focus, however, on just one particular county in my district, because I think it is perhaps illustrative of national problems. This county is Lake County. It has the lowest per capita income in the State of Michigan. One-third of the roads in this county, because it is so poor, are private roads. I understand that FHA has a policy of not assisting or providing assistance in housing when the home is located on a private road, which precludes one-third of the homes of the people in Lake County.

Is that in fact the policy?

Mr. NEVILLE. If it is a private road, the individuals themselves own and have ingress and egress to the property and it is presumed that they will maintain the road so that they can pass regardless of weather conditions.

Mr. VANDER JAGT. The question does not go to the maintenance of the roads, but the residents have been refused FHA assistance in purchasing a home if the home is located on a private road. The representation has been made that it is FHA policy not to assist in housing that is located on a private road.

Mr. NEVILLE. If an easement in perpetuity can be secured by the purchaser to permit him ingress and egress to a particular location, it would be approved.

Mr. VANDER JAGT. The basis of the rule is a concern about a guarantee of ingress and egress.

Mr. NEVILLE. If you did not have that and there was a dispute with the owner of the road, and he barricaded it, you could not gain entrance to your property.

Mr. VANDER JAGT. As long as ingress and egress can be assured in perpetuity, then there is no policy against assisting housing, even if it is located on a private road?

Mr. NEVILLE. That is right, sir.

Mr. VANDER JAGT. The one realtor in the whole county has complained to me over the years about frequently shifting policies in FHA, particularly on a national level. I think we all acknowledge that if we want to improve, we are going to have to shift policies occasionally.

I wonder what steps have been taken to strengthen the communications process, particularly in terms of written regular communication so that the citizens on the local level can be well aware of just exactly what is current FHA policy.

Mr. ELLIOTT. I am relatively new, so I cannot speak to the history as well as I would like, so I will ask that Mr. Neville answer that.

Mr. NEVILLE. The question of dissemination of information is a very difficult one—who will read it, and who will not read it. Anything that is of real significance by way of regulations and policy is put into the Federal Register.

We try to put out press releases explaining what the policy is, or what has occurred in connection with it. Our public relations staff has a list of rural newspapers and periodicals to which releases are given. We have lines of communications with the building industry and the real estate industry at the national level. We advise them frequently to keep them abreast of what is going on. If we do not call them, they will call us. They do this on a regular basis.

The real estate organizations, the building organizations, invite our directors and our local county supervisors to attend their meetings and have them explain exactly what is transpiring.

Getting all this down to the individual is a problem. I do not think that we reach all the way down, even with the efforts we make, to get our information to the public. The program is not too well known, consequently, we are obligated to push it as much as we can from an educational point of view. We are endeavoring to do just this.

Mr. HANSON. If I may add to that, Mr. Congressman. In addition to these sources of information, all of the agencies of the Department of Agriculture, your SCS, your extension service—all are fully informed of our programs and they visit with people around the countryside. They are aware of our programs, so this is one source of information to the people.

Another one, the rural electric cooperatives, for example, are very active in our housing program. As a matter of fact, many of their people act as packagers, I believe, Mr. Neville.

Mr. NEVILLE. Some of them.

Mr. HANSON. The farm credit system offices, banks, all of these are sources of information to the community.

Mr. VANDER JAGT. I am glad to hear of the efforts being made, and I appreciate if a newspaper will not print it, there's nothing you can do about it. I realize the difficulty of getting a message across.

I wonder, though, is there any special effort made, when there has been a change in FHA policy, to call to the public's attention that the policy used to be thus and so, but has been changed?

Mr. NEVILLE. We very definitely make an effort on every change. In the last couple of years we have made numerous changes to accommodate our program to its expansion. With every policy change, we have made a concerted effort to get the news into the local community.

Mr. VANDER JAGT. I understand that FHA emphasizes construction of new housing rather than the purchasing of an older home. Again, focusing in on this particular county, many of the best buys are in homes that are already built. I am wondering whether that policy of across-the-board emphasizing new housing rather than the purchasing of older homes, which in some cases might be a better buy, should be a little more flexible?

Mr. NEVILLE. Let me say this, that we have no restraints on the financing of existing housing, if that is what you mean—none whatsoever. But where there is an effective demand for an inventory of new property, we are obligated to encourage building so that the housing inventory of the particular community can be increased.

I can understand how you readily conclude that we are not interested in existing structures; but we are, because they are a part of the inventory of housing. Where new housing is required, we want to push it; we advocate its development.

Mr. VANDER JAGT. Yesterday, Mr. Elliott, we were talking about the time when you were sitting on the other side of the table, participating and cutting budgets, including cutting the budget of FHA. Now you are around on the other side of the table.

I think you told us that you attempted to meet the cuts by sort of an across-the-board reduction in personnel. Was that the gist of your testimony?

Mr. ELLIOTT. I will be specific. When the budget and manpower allotments are received in the Department, the Secretary has to make decisions based on priorities. There are various agencies that have a growth pattern, for example, the Animal and Plant Health Inspection Service. The increased meat production, and resulting increased inspection demands required more people. The allocation of resources to the Farmers Home Administration is acceptable since the Secretary made his decision based on the priorities within the resources available.

Mr. VANDER JAGT. I think it was in the area of rural housing that you mentioned either that there would be a percentage reduction across the board or the lid across the board would be capped on the various States—was that correct—in an effort to meet the budgetary restrictions?

Mr. ELLIOTT. When Farmers Home receives its allocation of resources, the Administrator has the problem of placing those within the States. That goes to the loan load of the States. There is no precise formula. If you could find one for me, you would be doing me a great favor.

Mr. VANDER JAGT. As a matter of fact, then, this year was there a freeze on employees devoting their time to rural housing?

Mr. ELLIOTT. No, sir. There was not a freeze on that specifically. As a matter of fact, we are using the same resources at the county level to do all programs.

It marvels me to see how people from different fields have taken these additional programs and adapted and adjusted to them. True, it is imperfect.

We have instituted training, as we pointed out yesterday, in Norman, Okla., to improve our peoples' abilities to deal with these new dimensions. There has been no cut or reduction in any specific area, but it involves the overall numbers of people that have been provided.

Mr. VANDER JAGT. The reason for my concern, as I checked on the figures for Michigan, is that in the last 10 years the amount of loans there going out for rural housing has gone from $4 to $70 million plus, and the number of employees has remained almost exactly the same.

I think that is a tribute to the effectiveness of their work, but I would hope then that there would be no 5-percent cut across the board without taking into account the job that a group is already doing.

Mr. ELLIOTT. Sir, I can only answer that to this extent. We accept the allocation of manpower resources given to the Farmers Home Administration. As I tried to point out yesterday, one of the basic efforts in Farmers Home, that has been quite successful, is to develop systems and procedure simplifications to permit increased workloads, as you indicated in Michigan. At the same time, we train our people to enable them to do their jobs better so that we can increase responsibilities as new programs come to them.

At the same time, we try to improve the selection of personnel.

Mr. VANDER JAGT. The reason for my concern, so that you can understand what I am talking about here—and I have no brief against Georgia; I just pulled it out of the hat—is that their increase in loans over the same 10-year period has gone from $6 million to $66 million, and their employees have increased by 30. In other words, with a much smaller increase than in Michigan, it takes 30 more people to handle that increase than the Michigan increase.

So my concern would be that there would be a decision to cut everybody 5 percent, without taking into account the really effective job that was done in some areas.

Mr. ELLIOTT. I find that each of our States has variables in their programs. Some are farm oriented and require more supervision in the farm loans. When you are talking about improving rural housing, the level of knowledge of the population may result in the need for more servicing than in other areas.

Without making a State-by-State analysis of the problem, we must be concerned with different levels of knowledge and education and experiences of the populations served, as well as the kinds of people served. I am only suggesting that each State, and indeed each county, has its own peculiarities in loan load for the different programs and in the servicing of the population in the various programs.

I can only suggest that these things must be taken into consideration when we try to allocate our resources.

Mr. VANDER JAGT. I think what you are telling me is what I want to hear. Let me state it, and see if——

Mr. ELLIOTT. If you do not do it to the disadvantage of the sovereign State of Georgia——

Mr. VANDER JAGT. Absolutely not. I think what you are telling me is that you do not believe in and anticipate any across-the-board cuts. Whatever cuts or budgetary restrictions that come along, each individual situation will be taken into account.

Mr. ELLIOTT. That is correct, sir, and the Secretary did the same on allocation of his resources.

Mr. VANDER JAGT. Thank you, Mr. Chairman.

Mr. FOUNTAIN. We are going to have to interrupt ourselves at this time to start into the Arkansas situation. We are going to ask Mr. Bob Hankins, State director, and Mr. Lee Cook, assistant State director, of the Arkansas Farmers Home Administration, if they would take a seat at the table.

At this point, I am going to yield to Congressman Alexander for the examination of these witnesses. Mr. Alexander is from the State of Arkansas and for some time has been interested and concerned about this problem. He is far more familiar with what has been going on and far more capable of eliciting from the witnesses, I think, the in-

formation the committee needs. I am now going to yield to him for that purpose.

Mr. Alexander?

Mr. ALEXANDER. Thank you, Mr. Chairman.

I wish to thank the Administrator and all of his associates that are here today, for their candor and their cooperation that they have demonstrated in the past few days.

Mr. Chairman, we have an important vote, I believe, shortly after 12, and it may be necessary to request the Chair to continue the hearing for another day.

Mr. FOUNTAIN. I am inclined to think that we may have to.

Mr. ALEXANDER. Mr. Elliott, does the policy of the Farmers Home Administration permit deliberate overevaluation or overvaluation of homes for the purpose of making loans to prospective borrowers of the Farmers Home Administration?

Mr. ELLIOTT. No, sir. It does not, but there is the problem of appraisals staying current with the markets as the markets change, and whether you stay current with that market is the question at hand.

Mr. ALEXANDER. Let me illustrate my concern by requesting the Chair to admit for the record a May 3, 1973, report of the Office of Inspector General, which is a special audit conducted primarily in Lee and St. Francis Counties, Arkansas, for the purpose of evaluating the adequacy of housing appraisals in Arkansas.

Mr. FOUNTAIN. At this point, with no objection, this audit report will be made a part of the record.

[See app. 9(A).]

Mr. ALEXANDER. Mr. Elliott, the audit disclosed, I believe, that the Farmers Home Administration appraisals of prefabricated dwellings were not consistent with their appraisals of conventionally constructed dwellings. It went on to say that in some instances, prefabricated dwellings were appraised for approximately $3,000 more per home than similar conventionally constructed dwellings.

A number of prefabricated dwellings—and I believe there are 47—have been taken into Government inventory and have been reappraised at approximately $3,000 less than they were originally appraised, thereby causing a substantial loss to the Government and to the taxpayers.

I think that because of the importance of this report, Mr. Chairman, it may be well if I summarize the report and then may possibly phrase questions based upon it.

Mr. FOUNTAIN. Yes.

Mr. ALEXANDER. The report goes on to say on page 5 that Mr. Knox, who was the supervisor in one of the counties inspected, stated that he was instructed by the State FHA office to appraise the prefab dwellings higher than conventionally built dwellings. He further stated that the higher evaluation was to cover the increased cost that the prefab builders had in preparing packaged applications, and the cost of interim financing that those builders incurred due to the building under the FHA conditional commitment method.

He stated that he personally considered the conventionally constructed dwellings to be superior in construction to the prefab dwellings.

Now, going back to page 3 of the OIG report, Mr. Elliott, I would like to point to the first overvaluation that was discovered by that report. It was an overvaluation which occurred on or about March 25, 1970, whereby a prefab dwelling of an applicant, one Bruce Gilmer, was valued at $11,500.

I think it is important to note there that three comparable properties were used in order to justify that conclusion, and I refer you to those three properties there at the end of page 3. The three comparable properties used on this appraisal were all FHA-financed properties, and they were all of a conventional-type construction.

The first comparable property that was used in order to justify that conclusion of $11,500 was of a borrower, Ben Harbin. The report goes on to say that the Harbin property was rated better than the prefab because it contained 190 square feet more living area, plus it had 336 square feet of carport and storage area. The Harbin dwelling also contained one and one-half baths and was of brick veneer construction and had built-in cook top and vent hood.

The report goes on to say that the appraisal report had erroneously listed the Harbin property selling for $12,000 in 1968, when, in fact, the property was actually purchased new in 1967 at $11,500.

I would, sir, if I may, just walk through these comparable purchases with you to illustrate the rationale upon which the overvaluation was made in the Arkansas situation. In the first instance to which I refer, the second comparable property that was used to justify this overvaluation, the report says was erroneously shown on the appraisal report as being located on a 50- by 100-foot lot, as being 5 years old, and as having been sold in 1967. The borrower's loan file shows that the dwelling was actually located on a 92- by 150-foot lot and was built in 1970.

It goes on to say that the property was purchased in 1970 and was sold for $10,500. The property was rated better than the prefab, but the prefab was appraised for more than $1,000 higher.

The third comparable comparison was made on the dwelling of one borrower Turner in that vicinity. That dwelling was rated poor because of its somewhat obsolescent kind of construction, apparently in reference to the wood siding on the exterior of the dwelling. This dwelling was located on a 2-acre lot with public water facilities and had a septic tank disposal system. The dwelling contained 90 square feet more living area than the prefab.

This house, the Turner house, sold for $7.150, yet it was used along with the other two to justify an overvaluation of $11,500 by the supervisor in that county of the Gilmer home.

I would continue on page 4 and point out that similar conventionally constructed dwellings were being appraised as much as $3,100 less per dwelling than prefab dwellings during this time in that same area.

On page 5 of this audit, I think it is important to note that on June 5 Mr. Sherman Williams, former rural housing specialist of the Arkansas State FHA office, now a district supervisor, made an appraisal of a prefab dwelling located in the FHA-financed Dogwood Acres subdivision.

The report went on to say that this appraisal was made at $11,350 and was used by Mr. Williams as a guide, and in fact, was copied

for all appraisals made in the FHA-financed Dogwood Acres subdivision, which ultimately financed 53 loans at a cost of approximately $600,000 to the Federal Government.

This appraisal by Mr. Williams was used as a guide for the financing of 53 homes at cost of $600,000. In the middle of page 6 of the audit, it says the Gilmer property was used as justification and basis for that conclusion, together with, at the top of the page, a reference to the dwelling of one Johnny Taylor. That paragraph says that this property was erroneously listed on the appraisal report as selling for $8,750 in 1968. It actually sold for $8,000 in that year.

Further to justify the overvaluation, a third comparable was used by referring to a prefab dwelling in Marianna, Lee County, Ark., where Mr. Williams had previously appraised his Lee County prefab dwelling.

It says Mr. Williams showed this dwelling as being as comparable or as equal to the prefab being appraised, that it was slightly less desirable due to its site location, and that it was sold for $11,250 in 1970.

There are a couple of more items that I would like to point out, if I may, before the questioning starts.

Mr. Williams—whom I do not know—and I would ask if he is here?

Mr. ELLIOTT. No.

Mr. ALEXANDER. Mr. Williams made his appraisal of a similar type situation in St. Francis County, and the report goes on to say that comparable houses of conventional design were valued from $1,000 to $3,000 less for dwellings than the appraised value put on the prefab dwelling.

It goes on to continue that in Lee County a similar appraisal was made by Mr. Williams in the Town and Country subdivision No. 2, and that the prefabs there were appraised by Mr. Williams at $11,250.

It goes on to say that in each case the comparables had erroneous information on them. In each case those erroneous reports were used to justify an overvaluation of a subdivision.

On page 8, in October of 1972, at OIG's request, a Mr. Thomas L. Dial, real estate appraiser of Helena, Ark., appraised two prefab dwellings located in the Town and Country subdivision to which I referred a minute ago. In the Town and Country subdivision No. 1, he appraised a house at $7,900 that had been previously appraised by FHA officials at $10,500; and in subdivision No. 2, he appraised the house at $8,150 which had previously been appraised by FHA officials at $11,250.

Continuing, the report says that FHA made 12 loans in the Town and Country subdivision No. 2; seven of these loans have now been abandoned, and forceclosure action has been taken. A Mr. Kennedy reappraised a property in the subdivision for $8,000, which had previously been appraised for $11,250.

He goes on to say that the reason that his appraisal is $3,250 less than the original FHA appraisal was that the house, in his opinion, was overappraised originally. Mr. Kennedy went on to say that in his judgment there will be a loss to the Federal Government in the Town and Country subdivision of over $20,000 on the seven dwellings that foreclosure action has been taken on to this point in time.

One more point. Referring to page 10, in another section of the State, Miller and Lafayette Counties, it is reported that in those counties the same prefab dwellings were used to build a 60-dwelling subdivision, and at this point in time foreclosure action has been taken on approximately 40 of those 60 loans at an estimated loss to the Government of over $120,000.

My question to you, sir, does the national Farmers Home Administration office know of any situation anywhere else in the country com-

Mr. ALEXANDER. Do you have any reason to disagree with the report?

Mr. NEVILLE. No, sir.

Mr. ALEXANDER. Have you read the report, Mr. Elliott?

Mr. ELLIOTT. I have.

Mr. ALEXANDER. Do you any reason to disagree with the report?

Mr. ELLIOTT. I have no reason to at this point. We are investigating it in detail and, frankly, the individual rights of the people that may or may not be involved in this in the due process should not be prejudiced. Therefore, I am in no position until the evidence is in to commit to this situation any of my personal opinions.

Mr. Alexander, if we do find any situation that requires action, it will be taken; but until then, it would be prejudicial for me to give an opinion and I feel that I must remain silent.

Mr. ALEXANDER. Mr. Elliott, I have here a copy of a letter dated May 22, 1973, from Mr. Robert L. Hankins, who is the president and State director of the Farmers Home Administration in Arkansas, which, Mr. Chairman, I would offer for the record.

Mr. FOUNTAIN. It will be received, without objection.

[See app. 9(B).]

Mr. ALEXANDER. As I understand it, the May 22 letter from Mr. Hankins is in response to the May 3, 1973, report to which I just referred. I will read two or three excerpts from this reply from Mr. Hankins.

The letter begins, "This interim report is provided in accordance with your telephone instructions." It goes on to say, "In earlier years the Farmers Home Administration started a rural housing program with a community father-son type builder." It goes on down in the report to say, in explanation of his policies in Arkansas, "It was the presumption that this mass production," referring to the father-son type builder, "of homes would help to meet the pressing need for rural housing and assist in meeting the national housing goals. As a result of this experience, we were made aware of our years of underappraising real estate properties. To further substantiate this fact, we now find many of the small builders were forced out of business."

Continuing, "To meet this problem, we immediately took action to update our appraisal methods and to make employees charged with this responsibility knowledgeable of the need to use current sales information from units sold for cash or financed by conventional lenders."

In the last paragraph Mr. Hankins says, "This updating of our appraisal system has produced a good rural housing program."

Mr. Hankins, do you still agree with the statement that you made in the letter to which I referred?

Mr. HANKINS. As far as the overall program is concerned in Arkansas, Mr. Alexander, I still agree with the statement.

Mr. ALEXANDER. Mr. Hankins, did you or anyone in your office in Arkansas instruct Mr. Knox in St. Francis County to overvalue the houses that are referred to in the OIG report?

Mr. HANKINS. No, sir. I did not.

Mr. ALEXANDER. Do you know anyone in your office who authorized that overvaluation?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. Mr. Chairman, I believe the statement that Mr. Hankins is about to make would disagree with the OIG report. I believe it is customary in situations of this type, to put the witnesses under oath.

Mr. ELLIOTT. Mr. Chairman, I request one consideration. We are at the present time reviewing the facts in the Farmers Home Administration. This is under active investigation. I believe that this present time if the context of this hearing has changed that I should be informed so that we may obtain counsel.

Mr. FOUNTAIN. We are going to have to take a recess anyway, Mr. Elliott. I do not think we are going to be able to finish. We have to be on the floor to vote.

The subcommittee stands in recess until tomorrow morning at 10.

[Whereupon, at 12:05 p.m., the subcommittee adjourned, to reconvene at 10 a.m., Thursday, June 7, 1973.]

FARMERS HOME ADMINISTRATION (RURAL HOUSING PROGRAM OPERATIONS)

THURSDAY, JUNE 7, 1973

House of Representatives,
Intergovernmental Relations Subcommittee
of the Committee on Government Operations,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:20 a.m., in room 2247, Rayburn House Office Building, Hon. L. H. Fountain (chairman of the subcommittee) presiding.

Present: Representatives L. H. Fountain, Don Fuqua, Bill Alexander, Clarence J. Brown of Ohio, and Alan Steelman.

Also present: James R. Naughton, counsel; and Richard Thompson, minority staff member, Committee on Government Operations.

Mr. Fountain. Let the subcommittee come to order, and let the record show that a quorum is present.

Mr. Elliott?

Mr. Elliott. Yesterday I pointed out that I would request advice of counsel. I did so in order to be sure that we would not prejudice the judicial process and to protect individual rights of personnel I am responsible to and for.

The Congressman from Arkansas had requested in his discussion that I read this audit report by the Inspector General in the region area. I had read it and I found it full of inconsistencies.

I did not have time to put it in the record, because I did not wish to interrupt the honorable Congressman. However, I had real concern about many elements of this audit report and have instigated a full investigation to find the facts concerning all aspects of this audit report.

With that, sir, to assure you that these gentlemen have the privilege of making their own statement for the record, they have informed me that they are willing, without question, to testify under oath. I would like to point out for the record that they do so without personal counsel. We are unable in the Department to provide them with personal counsel, although I do have counsel in my capacity as Acting Administrator.

Mr. Fountain. I would like to say to Mr. Hankins, Mr. Cook, and Mr. Williams, that if for any reason, because of the request that you give your testimony under oath, you want to consult counsel or prefer not to testify, we can always bring you back again.

But as I understand it, you are willing to be sworn in and questioned with respect to this audit or anything else that refers to the work that you have been engaged in.

You have been advised that you have a right to counsel. If for some reason you need the advice of counsel we will decide on it at that time and give you a chance to obtain counsel.

I think the record should indicate that none of this discussion is designed to leave any inference or impression that the committee thinks anyone is guilty of anything. It just happens that because of the contradictions within the report, the distinguished gentleman from Arkansas, Mr. Alexander, felt that we should pursue the course that this committee has in the past in situations of this kind.

So we will proceed.

If you will raise your right hand, Mr. Hankins.

Do you solemnly swear that the testimony you are about to give to this subcommittee hearing in the matter about which the subcommittee is making inquiry will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. HANKINS. Yes, I do.

Mr. FOUNTAIN. Mr. Alexander?

Mr. ALEXANDER. First, I would like to again thank the Administrator, Mr. Elliott, and his associates, all of you, for your candor in this hearing.

Mr. Elliott, I am especially appreciative of your statement that you personally have instituted an investigation of this case.

Inasmuch as you have commented on that subject, I do not feel constrained to reply. You are a new Acting Administrator of the Farmers Home Administration, and it may be of some value for you to know of the difficulty that we have had in obtaining the information from the Farmers Home Administration.

Your predecessor, Mr. James Smith, dragged his heels for 4 years on this case. That is the reason that we are now, here in this Congress, doing it the hard way. I first learned of complaints about the operation of the Farmers Home Administration in 1969, about 6 or 8 months after I had been sworn in as a freshman Member of Congress.

I think it would be beneficial for you to know that I took the complaints under advisement and did nothing with them, except to compare complaints from one county with another county, 200 miles apart. In each case, the complainants, my constituents, the ultimate authority in this country, which all of us will recognize, were being mistreated by the operations of the Farmers Home Administration. I tried to do it the easy way by passing these complaints on to the State authorities, represented by Mr. Hankins on your right, and to the national authority, Mr. Smith. I received darn little cooperation. That is why we are here.

If we had had the cooperation that would normally be expected by any Federal agency, we could have gotten to the bottom of this thing years ago. Furthermore, I believe we could have saved the taxpayers a lot of money in the process.

Mr. ELLIOTT. I can assure you that you will have our cooperation. I will also assure you that, as long as I am in my capacity, you will get cooperation. We are endeavoring to take corrective actions.

Mr. ALEXANDER. Mr. Elliott, I believe you. I believe that the statement you are making is true, that you are determined to get to the bottom of the discrepancies that have plagued the Farmers Home Administration. You have already indicated that when you agreed to the

recommendations of the General Accounting Office and of the Office of Inspector General to some of the reports.

You mentioned that there are contradictions in the report. Mr. Chairman, maybe we should address ourselves this morning to those contradictions.

Mr. FOUNTAIN. Go right ahead.

STATEMENT OF ROBERT HANKINS, STATE DIRECTOR, ARKANSAS FARMERS HOME ADMINISTRATION

Mr. ALEXANDER. Mr. Hankins, you said yesterday at the conclusion of the hearing before we recessed—and I quote from the record—I asked you—I said, "Mr. Hankins, do you still agree with the statement that you made in your letter to which I referred?"

Now, that letter was the May 22 letter.

Mr. HANKINS. You are talking about the second paragraph, Mr. Alexander?

Mr. ALEXANDER. Mr. Hankins, let me rephrase the question so there will not be any misunderstanding. I am referring to the May 22, 1973, letter to the Director, Internal Review Staff, Farmers Home Administration, Washington, D.C., bearing your signature, Robert L. Hankins, State director, which is in reply to the report to which I referred yesterday by the Office of the Inspector General, which Mr. Elliott now says there are contradictions in.

This letter of May 22 was in reply to that report. Is that correct?

Mr. HANKINS. Correct. However, the letter was only an interim reply to that report.

Mr. ALEXANDER. Did you have occasion to discuss this report with the Office of Inspector General?

Mr. HANKINS. Yes, sir, the rough draft.

Mr. ALEXANDER. My reference indicates that you discussed this report with the Office of Inspector General on two occasions.

Mr. HANKINS. This is correct.

Mr. ALEXANDER. I believe, April 10, 1973, and April 13, 1973.

Mr. HANKINS. That is correct.

Mr. ALEXANDER. On those occasions, did you or did you not read the report?

Mr. HANKINS. Sir, the report was in rough form. We discussed the report, but we did not read it in the entirety and we did not have an opportunity to study it.

Mr. ALEXANDER. Did you discuss the so-called contradictions that are alluded to by Mr. Elliott?

Mr. HANKINS. Sir, these contradictions, as I know them, were not in the report at that time, or so worded.

Mr. ALEXANDER. Did the representatives from the Office of the Inspector General discuss with you any of the items which I referred to yesterday, concerning the overvaluation of the homes in Lee and St. Francis Counties?

Mr. HANKINS. Yes, sir, they did.

Mr. ALEXANDER. Did they discuss with you the specific properties to which they refer as a basis for their evaluation?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Did you at that time express any objection to their representations to you?

Mr. HANKINS. Yes, sir. But it was not as strong as it was later on when we saw the final report.

Mr. ALEXANDER. All right, sir.

With whom did you discuss this report that was representative of the OIG?

Mr. HANKINS. The OIG representative?

Mr. ALEXANDER. Yes.

Mr. HANKINS. Mr. Martin, Mr. Stuckey.

Mr. ALEXANDER. Would you describe to us that discussion on April 10 and April 13 that you engaged in with the representatives of OIG?

Mr. HANKINS. We discussed it, but the report was not in final form. At that time they did not bring out all of the points that we are objecting to at this time.

Mr. ALEXANDER. Let me ask you specifically, going to the report, beginning on page 1, what items in this report do you object to?

Mr. HANKINS. The allegations of the OIG that the appraisals of prefab dwellings were not consistent with the appraisals of conventionally constructed dwellings.

Mr. ALEXANDER. Mr. Elliott, I would like very much to question the witness and elicit from him his responses to my questions.

Mr. ELLIOTT. He does not have the report in hand. I will give it to him.

Mr. ALEXANDER. All right, sir.

Mr. Hankins, I am sorry; I did not hear that answer a minute ago.

Mr. HANKINS. The allegations of the OIG that the appraisals of prefabricated dwellings were not consistent with the appraisals of conventionally constructed dwellings.

Mr. ALEXANDER. You object to the conclusion of the audit report which states that the Farmers Home Administration appraisals in Arkansas of prefabricated dwellings are not consistent with their appraisals of conventionally constructed dwellings? You object to that?

Mr. HANKINS. Yes.

Mr. ALEXANDER. All right, sir.

Do you object to the next sentence that says, in some instances, prefabricated dwellings were appraised for approximately $3,000 more than similar, conventionally constructed dwellings?

Do you object to that?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. You object to that?

Mr. HANKINS. Yes.

Mr. ALEXANDER. All right, sir.

Let's go down to the next sentence. "A number of these prefabricated dwellings had been taken into Government inventory and had been reappraised at approximately $3,000 less than they were originally appraised."

Do you object to that?

Mr. HANKINS. It is not consistent.

Mr. ALEXANDER. Do you object to it? Does it meet with your approval, or does it not meet with your approval?

Mr. HANKINS. It does not, sir.

Mr. FOUNTAIN. What you are asking, Mr. Alexander, is whether each statement is true or false?

Mr. ALEXANDER. Yes, sir.

It goes on to say that State office personnel advise that the appraisals on the prefabricated dwellings were increased to try to increase the volume of rural dwellings and to meet the demand of rural housing loans in the State. However, FHA instructions in effect at the time did not contain any provisions for appraising a dwelling for more than its current market value.

Do you object to that, or is that true or untrue?

Mr. HANKINS. I object to the allegations of the OIG that dwellings were appraised for more than their current market value.

Mr. ALEXANDER. You object to that? That is not true?

Mr. HANKINS. Right.

Mr. ALEXANDER. All right, sir.

Now, let's go to the next page.

You do admit that you did meet with the OIG inspectors on April 10 and April 13?

Mr. HANKINS. Yes.

Mr. ALEXANDER. All right, sir.

Let us go on, looking down to the next to the last paragraph. It says, "A further discussion was held on April 13, 1973, with Mr. Hankins and Mr. Cook concerning our recommendations. Personnel generally agreed with our findings and recommendations and expressed a desire to take corrective action. Their comments, where appropriate, were included in the details section of this report."

Is that a true statement? Did you, on April 13, generally agree with the findings and recommendations expressed by the OIG inspectors when they met with you on those two occasions?

Mr. HANKINS. We generally agreed with the recommendations, Mr. Congressman, as to what they had on their paper at that time.

Mr. FOUNTAIN. What you are saying is that what they had on the paper at that time was not the complete report as it came out?

Mr. HANKINS. That is true.

Mr. ALEXANDER. All right, sir.

Let us go through this report and find out what was not discussed with you that you now object to.

I think it would be appropriate to begin on page 5, in the middle of the page, where it says that Mr. Knox stated that he was instructed by the State FHA office to appraise the prefab dwellings higher than conventionally built dwellings.

Did you discuss that subject with the OIG investigators?

Mr. HANKINS. Yes, sir. It was discussed, but not in this light. The discussion brought out that maybe Mr. Knox had made a statement to OIG that questions relative to appraisals concerning prefab dwellings be referred to the State office.

Mr. ALEXANDER. What was the nature of your discussion at that time? Would you describe to us the discussion with these two men with reference to this statement?

Mr. HANKINS. They did not point out the allegation that Mr. Knox had said that the higher valuation was to cover the increased cost of prefabs, and that the conventionally constructed dwellings were superior to construction of prefab dwellings.

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Mr. ALEXANDER. Did they say that Mr. Knox had stated that he was instructed by State FHA officials to appraise prefab dwellings at higher value than the conventionally built dwellings? Did they or did they not?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. They did not discuss that with you?

Mr. HANKINS. No.

Mr. ALEXANDER. Neither of these gentlemen—who were they?

Mr. HANKINS. Mr. Stuckey and Mr. Martin.

Mr. ALEXANDER. Mr. Stuckey and Mr. Martin, investigators of the Inspector General, the Department of Agriculture—and you are saying here now, here today under oath, that they did not discuss this with you?

Mr. HANKINS. Not in this manner.

Mr. ALEXANDER. In what manner did they discuss it with you?

You met on two occasions, and you replied to that discussion with this letter that I have here in my hand, and you make no reference whatever to your objections in this letter of May 22.

Mr. HANKINS. The reason is that we did not have the final report.

Mr. ALEXANDER. I will get to the reason a little later.

Mr. FOUNTAIN. Will the gentleman yield at this point?

Mr. ALEXANDER. Yes.

Mr. FOUNTAIN. Do we have information in the record as to what person in the State office is supposed to have instructed Mr. Knox?

Mr. ALEXANDER. I intend to reach that in just a minute, Mr. Chairman.

Mr. FOUNTAIN. Go right ahead.

Mr. ALEXANDER. I repeat the question, Mr. Hankins. Are you saying, now, that neither of the gentlemen from OIG discussed this fact with you, this allegation with you?

Mr. HANKINS. I do not recall. I will supply that information later to the committee.

[The following statement was subsequently provided:]

On April 10, 1973, Mr. Don Martin, representative of OIG, led in a discussion of the proposed contents for an audit report on appraisals.

A few minutes prior to the beginning of the meeting, Mr. Martin distributed some very rough copies of the findings that he said would be the material for the report. We were advised to review the copy and be ready for our remarks.

In accordance with my recollection of the subsequent discussion, we agreed with some items and disagreed with many of the statements made by Mr. Martin. The portion of the copy relative to the alleged actions and statements by Mr. John Knox, FHA Supervisor for St. Francis County, was discussed but not in the light reflected in the final audit report dated April 10, 1973. To my knowledge, no transcript of the discussion was made, and we cannot recall all the exact conversation between all individuals attending the meeting. However, I feel certain the statement attributed to Mr. Knox was not accepted as fact. Any alluding to this statement by the OIG would have been considered as information that was refutable.

In the meeting of April 13 with Mr. Martin, the discussion was generally along the lines of what the audit recommendations for State office corrective action would be.

Mr. ALEXANDER. We are here now, Mr. Hankins, to discover what you know about these facts, these allegations. We have gone to a lot of trouble to call these hearings. You have come all the way from Arkansas. We would like to know what you know about it right now.

Mr. HANKINS. To the best of my knowledge, it was not discussed.

Mr. ALEXANDER. Are you saying now that it was not discussed?

Mr. HANKINS. I will say it was not discussed.

Mr. ALEXANDER. Mr. Hankins, when did you first get a complete report—before or after May 22?

Mr. HANKINS. It was before May 22.

Mr. ALEXANDER. It was before May 22?

Mr. HANKINS. Right.

Mr. ALEXANDER. All right, sir.

Let's go on to other parts of this report that seem to be somewhat contradictory. On page 3 of this OIG report, it says that the first appraisals of the prefab dwellings—and I will refresh your recollection—were deliberately overvalued at approximately $3,000 per dwelling more than conventionally built homes.

It says here that the first appraisal of these prefab dwellings in Lee and St. Francis Counties was made by John F. Knox, St. Francis County supervisor, on March 25, 1970.

Was this discussed at your meeting on either of these occasions with the OIG inspectors?

Mr. HANKINS. Yes, sir; they discussed these.

Mr. ALEXANDER. They discussed these?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. It goes on to say that Mr. Knox appraised the prefab dwelling at $11,500. Was this discussed?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. All right, sir.

It goes on to say that the appraisal was made on the RH loan applicant, Carey Bruce Gilmer, who subsequently received a Rural Housing loan to purchase the dwelling.

Was this discussed, Mr. Hankins?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. It goes on to refer to three comparable properties that were used as a basis for this valuation of $11,500. The first comparable property was borrower Ben Harbin. The second comparable property was borrower James Chatters. The third borrower was Eugene Turner.

Were these three comparable properties discussed by the OIG inspectors; yes or no?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Mr. Hankins, the report refers in each case to erroneous facts in the FHA records that were noticed by the OIG inspectors.

Did they discuss these errors with you?

Mr. HANKINS. They mentioned that there were errors in the appraisals, yes.

Mr. ALEXANDER. In other words, your FHA records, were not correct?

Mr. HANKINS. According to the OIG report, this is true, sir.

Mr. ALEXANDER. Did you follow up on that to make that determination of whether it was true or not true?

Mr. HANKINS. We have not as yet.

Mr. ALEXANDER. You have not?

Mr. HANKINS. No.

Mr. ALEXANDER. You do not know whether or not the three comparable properties that were used as a basis for evaluation were based on error or based on fact?

Mr. HANKINS. This is true.

Mr. ALEXANDER. You say that you first received notice of this when?

Mr. HANKINS. It was prior to the 22nd.

Mr. ALEXANDER. Of May?

Mr. HANKINS. Right.

Mr. ALEXANDER. 1973?

Mr. HANKINS. Right.

Mr. ALEXANDER. What have you done to determine the truth or untruth of the OIG report as referred to these three comparable properties?

Mr. HANKINS. Nothing, sir.

Mr. ALEXANDER. You have not done anything?

Mr. HANKINS. No.

Mr. ALEXANDER. Why have you not done anything?

Mr. HANKINS. I was out in the State on other complaints and had not had time to get around to it, sir.

Mr. ALEXANDER. Have you instructed anyone in your office to do anything with reference to this report?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. All right, sir.

Mr. FOUNTAIN. How long ago has this been?

Mr. NAUGHTON. With respect to when the report was received by the State office, I have a letter from R. L. Caldwell, Assistant Regional Inspector General, Temple, Tex., apparently forwarding copies of the audit that we are discussing to Washington, dated May 3, 1973.

This letter indicates that carbon copies were sent to the State director, Arkansas State FHA Office, in duplicate with two copies of the report. I would assume by that they would have been received fairly soon after May 3.

Is that correct?

Mr. HANKINS. Right.

Mr. NAUGHTON. The response made to the national office to the audit that we have also been discussing here was dated May 22. So you would have had it about 2 weeks or so before the reply was made.

Mr. ALEXANDER. Shall we continue with the inconsistencies in this report, Mr. Hankins?

It goes on, on page 4, and says that similar conventionally constructed dwellings were being appraised as much as $3,000 less than prefab dwellings during this time, and the following examples are cited. It refers to Ollie R. Harrison, James H. Ware, and Doris W. Young.

Did you discuss these comparables for conventionally constructed dwellings?

Mr. HANKINS. Were they discussed?

Mr. ALEXANDER. Yes, sir.

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. They were discussed?

Mr. HANKINS. Right.

Mr. ALEXANDER. All right, sir.

Now, on page 5 of the OIG report, on June 5, 1970, Mr. Sherman Williams, former rural housing specialist, Arkansas State FHA Office, now district supervisor, made an appraisal of a prefab dwelling located in the FHA-financed Dogwood Acres subdivision at Madison, Ark., in St. Francis County.

Was this discussed with you by the OIG inspectors?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. It was?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Did you go on then to discuss that Mr. Williams was going to make an appraisal of that subdivision—I stand corrected. Mr. Williams made an appraisal of that subdivision, which was used as a guide to finance 53 loans at a cost of approximately $600,000.

Did you discuss that with them?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. You did that?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Continuing with the report, did you discuss the fact with the OIG investigators that the comparable used for this appraisal was the Bruce Gilmer property to which I referred a minute ago? Was that one of the comparables that you discussed with the OIG inspectors?

Mr. HANKINS. I cannot remember, sir.

Mr. ALEXANDER. You do not remember that?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. All right, sir.

Did you discuss the other comparables which, according to the report, were based on error?

Mr. HANKINS. I am sure that we discussed some comparables.

Mr. ALEXANDER. Let me refresh your recollection. You said a minute ago that you do not remember whether or not you discussed the Bruce Gilmer property. Are you now saying that you are sure that you discussed these comparables?

Mr. HANKINS. No, sir. I am not going to say that. I am going to say I do not remember.

Mr. ALEXANDER. You do not remember?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. All right.

At the time, Mr. Williams made his appraisal, there were numerous FHA-financed conventional-type dwellings under construction in St. Francis County by various builders. Although these buildings were similar in size, location, and design to the prefab dwellings, they were being appraised, contracted, and built from $1,000 to $3,000 less per dwelling than the appraised value put on the prefab dwelling.

Did you discuss that?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. You did discuss that?

Tell me about your conversation with these two inspectors concerning this allegation by them that in one of your counties conventionally built houses were selling for from $1,000 to $3,000 less than prefab housing.

Would you tell me the nature of your discussion, and the content of it, with these two inspectors?

Mr. HANKINS. We discussed the comparables in this situation. We were in agreement, basically, as far as the FHA State office is concerned, that our appraisals were all right. There may have been some error in judgment.

Would it be all right if I passed that question on to Mr. Williams?

Mr. ALEXANDER. I will get on to Mr. Williams in just a few minutes.

Mr. HANKINS. All right, sir.

Mr. ALEXANDER. Would you continue with the nature of your discussion? Was it a long discussion or a short discussion? How long a time did it take for you to talk about this problem in St. Francis County?

Mr. HANKINS. I believe the first discussion was about 30 to 45 minutes.

Mr. ALEXANDER. Would you tell us on this committee——

Mr. HANKINS. We went over the audit report that we had in rough draft. We discussed basically what I have mentioned.

Mr. ALEXANDER. Did you disagree with them about their findings on the conventional valuations?

Mr. HANKINS. We disagreed with them. We thought we would check it out further.

Mr. ALEXANDER. You expressed disagreement to the inspectors in their appraisals?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. In other words, you said, "This is a contradiction of the findings that I have made," and that this is incorrect?

Mr. HANKINS. To a certain degree; yes, sir.

Mr. ALEXANDER. I see. Why did you not put that in your May 22, 1973, response to that letter? Is that not true, Mr. Hankins, that——

Mr. HANKINS. You mean May 22?

Mr. ALEXANDER. May 22, 1973.

I am going to refer to that letter again in response to this report. We could go on through this report, but I am interested in why you said it was the presumption that mass production of homes would help to meet the pressing need of rural housing and assist in meeting the national housing goals.

> As a result of this experience, we were made aware of our years of underappraising real property. To meet this problem, we immediately took action to update our appraisal attitude and to make employees charged with this responsibility knowledgeable of the need to use current sales information from units sold for cash or financed by conventional lenders.

You go on to say that "this updating of our appraisal system has produced a good housing program."

Why did you not in that letter, Mr. Hankins, disagree with some of the allegations that were made by the inspectors that your office in Arkansas was deliberately overvaluing these properties?

Mr. HANKINS. Well, sir, I guess it was an oversight on my part.

Mr. ALEXANDER. Just an oversight on your part?

Mr. HANKINS. Yes.

Mr. ALEXANDER. In other words, you got two men from the Office of Inspector General that came to Arkansas in response to a flurry of public notice—and I refer here, Mr. Chairman, to a clipping from an Arkansas newspaper dated January 14, 1972, the headline of which says, "Defective Houses Sold Through FHA, Thornton Says." This

is the former attorney general of Arkansas, who is now a Member of Congress.

I offer this for the record at this point.

Mr. FOUNTAIN. With no objection, it will be received.

[The article follows:]

[From the Arkansas Gazette, Jan. 14, 1972]

DEFECTIVE HOUSES SOLD THROUGH FHA, THORNTON SAYS

Attorney General Ray H. Thornton said Thursday his office had found many defective low-cost houses in the Marianna area that were built for sale through the federal Farmers Home Administration program.

Thornton's office started an investigation of the housing in November after state Representative J. B. Smith of Marianna made a complaint that houses being sold under the FHA program were badly built, leaving poor persons with 30-year mortgages and homes that were falling apart rapidly.

In a news release, Thornton said his office had examined 31 houses in two subdivisions built in the last two or three years by Lee Builders, Inc., of Marianna. Lee Builders is owned by A. C. Sisk Jr., Representative Smith's Republican opponent in 1970.

One of the subdivisions is about four miles south of Marianna on state Highway 1 and the other is north of Marianna at Haynes. Ten of the houses had been sold and the loans had been approved by the Farmers Home Administration. Thornton said the other 21 homes were vacant and apparently had not been sold.

He said he discovered homes with "badly chipping and peeling exterior paint, rough and uneven concrete and tile floors, shabby and unfinished interior paneling, poor installation of doors, windows, appliances and plumbing fixtures, and overall substandard materials and poor construction."

His investigation was made in co-operation with FHA officials, Thornton said.

"They have assured me that no more loans will be made for purchases of these homes until such time as the contractor rebuilds or otherwise repairs the defects to the satisfaction of FHA officials," Thornton said.

He also said FHA officials told him that the agency previously had approved loans to families to make the necessary repairs to bring the homes up to acceptable standards.

Thornton said families who had bought such homes with FHA loans should contact the county or state FHA office.

The FHA operations have been under investigation by various groups since last summer. United States Representative Bill V. Alexander of Osceola said that he was receiving complaints from several East Arkansas communities about bad homes being approved by the FHA and other irregularities.

The General Accounting Office and the House Committee on Government Operations have been conducting investigations. The investigations have covered several East Arkansas counties.

Sisk said Thursday the investigations were political. Sisk is chairman of the Lee County Republican Committee and served two brief appointments by Governor Winthrop Rockefeller in 1967 and 1970 as Lee County tax assessor. He filled the unexpired terms of assessors who died.

Sisk said the same type of homes, built with the same package of materials, were being constructed by "good Democrats" in St. Francis and Phillips counties and that he thought it strange that no investigations were undertaken of those enterprises. He declined to name the companies.

Mr. ALEXANDER. Knowing of these statements made in Arkansas, a flurry of television publicity adverse to the Farmers Home Administration, knowledge of my interest which I have expressed to you which originates from our constituents over in the First Congressional District, two inspectors came to your office and talked to you about these deficiencies and you failed to reply to these deficiencies because it was an oversight?

Are you telling that to this committee today?

Mr. HANKINS. To go back to my original letter, we did say in the last paragraph, an in-depth analysis is being made of our appraisals, and a complete report will be submitted in the near future.

Mr. ALEXANDER. Have you made an in-depth analysis, Mr. Hankins?

Mr. HANKINS. We are in the process of making an analysis.

Mr. ALEXANDER. How long have you been aware of the concern of the operation of the Arkansas Farmers Home Administration?

Mr. HANKINS. By whom, sir?

Mr. ALEXANDER. By the General Accounting Office of the U.S. Congress.

Mr. HANKINS. I have been aware of this for some time.

Mr. ALEXANDER. You say for some time? How long?

Mr. HANKINS. Whenever they came in, approximately 1970, 1971.

Mr. ALEXANDER. About 1970?

Mr. HANKINS. Right.

Mr. ALEXANDER. You have been aware of this concern and you are still working on your analysis?

Mr. HANKINS. Yes, sir. We are working on an analysis and some other things to upgrade the Farmers Home Administration housing program in Arkansas.

Mr. ALEXANDER. Up until this point in this report, you had not contradicted the facts that were discussed, particularly, only the conclusions.

Would you like to go through this report?

Mr. Chairman, would I have time to go through and point out some other inconsistencies?

Mr. FOUNTAIN. Go right ahead. Just give him a chance to explain them.

Mr. ALEXANDER. All right, sir.

Mr. Hankins, the report goes on to say an appraisal was made of the prefab dwellings in Lee County, Ark., and specifically refers to the Town and Country subdivision.

Mr. HANKINS. What page are you on, sir.

Mr. ALEXANDER. Page 7.

Then it talks about the comparables that were used as a basis for valuing a sample prefab dwelling at $11,250. It refers there to three comparables, one Klenk. In that statement, it says, the appraisal erroneously listed the selling price of this comparable at $12,000.

An option to purchase agreement in the FHA loan file of Mr. Klenk shows the selling price of the property to be $10,000.

Did you discuss this error in using this comparable as a basis for this valuation?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. What did you say to the two gentlemen from OIG about this error and about this comparable?

Mr. HANKINS. I do not remember, sir. We discussed it; I remember that. I do not know what was said.

Mr. ALEXANDER. What did they say to you?

Mr. HANKINS. I do not remember.

Mr. ALEXANDER. You did discuss it?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. All right, sir.

Did you discuss the second comparable listed there, of one Mr. Passmore?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Do you remember the discussion?

Mr. HANKINS. I remember that the dwelling was rated poorer than the one being appraised.

Mr. ALEXANDER. Do you remember the Passmore discussion?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Could you tell us about that, sir?

Mr. HANKINS. This dwelling was rated poor, I remember that. It was near Moro, Ark.

Mr. ALEXANDER. Is that all you remember about the discussion?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. It goes on here to say that this comparable, located in Moro, Ark., contained over 1,000 square feet, more living area than the prefab being appraised, and also had 336 square feet of carport and storage area. The comparable was of brick veneer construction, was 6 years old, and was listed as selling for $10,000 in March 1969.

Do you remember that?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. You do not remember that part of it?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. Let's go on to the next one, where it talks about the third comparable. I will just read this. "The third comparable used was the same type prefab dwelling as the one being appraised. This comparable was located in Garland City, Ark."

Do you know where Garland City is?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. How far is that from Marianna?

Mr. HANKINS. 250 miles.

Mr. ALEXANDER. Can you tell me why a comparable was used 250 miles away?

Mr. HANKINS. Yes. Because it was similar in design and construction.

Mr. ALEXANDER. All right, sir.

Did you not have some comparables in the neighboring counties, in Phillips County?

Mr. HANKINS. Mr. Alexander, this is a judgment the appraiser needs to make. I remember this case quite well. It is the appraiser's prerogative to go beyond local areas, if he feels the need to do so, to obtain suitable comparables.

Mr. ALEXANDER. You are saying, the appraiser in this case went 250 miles away to get a comparable that was $10,800, when he could have gone 20 miles down the road and gotten a comparable of the same dwelling for $9,500.

Mr. HANKINS. Again, this is a judgment factor.

Mr. ALEXANDER. It is a matter of judgment?

Mr. HANKINS. Yes.

Mr. ALEXANDER. It is a policy of your office, you as Director?

Mr. HANKINS. In this case, yes.

Mr. FOUNTAIN. Would the gentleman yield?

Mr. ALEXANDER. Yes.

Mr. FOUNTAIN. You said, in this case, yes. Why this case?

Mr. HANKINS. Mr. Williams appraised this property, and Mr. Williams is qualified to appraise in any part of the State of Arkansas.

Mr. FOUNTAIN. Mr. Alexander, because some of your questions might be apropos to one of the other men rather than Mr. Hankins, I think I will swear them in also.

Mr. ALEXANDER. All right, sir.

If you want to go ahead and do that, it is all right.

Mr. FOUNTAIN. Mr. Cook and Mr. Sherman Williams, will you hold up your right hands?

Do you solemnly swear that the testimony that you are about to give during the course of this hearing about this investigation will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. WILLIAMS. I do.

Mr. COOK. I do.

Mr. FOUNTAIN. Thank you.

STATEMENT OF LEE COOK, ASSISTANT TO STATE DIRECTOR, ARKANSAS FARMERS HOME ADMINISTRATION; ACCOMPANIED BY SHERMAN WILLIAMS, DISTRICT SUPERVISOR

Mr. ALEXANDER. Mr. Hankins, going over to page 8, October of 1972, at OIG's request, Mr. Thomas Dial, a real estate appraiser in Helena, Ark.—and for the record, Mr. Chairman, it is close in proximity to Marianna, Ark., less than 30 miles.

Mr. Dial appraised two prefab dwellings located in Lee County in the Town and Country subdivisions 1 and 2. He appraised the first dwelling at $7,900. FHA officials had appraised that same prefab dwelling at $10,500.

Mr. Dial appraised a dwelling in that Town and Country subdivision No. 2 at $8,150, whereas the Farmers Home Administration had appraised that same dwelling for $11,250.

Did you discuss this difference of appraisal with the OIG inspectors?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Could you relate to the committee the nature of your discussion and its contents?

Mr. HANKINS. We discussed the reasons why there was a decline in the value of the houses during the 2-year period, Mr. Alexander. This was due to the racial strife and the boycott against white-owned business, which was given wide publicity in the press, in Marianna and the adverse publicity that we received on these houses. These were the basic reasons why home values declined.

Mr. ALEXANDER. I see.

In other words, you are saying that the reason that there is almost an average of $2,500 difference in these appraisals is because of the racial strife at Marianna?

Mr. HANKINS. Yes, the boycott, the racial strife, and the adverse publicity.

Mr. ALEXANDER. The economic boycott and the bad publicity from these hearings?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. I see.

Mr. HANKINS. As you know, during the boycott much of the shopping area in Marianna was closed.

Mr. ALEXANDER. Yes, sir.

Mr. BROWN. Would you yield?

Mr. ALEXANDER. Yes.

Mr. BROWN. Are you saying that because of what was going on in Marianna, the properties in Marianna were appraised lower? Is that what you are saying?

Mr. HANKINS. No, sir. The original appraisals were made in 1970, prior to the disruption we mentioned. Then an outside appraiser, Mr. Dial, came in at the request of OIG. He appraised the housing 2½ years later at $7,900 and $8,150 in these two subdivisions.

In our judgment, the decline in values was due to the racial strife that occurred in Lee County, the boycott at the same time, and the bad publicity that we received.

Mr. BROWN. I am not following you.

When did that occur? And the subsequent appraisal was lower because of that? Is that what you are saying?

Mr. HANKINS. Yes, sir.

Mr. BROWN. The OIG man appraised at the subsequent time when OIG came in and inspected this situation—that the appraisal was lower on whose part?

Mr. HANKINS. This outside appraiser that OIG brought in.

Mr. BROWN. Did they appraise them lower at that time because a situation existed when they made their appraisal that related to racial strife and boycott in the community?

Mr. HANKINS. Yes, sir. It did not exist when we appraised the houses originally.

Mr. BROWN. Had there been any violence?

Mr. HANKINS. Not of any magnitude that I know about. However, there was a boycott and some passive resistance.

Mr. BROWN. Thank you.

Mr. ALEXANDER. In other words, Mr. Hankins, I believe you are saying that the property lost value because of the racial strife, economic boycott, and the adverse publicity of this investigation?

Mr. HANKINS. Yes, sir.

Mr. FOUNTAIN. Which investigation?

Mr. ALEXANDER. Of the attorney general of Arkansas, the General Accounting Office.

Mr. HANKINS. It could have been either of them.

Mr. ALEXANDER. Any and all of them. Is that right, sir?

Mr. HANKINS. Yes.

Mr. ALEXANDER. Following that, it says FHA made 12 rural housing loans in the Town and Country subdivision—all of the properties valued at $11,250. Seven of the borrowers have since moved out of the dwellings, and the dwellings have been taken into Government inventory or foreclosure action was in process. Foreclosure action was taken on borrower Howell.

This prefab dwelling was taken into the Government inventory and reappraised for $8,000 in March 1972 by Mr. Joe Kennedy, the Lee County supervisor. OIG inspected the Howell property and dwelling and found that the borrower had only lived in the house about 3 months and that the dwelling was essentially in the same condition as it was when it was new.

Mr. Kennedy, your inspector in Lee County, stated the reason that his appraisal was $3,250 less than the original FHA appraisal was the house, in his opinion, was overappraised originally.

Did you disagree with that statement when the inspectors came?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. Do you remember them questioning you about it?

Mr. HANKINS. Yes.

Mr. ALEXANDER. What was your reply?

Mr. HANKINS. We went back in and appraised some of these houses at a lower value than we originally put on them.

Mr. ALEXANDER. Did you do that because of the economic boycott, the racial strife, and this investigation?

Mr. HANKINS. We did that to see what the value would be. The situation had changed.

Mr. ALEXANDER. In fairness to your statement, it goes on to say that he also stated that the unfavorable newspaper publicity about the poor construction in the subdivision had affected the market for the dwelling. He stated that he did not have any buyers for that dwelling even at the $8,000 selling price.

He went on to say that the Government would have a loss of over $20,000 on the seven dwellings that foreclosure action had been taken on.

You had, I believe, some prefab dwellings over in Miller and Lafayette Counties?

Mr. HANKINS. This is true.

Mr. ALEXANDER. Is this correct?

Mr. HANKINS. Yes.

Mr. ALEXANDER. Over in Miller and Lafayette Counties you had a similar circumstance developing?

Mr. HANKINS. This is true.

Mr. ALEXANDER. According to the Inspector General's report, you financed 60 rural housing loans in those two counties of prefab construction. Is that correct?

Mr. HANKINS. This is true; yes, sir.

Mr. ALEXANDER. The prefab dwellings were originally appraised from $10,500 to $11,000. Between 1970 and 1972, foreclosure action was taken in the process of about 30 of those loans, and the houses were reappraised from $8,000 to $9,500 when taken into Government inventory.

Mr. Hankins, did you have any racial strife over in Miller County and Lafayette County?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. Did you have any economic boycott over there?

Mr. HANKINS. Not in Lafayette County

Mr. ALEXANDER. Will you explain the difference in the valuation 250 miles away?

Mr. HANKINS. To the best of my ability.

We thought that this was a good situation. We had several applicants who lived in this area that did not have decent, safe, and sanitary housing. They could make the payments on interest credit loans of $45 a month. We put them into these houses. Whenever they wanted a car or washing machine or something similar, they bought it and in some cases moved out of the houses and back to the shacks.

Mr. ALEXANDER. Is it not true that you lost about 40 of those loans out of 60 over there at the cost to the Government of over $120,000?

Mr. HANKINS. Not at the present time, but we could.

Mr. ALEXANDER. Did you discuss that fact with the OIG inspectors?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. What was the nature of the discussion and your reply to them?

Mr. HANKINS. We discussed the problems involved in making loans to low-income families and acknowledged we had made some mistakes in selecting applicants.

Mr. ALEXANDER. Did you make a mistake over in Lee County, too, Mr. Hankins?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. It was the economic boycott and the racial strife in Lee County?

Mr. HANKINS. Yes.

Mr. ALEXANDER. And adverse publicity?

Mr. HANKINS. Yes.

Mr. ALEXANDER. Over in my district. But over in Lafayette and Miller County you made a mistake?

Mr. HANKINS. Yes, sir. My staff and I were of the opinion that these families, if given a chance to improve their living conditions, would repay the loans.

Mr. ALEXANDER. Let's talk about Lee County one more minute.

Mr. Chairman, I refer to another report of the Office of the Inspector General, dated March 20, 1973, No. 412-233-T, which is an audit report of the Farmers Home Administration program in St. Francis County, Ark.

Mr. FOUNTAIN. Do you have a copy of that?

Mr. HANKINS. No, sir.

Mr. FOUNTAIN. Is there one available?

Mr. ALEXANDER. I submit that for the record, Mr. Chairman.

Mr. FOUNTAIN. Without objection it will be made a part of the record.

[See app. 10.]

Mr. ALEXANDER. I refer to the summary of the results of that report very briefly. This is an audit report of the Dogwood Acres subdivision in St. Francis County, to which we referred previously.

It says, four FHA-financed subdivisions involving 63 dwellings with loans totaling $750,000 are experiencing serious problems with household sewage disposal systems, surface drainage, and street construction. Septic sewage is surfacing in the Dogwood Acres, Magnolia Acres, and Dawson subdivision, creating a health hazard, as well as offensive odors in the area.

Residents stated that they were unable to use the sewage system during wet weather, as raw sewage would back up into the bathtubs and the commodes.

Streets in the Dogwood Acres, Magnolia Acres, and Redbud Acres subdivisions constructed within the past 2 years did not have adequate grading and have disintegrated in some areas.

Continuing on down to the last paragraph. Three FHA-financed houses had one-quarter inch paneling suitable only for interior use installed on exterior carport areas. This paneling, which was unapproved for exterior use, already shows signs of deterioration.

In addition, enclosures for water pumps for these dwellings were not provided to prevent the pumps from freezing. The borrowers stated that the pumps had frozen on several occasions.

Also, necessary concrete walkways were not provided from the driveways to the front entrances.

Over on page 6, Mr. Hankins, it says that the streets and driveways in this subdivision were paved with a layered oil compound which has dissolved in many cases and is in need of repair. Streets were constructed without adequate grading and structures, culverts, and drainage ditches; surface drainage was not provided. Surface water had washed out the streets in some places.

Mr. Willard Whittaker, mayor of Madison, Ark., stated that the streets in this subdivision had not been accepted by the city of Madison for maintenance purposes. He stated that the paved streets in this subdivision were of very poor quality and would not compare favorably with city asphalt streets adjacent to the subdivision.

Now, Mr. Hankins, have you been apprised of this report?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. What action have you taken on this report?

Mr. HANKINS. Concerning corrective actions, we are not approving any other subdivisions in this area where septic tanks are proposed. We are trying to correct the malfunctioning septic tanks that we now have. We have a feasibility study underway to determine whether a central sewage system will be feasible.

On streets and drainage, the county has accepted dedication of streets in Magnolia and Redbud Acres. We feel that the county also will accept dedication of streets in the Dawson subdivision. Dogwood Acres has been annexed to the city of Madison, and acceptance of the streets for maintenance will be obtained from the city soon.

Mr. FOUNTAIN. What is the population of Madison?

Mr. HANKINS. I defer that to Mr. Cook.

Mr. ALEXANDER. Less than 1,000, Mr. Chairman.

Mr. FOUNTAIN. Thank you.

Mr. ALEXANDER. Mr. Hankins, is it not true that all or most of the houses in all of the subdivisions to which I have referred this morning and yesterday were supplied by Pacific Homes, Inc.?

Mr. HANKINS. The ones that you referred to up to now?

Mr. ALEXANDER. Yes.

Mr. HANKINS. I believe this is correct; yes, sir.

Mr. ALEXANDER. How many houses have been financed through the Arkansas Farmers Home Administration from Pacific Homes, Inc.?

Mr. HANKINS. I do not have that figure. Could I refer it to one of these gentlemen?

Mr. FOUNTAIN. Any one of those gentlemen may answer.

Mr. COOK. I am not prepared to give that figure. I will supply it.

Mr. ALEXANDER. Would you give me an approximation? We will not hold you to it.

Mr. COOK. We think that approximately 5 percent of our loans were for prefab houses. For example, in the 1972 fiscal year, we had approximately 4,700 total loans, and about 191 of those were manufactured homes. About 75 or 80 percent of these were Pacific Homes.

Mr. FOUNTAIN. Would you supply the details for the record?

[See app. 11.]

Mr. ALEXANDER. About 75 percent of the homes came from Pacific Homes, Inc.?

Mr. FOUNTAIN. Where are their headquarters?

Mr. HANKINS. Marks, Miss.

Mr. FOUNTAIN. How far is that?

Mr. HANKINS. Fifty miles from Helena, Ark.

Mr. FOUNTAIN. How large a company is that? Do you know?

Mr. HANKINS. No, sir, I do not.

Mr. FOUNTAIN. Do you know how long it has been in existence?

Mr. COOK. I do not know.

Mr. FOUNTAIN. Proceed.

Mr. ALEXANDER. Mr. Hankins, approximately 75 to 80 percent of the homes, the prefab homes, that are financed by FHA come from Pacific Homes, Inc. of Marks, Miss.

Is that correct?

Mr. HANKINS. Yes.

Mr. ALEXANDER. Of the total number of the prefabricated homes, what was your ballpark estimate of the number in Arkansas?

Mr. COOK. Based on 1 year's operation, we would estimate possibly 500 since 1969.

Mr. ALEXANDER. Approximately 500 prefabricated homes?

Mr. COOK. Yes.

Mr. ALEXANDER. Mr. Hankins, this is a very important question. Of the total number of prefabricated homes financed by Arkansas Farmers Home Administration, what percentage would you estimate that foreclosure procedures have been instituted on?

Mr. HANKINS. Would you repeat that question, please?

Mr. ALEXANDER. What percentage of the prefabricated homes has the Arkansas Farmers Home Administration experienced concerning abandonment, foreclosure, or transfer?

Mr. HANKINS. May I confer?

Mr. ALEXANDER. You are the director of the State office. Would you say that there is a high percentage or a low percentage?

Mr. HANKINS. Of Pacific built homes?

Mr. ALEXANDER. Yes, sir.

Mr. HANKINS. In some areas, it is high, in others it's low.

Mr. ALEXANDER. Taking an average between high and low and considering a base of 500, what would be your ballpark estimate, based on your own experience, now, as director of Arkansas FHA? How many of those do you think you have people moving in and out of?

Mr. HANKINS. I prefer to refer that question.

Mr. ALEXANDER. Could you give me any general answer?

Mr. FOUNTAIN. Is there any other member of the group that can answer that question?

Mr. COOK. Mr. Chairman, it would be an estimate.

Mr. FOUNTAIN. We understand that.

Mr. COOK. We would estimate approximately 10 percent.

Mr. FOUNTAIN. Ten percent?

Mr. COOK. Yes.

Mr. ALEXANDER. I would like to ask, Mr. Chairman, for the record, that we be supplied with the precise information of the number of prefabricated houses financed in Arkansas during the directorship of Mr. Hankins, the percentage of those houses supplied by Pacific Homes, Inc., together with the other suppliers, and the percentage of abandonment, foreclosure, and/or transfer of borrowers from those prefabricated houses.

Would you supply that information to us, Mr. Hankins?

Mr. HANKINS. Yes, sir.

[See app. 11.]

Mr. NAUGHTON. Would you yield?

Mr. ALEXANDER. Yes.

Mr. NAUGHTON. Mr. Cook, you gave an estimate just a moment ago of 10 percent becoming foreclosures. Were you referring to Pacific Homes prefabricated housing?

Mr. COOK. I understood the question to be prefab housing.

Mr. NAUGHTON. I am wondering how accurate that is, because the report that we have been discussing today identifies 72 homes manufactured by Pacific Homes, of which apparently 47 have been foreclosed or are in the process of being foreclosed. So the percentage for those alone is well over 50 percent.

Your figures indicate that only 191 prefabricated homes were built in 1972 in the entire State. Is the figure in the report accurate, that 47 of these homes have been foreclosed or come back into inventory in the areas named?

Mr. COOK. Sir, I do not have a comparison of the number of manufactured homes and foreclosures at this point, for Pacific Homes or other prefab homes. I have figures for total loans and foreclosures. I also have the figures on loans in the process of foreclosure, and the voluntary conveyance offers that are in process for the State. We have this information for the four counties mentioned in the OIG study.

I cannot, however, give you the total number of prefab homes that are in foreclosure today. I can provide you with it.

Mr. NAUGHTON. Is it not logical to expect that the total figures for Pacific Homes, when you get them, will be substantially over 10 percent?

Mr. BROWN. What figures?

Mr. NAUGHTON. Foreclosures or homes coming back into inventory through other means.

Mr. COOK. There is a possibility that this may happen, but the records that we have in our office do not indicate this.

Mr. NAUGHTON. Do you quarrel with the accuracy of the 47 foreclosures cited in the report of the Office of Inspector General?

Mr. COOK. Yes, at this point. I understood that OIG may have included that in the 47 homes that had been vacated, but no liquidation action had been initiated.

Mr. NAUGHTON. Foreclosed or abandoned—when for some reason, the borrower has moved out and is not making his payments.

Mr. COOK. If he has moved out, we have a problem. We have moved in on those that have moved out but we have not determined that liquidation is necessary for all delinquencies.

The OIG apparently assumed that we are going to get the 47 homes back. I would not quarrel with that assumption, but we hope that liquidation will not be necessary in all cases.

Mr. NAUGHTON. On transfers, if I understand it correctly, a transfer would occur where a borrower will not or cannot meet his payments and wants to move out and you are successful in getting someone else to take over that house.

There have been some transfers on Pacific Homes dwellings, have there not?

Mr. COOK. My understanding is, yes.

Mr. NAUGHTON. As I understand it, these prefabricated houses from Pacific Homes were generally appraised in the $11,500 range. Is that accurate?

Mr. COOK. Yes, sir.

Mr. NAUGHTON. When you have made transfers, have any of those transfers been made at a new price around $11,000, or has it been down closer to $8,000?

Mr. COOK. I think we have some both ways. There have been some instances where there have been transfers at the amount of the debt, some for less than the amount of the debt.

We have authority to transfer at the present market value. If the debt exceeds the present market value, we would not load the new borrower with the full amount of the debt. We have authority to reduce the debt to the market value.

Mr. NAUGHTON. Have you had any reappraisals of Pacific Homes dwellings that have come out at an appraisal figure as high or higher than the initial appraisal?

Mr. COOK. I cannot answer that.

Mr. NAUGHTON. Do you know of any?

Mr. COOK. No, sir.

Mr. NAUGHTON. Do you have some you know of that came out around the $8,000?

Mr. COOK. Yes, sir. We have some in inventory at that figure.

Mr. FOUNTAIN. Mr. Alexander?

Mr. ALEXANDER. Thank you, sir.

Mr. Hankins, I get from the evidence that has been put in the record that of the prefabricated homes that are financed in Arkansas, you have experienced a high percentage of abandonment, foreclosure, and transfer in some cases, and you say a low percentage in other cases.

Adding the two together and striking an average, would you say, based on your experience as Director of the Farmers Home Administration in Arkansas, that the abandonment, foreclosure, and transfer percentage for prefabricated homes is less than or more than conventionally-constructed homes?

Mr. HANKINS. I cannot answer that, sir. I would have to get those figures for you.

[See app. 11.]

Mr. ALEXANDER. How long have you been Director of the Farmers Home Administration in Arkansas?

Mr. HANKINS. Since June 1969.

Mr. ALEXANDER. Four years?

Mr. HANKINS. Yes.

Mr. ALEXANDER. You have no idea of that?

Mr. HANKINS. It likely would be higher; I do not know how much higher.

Mr. ALEXANDER. Just based on your general observation and knowledge as Director, have you a higher abandonment, foreclosure, or transfer of prefabricated homes than conventionally built homes?

Mr. HANKINS. Yes, sir. To what degree, I do not know.

Mr. ALEXANDER. We will allow you to submit that information for the record, at a later time, but it is generally higher?

Mr. HANKINS. Yes.

Mr. ALEXANDER. When did you first conclude that the abandonment, foreclosure, and transfer ratio of prefab homes is higher than conventionally built homes? When did that first occur to you?

Mr. Williams, I am asking this question of Mr. Hankins. I will give you a chance later to answer.

Mr. HANKINS. To the best of my knowledge, it was about 1½ or 2 years ago.

Mr. ALEXANDER. Approximately 1½, 2 years ago?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. All right, sir.

Mr. Hankins, with this knowledge in mind and with the knowledge that your office places a higher appraisal value on prefab homes than conventionally built homes, why did you allow this policy to continue?

Mr. HANKINS. The appraisal policy?

Mr. ALEXANDER. Yes, sir.

Mr. HANKINS. This is a judgment factor for the appraiser to determine. It is not continuing, in fact, we have appraised some prefab homes lower than similar conventional homes.

Mr. ALEXANDER. Generally, would you not say prefabs are appraised a little higher than conventionally constructed homes?

Mr. HANKINS. No, sir, I would not say that at this time.

Mr. ALEXANDER. The OIG inspectors made that statement.

Mr. HANKINS. I am talking of the present time.

Mr. ALEXANDER. They have been in the past?

Mr. HANKINS. Yes, sir. This may have occurred while we were updating our appraisal approach.

Mr. ALEXANDER. When did this practice discontinue in your office of appraising prefabs higher than conventionally built homes? Have you discontinued that policy recently, a year ago, or how long has it been?

Mr. HANKINS. I would have to check our records on this.

Mr. ALEXANDER. Based on your impressions and general observations as Director of FHA, has it been long ago or recently?

Mr. HANKINS. I cannot answer that question, sir.

Mr. ALEXANDER. Let's take it by the numbers here. Has it been less than 1 year or more than 1 year? Would you venture a guess?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. You do not remember whether it was more than 1 year ago or less than 1 year ago?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. Was it less than 2 years ago or more than 2 years ago?

Mr. HANKINS. I do not——

Mr. ALEXANDER. You do not remember?

Mr. HANKINS. I do not remember.

Mr. ALEXANDER. Was it more than or less than 3 years ago?

Mr. HANKINS. I do not remember.

Mr. ALEXANDER. Was it the policy established prior to your coming to the directorship of Farmers Home Administration in Arkansas? Did you have that policy 4 years ago?

Mr. HANKINS. What policy is that, sir?

Mr. ALEXANDER. Placing higher appraisals on prefab houses than on conventionally built houses.

Mr. HANKINS. I do not know.

Mr. ALEXANDER. You do not know?

Mr. HANKINS. No.

Mr. ALEXANDER. You do not know what the policy was before you got there?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. But you have continued that policy since you have been there?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Has that been for 4 years?

Mr. HANKINS. You mean of appraising prefabs?

Mr. ALEXANDER. Yes, sir.

Mr. HANKINS. Again, I get back to this. It is a judgment factor and based on market value as reflected in the sales price of comparable properties. We have updated our market data on comparable properties.

Mr. ALEXANDER. When did you first allow prefabs to be financed by Farmers Home Administration?

Mr. HANKINS. They have been financed since I have been State director. I believe there were some being financed before I became State director.

Could I refer this question to Mr. Williams?

Mr. ALEXANDER. Yes, sir.

Mr. FOUNTAIN. Mr. Williams?

Mr. WILLIAMS. It is possible that some prefabricated housing was financed several years ago, prior to Mr. Hankins becoming State director. This would be on a small scale.

Mr. ALEXANDER. Nonetheless, you are aware of a policy based on judgment—individual judgment—of placing a higher value on prefabricated houses than conventionally constructed houses?

Mr. HANKINS. Not necessarily, sir.

Mr. ALEXANDER. You are saying the practice does go on? Is that correct?

Mr. HANKINS. It depends upon the area, the market situation, and the judgment of the appraiser.

Mr. ALEXANDER. You read the OIG report that says you deliberately overvalue prefab houses in Arkansas? You have read that and you have talked about it?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Are you saying now that that practice does occur in Arkansas, based on what you know as Director?

Mr. HANKINS. That we are appraising prefabs higher than conventional?

Mr. ALEXANDER. Yes, sir. Based on your experience, are you saying that that does occur? You said a minute ago in answer to one of my questions that you did not know how long it has been going on, but you believed that it was going on?

Mr. HANKINS. We have continuously used the market value approach.

Mr. ALEXANDER. Are you saying, when you say it is a market approach, that it does occur and that you have known that it occurs, but you do not know how long? Is that what you are saying?

Mr. HANKINS. Yes, sir. We changed from the normal value approach to the current market value approach in about 1969.

Mr. ALEXANDER. Now, I asked you yesterday, Mr. Hankins, if you had knowledge, and I will repeat the question.

In the last paragraph I said, "Mr. Hankins, did you or anyone else in your office instruct Mr. Knox in St. Francis County to overvalue the houses referred to in the OIG report?"

Your answer was, "No, sir, I did not."

Is that your answer today?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Then I asked you did you know anyone in your office that authorized that overvaluation, and your answer was, "No, sir."

Is that your answer today?

Mr. HANKINS. That is correct.

Mr. ALEXANDER. Now, Mr. Hankins, you admitted a minute ago that you knew of this policy and that you knew, according to this report, that Mr. Knox said in the report that he was instructed by the Arkansas office to deliberately overvalue these houses.

You read that?

Mr. HANKINS. Yes.

Mr. ALEXANDER. I am asking you again today, Mr. Hankins, if you know who in your office instructed Mr. Knox to overvalue the houses referred to in this report?

Mr. HANKINS. Mr. Congressman, I have asked every member of my staff. If the person is there, I do not know it.

Mr. ALEXANDER. You did know about the policy?

Mr. HANKINS. Yes, sir. I am aware the OIG report alleged that such a policy exists.

Mr. ALEXANDER. You knew about the policy of overvaluation but you do not know who is responsible for that policy?

Mr. HANKINS. If the policy exists.

Mr. ALEXANDER. You have said it does exist.

Mr. HANKINS. Yes, sir. The OIG report contains allegations that this policy exists.

Mr. ALEXANDER. You have said that you did not authorize it?

Mr. HANKINS. No, sir, I did not authorize it.

Mr. ALEXANDER. That you do not know who authorized it?

Mr. HANKINS. Yes, sir.

Mr. FOUNTAIN. Will the gentleman yield?

Mr. ALEXANDER. Yes.

Mr. FOUNTAIN. Who sets the policy in matters of this kind?

Mr. HANKINS. I am supposed to. We checked this out. Nobody in the State office at the present time has any knowledge of this.

Mr. FOUNTAIN. Everyone you have talked to under you in the State office has said that they did not establish the policy of overvaluing prefabricated houses?

Mr. HANKINS. This is true.

Mr. BROWN. Mr. Chairman?

Mr. ALEXANDER. May I just go on one further point? Then I will be glad to yield.

The Administrator, Mr. Elliott, mentioned a minute ago that there were some contradictions here. I will certainly agree that there is a contradiction here.

Mr. Hankins, can you explain to me why you, having knowledge of this contradiction, knowledge of the policy of overvaluation and no knowledge of who authorized it, did not in any shape, form, or fashion, reply to that contradiction in your reply to the OIG report, dated May 22, 1973? Can you explain that to me?

Mr. HANKINS. As earlier mentioned, this letter was not intended as a complete response to the OIG report. Another reason is because of these investigations that are going on in St. Francis County.

Mr. ALEXANDER. You are saying that you did not reply to the investigation because of the investigation?

Mr. HANKINS. There is another investigation going on at the present time.

Mr. ALEXANDER. What investigation is that?

Mr. HANKINS. The investigation on chattel security.

Mr. ALEXANDER. Chattel security?

Mr. HANKINS. The OIG is there at the present time.

Mr. ALEXANDER. What does that have to do with the overvaluation of these houses?

Mr. HANKINS. I wanted to wait until we got this matter cleared up.

Mr. ALEXANDER. On chattel security?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. May I discover why?

Mr. FOUNTAIN. Do not hesitate to give a full explanation any time you want to continue, Mr. Hankins.

Mr. ALEXANDER. Do you have something further that you want to say on that?

Mr. HANKINS. No, sir.

Mr. FOUNTAIN. I thought you had something to say and that you were cut off by Mr. Alexander.

Mr. ALEXANDER. Would you explain what chattel security has to do with overvaluation of real property?

Mr. HANKINS. This is one of the things that we were waiting on. That should be finalized soon.

We have had our engineer over there to look at these houses.

Mr. ALEXANDER. Did the OIG inspectors talk to you about the chattel security?

Mr. HANKINS. No, sir. Not in this audit report.

Mr. ALEXANDER. In what way is chattel security relative, in your imagination, to the problem that we are discussing here?

Mr. HANKINS. It is not relative to the problem here. I was hesitant to act until they completed the other investigation, because we have had so much trouble in St. Francis County. It has been under investigation for about 3½ years.

Mr. ALEXANDER. You are having trouble with chattel security over there?

Mr. HANKINS. Housing also.

Mr. ALEXANDER. I understand about the housing. You say the reason you did not give an explanation of the conflict and the inconsistencies of your knowledge and the allegations contained in the discussions in the OIG report is because of your concern for the chattel security problems in St. Francis County?

Mr. HANKINS. This is partly it, true.

Mr. ALEXANDER. Do you have any other explanation, in addition to the partial problem?

Mr. HANKINS. I am up here for one thing.

Mr. ALEXANDER. You got this report May 3, which was a month before I got it. You have 30 days on me.

Mr. HANKINS. This is true. I will agree that we have been negligent about getting this report out.

Mr. ALEXANDER. I am aware of the inconsistencies. I have read the report and you have, too.

Mr. HANKINS. Yes.

Mr. ALEXANDER. But in your letter of May 22, 1973, you did not address yourself to these problems. You are saying now it is because of the chattel security problem in St. Francis County.

Mr. HANKINS. This is partially the reason.

Mr. ALEXANDER. Mr. Chairman. I yield.

Mr. FUQUA. Mr. Chairman, I have a question.

Mr. FOUNTAIN. Mr. Brown first, then we will come back to you.

Mr. BROWN. In this report, there is a statement on page 5. This is the report dated May 3 of the Office of the Inspector General of the Department of Agriculture—that Mr. Knox stated that he was instructed by the State FHA office to appraise the prefab dwellings higher than the conventional dwellings.

Have you talked to Mr. Knox to know who in the office gave him that instruction?

Mr. HANKINS. No, sir; we have not. We believe such an instruction was not given by anybody.

Mr. BROWN. Has anyone talked to Mr. Knox to find out who gave him that instruction?

Mr. HANKINS. No, sir; not at this time.

Mr. BROWN. You have made inquiry throughout the State office and have not come up with anybody that gave him that instruction?

Mr. HANKINS. No, sir.

Mr. BROWN. Mr. Hankins, is there any conscious policy to try to encourage the utilization of prefabricated housing in the Farmers Home Administration, any conscious policy within the Farmers Home Administration to encourage the utilization of the prefabricated housing, that you are aware of?

Mr. HANKINS. No, sir.

Mr. BROWN. Or HUD?

Mr. HANKINS. No, sir.

Mr. BROWN. Or in the Office of the Farmers Home Administration at the State level in Arkansas?

Mr. HANKINS. No, sir.

Mr. BROWN. Is there some feeling on your part that prefabricated housing, as a matter of economy or stimulation of low-cost production or anything else, should be encouraged for one reason or another?

Mr. HANKINS. No, sir.

Mr. BROWN. Do I understand from the questions that have been developed here that the firm, Pacific Homes, Inc., is located in such a way that it can most conveniently serve the area where these homes are being built?

Mr. HANKINS. Yes. It is approximately 50 miles from Helena, Ark.

Mr. BROWN. That serves in this area where these cases are developed that are listed in the Office of Inspector General of the Depart-

ment of Agriculture—that is located in such a way that it is convenient to this area, where these cases are developed?

Mr. HANKINS. Yes, sir.

Mr. BROWN. Do you have any other prefabricated home builders in that area?

Mr. HANKINS. We have some more prefabricated home builders in the State. I believe there are seven or eight on our latest list.

I would like to defer that question to Mr. Cook.

Mr. BROWN. Were any of these builders located in counties closer than Pacific Homes?

Mr. HANKINS. Yes, sir; at one time. But, most of them were outside of the State. We now have seven modular housing manufacturers approved by the State office. All are located outside the State.

Mr. BROWN. In 1972, you had a longer list that included some within the State of Arkansas?

Mr. HANKINS. That's true.

Mr. BROWN. Why the change?

Mr. HANKINS. We sent them all a letter to ask them if they wanted to stay on our approved modular home list in the State of Arkansas. We had a response from these seven.

Mr. BROWN. There's no other qualification, other than responding to this letter?

Mr. HANKINS. If they're already on the list, and our architect has approved their plans and specifications.

Mr. BROWN. Did you have any other custom builders in the five-county area—I think it's a five-county area—the area that is involved in these cases reported by the Inspector General in his May 3 report?

Mr. HANKINS. I didn't follow you, Mr. Brown.

Mr. BROWN. In the area covered by the cases listed in the Inspector General's May 3 report, in that area were there any custom builders located?

Mr. HANKINS. You're talking about modular homes?

Mr. BROWN. Custom builders, a guy that builds one house at a time, and doesn't do prefabricated work.

Mr. HANKINS. Yes, sir.

Mr. BROWN. There were in that area such builders?

Mr. HANKINS. Yes, sir.

Mr. BROWN. Do you have any personal relationship with the people in Pacific Homes?

Mr. HANKINS. No, sir.

Mr. BROWN. Financial relationship?

Mr. HANKINS. No, sir.

Mr. BROWN. Did they package these projects and bring you the home purchaser, or do you know in these cases that are listed in the Inspector General's report that the home purchaser came in first? Did he come in with the builder? Did he come in on his own? Did he make a contract through a lending company, or did they all have common association with the Farmers Home Administration; that being through the builder?

Mr. HANKINS. Could I refer that question, Mr. Cook?

Mr. COOK. Mr. Congressman, in most cases the builder brought a package with an application for the borrower who financed their

Pacific Homes through the Farmers Home Administration. He brought the applicant to us.

Mr. BROWN. He sold the applicant on buying a Pacific home and getting his financing through Farmers Home Administration; then brought it in to the Farmers Home Administration?

Mr. COOK. This is my understanding. Yes, sir.

Mr. BROWN. What kind of credit reference check would you ordinarily do in such a case to find out whether or not the guy can pay his rent and so forth?

Mr. COOK. At the present time, when we receive an application from an applicant, a credit report is requested and a verification of income is requested. If necessary, there is additional investigation of his ability to repay the loan.

If there is any question concerning his eligibility, we obtain additional information.

Mr. BROWN. That is at the time the builder brings him in to get his loan application approved?

Mr. COOK. This is a part of processing the application.

Mr. BROWN. Does he come in ordinarily at some other time without the builder?

Mr. COOK. Yes, sir. It is necessary that the county supervisor, somewhere in here, have an interview with this applicant.

Mr. BROWN. With or without the builder present?

Mr. COOK. It could be either way.

Mr. BROWN. There is no requirement in the FHA requirements?

Mr. COOK. No, sir, but usually the county supervisor has at least one private interview with the family.

Mr. BROWN. During that interview, with or without the builder who has brought him in sitting next to him, do you give him any advice as to alternative housing possibilities that exist in his area as to the style of home he might be able to purchase, or the amount he might be obligated to pay, or the credit arrangements that he might be able to obtain?

Mr. COOK. Sir, if the builder brings the applicant in, we explain to the applicant what assistance we can provide. This is the builder's applicant.

If we get involved telling him——

Mr. BROWN. Say that again. That is the builder's applicant. It's not your applicant. It's the builder's applicant, right? He brought him in. He's out there peddling the housing.

Mr. COOK. He's trying to sell the house; yes, sir.

Mr. BROWN. That serves your purpose because you want to get these poor folks into rural housing, right?

Mr. COOK. If this house will meet our housing requirements, the applicant is eligible, and the cost of the house does not exceed its market value, we do not tell the man that he can go over to a competitor. We can get in trouble if we did this.

Mr. BROWN. You can get in trouble with the builder?

Mr. COOK. Yes, sir.

Mr. BROWN. He might not bring you the purchasers?

Mr. COOK. Yes, sir. He'll squawk because it would be inequitable.

Mr. BROWN. The builder will squawk.

Mr. COOK. Yes, sir.

Mr. BROWN. He's helping you to do your job of getting these folks into rural housing. If you have a good relationship with the builder, you are being assisted in doing your job. Is that right?

Mr. COOK. This is correct.

Mr. BROWN. Suppose the builder says to the applicant, I've got a good relationship with the Farmers Home Administration. I think I can help you get your financing on this if you need any help in getting started, in your credit reference, I can help you with your credit reference.

Does he ever do that sort of thing, do you suppose?

Mr. COOK. I suppose they do. We order the credit report ourselves from the credit bureau.

Mr. BROWN. The builder might have a relationship with the credit bureau, too?

Mr. COOK. We order the credit report through a contract source and ask that it come to our office, not through the builder.

Mr. BROWN. I see. So you operate independently on the credit report?

Mr. COOK. Yes.

Mr. BROWN. What about the possibility of the builder assisting the housing buyer in his early payments of rent? Is that a possibility?

Mr. COOK. Although it might be a possibility, I am not aware of anything of this nature.

Mr. BROWN. Once you sign off on this and say, a deal is a deal. This is an arrangement we have where we will approve the purchase of this house, and approve the creditor and the home passes our inspection and so forth; the builder gets his money, doesn't he?

Mr. COOK. After the final inspection on the house, and everybody's satisfied?

Mr. BROWN. Yes.

Mr. COOK. Yes, sir. After the final inspection.

Mr. BROWN. When does that usually occur, after the builder and his client have come in?

Mr. COOK. Sir, there are several ways homes are built. In some cases, we use the contract method. A builder, for example, might agree with the borrower to build his house according to the plans and specifications for x number of dollars.

Mr. BROWN. The house may not yet be constructed?

Mr. COOK. Right. We might close the loan, then the borrower and the builder execute a contract. The builder is paid as the building progresses.

Mr. BROWN. The builder really is financed to construct the house?

Mr. COOK. Yes.

Mr. BROWN. That's where he brings the buyer in, shows him the stakes on the ground, and they walk through the front door, and she is already putting the curtains up in the bedroom.

Mr. COOK. In most cases we issue a conditional commitment to a builder which states that we would make a loan of an agreed value to an eligible applicant to buy this house, if it is constructed in accordance with the plans and specifications.

An application may be processed at any time and funds obligated for a family to buy this house when it is ready for occupancy.

Mr. BROWN. Then the house is in being, he just brings the guy, he sold the guy the house; in effect, he brings the guy and gets the financing and that's ready to go.

Mr. COOK. Yes, sir.

Mr. BROWN. The builder's required to have his own financing and advancement?

Mr. COOK. In this case; yes, sir.

Mr. BROWN. When do you cover the cost of that house?

Mr. COOK. When we close the loan and take a deed. And the title of the property changes hands.

Mr. BROWN. If the occupant of the house discovers the next day that he's been oversold in some way, that he can't meet his financial obligation on the house, or he doesn't like the house, and the builder has got his money, the taxpayer is stuck with the situation at that point. Is that right?

Mr. COOK. Yes and no. The taxpayer has a note and mortgage from the borrower.

If we are accurate on our estimate of value, there is no risk involved. If the original borrower is dissatisfied, someone else will be willing to assume the loan.

Mr. BROWN. If you have a willing buyer at a certain price, and the guy that's going to sell that house at a certain price, and if you feel that this is moving houses, and your appraisal comes fairly close to what they agreed upon in price; everybody is happy. Right?

Mr. COOK. Sir, we have to determine whether a willing and typical buyer in the area would pay the asking price for the property.

Mr. BROWN. If a builder has a client and he has brought him into you, that proves that you've got a market value, right?

Mr. COOK. Very seldom do we have a disagreement on what the market value is on a piece of property.

Mr. BROWN. You do not want to advise the buyer and say, wait a minute, you can buy a better house cheaper than that, because you're going to lose that buyer, correct?

Mr. COOK. That's right.

Mr. BROWN. There'd be no point in advising the home buyer that he could get a better deal, as you said earlier, you would get the builder mad at you and he might not bring you the next client.

Mr. COOK. That is correct.

Mr. BROWN. Thank you, Mr. Chairman.

Mr. FOUNTAIN. Mr. Fuqua?

Mr. FUQUA. Thank you, Mr. Chairman.

Mr. Hankins, going back to the colloquy between you and Mr. Alexander, in the report, that Mr. Knox was instructed to appraise prefabs higher than those regularly constructed, you said that you did not know when this policy ceased.

Mr. HANKINS. Correct. In fact, I do not know that the policy ever existed.

Mr. FUQUA. Did you initiate this policy when you came in as State director 4 years ago, or was it in existence prior to that time?

Mr. HANKINS. This prefab came out about the time that we were involved in getting into this housing program. We were actually upgrading our appraisals. At the time, we may have set our sights a little too high.

Mr. FUQUA. When did you become aware that this was taking place, that there were higher appraisals for prefab homes?

Mr. HANKINS. I don't remember, sir.

Mr. FUQUA. Early in your administration or late?

Mr. HANKINS. I don't remember, sir.

Mr. FUQUA. What was your reaction when you found out about it?

Mr. HANKINS. We were in the process of always upgrading our appraisals to get them more in line over the State. The final determination is a judgment decision of the appraiser, and the appraised value of the same house may vary from section to section.

Mr. FUQUA. Is it a judgment factor if a man said that he was told to do that?

Mr. HANKINS. I have not been able to find anyone who made that statement.

Mr. FUQUA. All right, then. You don't know who made the statement?

Mr. HANKINS. No, sir. I do not believe anyone made the statement.

Mr. FUQUA. What did you do about it? Did you stop it?

Mr. HANKINS. I haven't done anything at the present time.

Mr. FUQUA. It is still going on?

Mr. HANKINS. I don't know that.

You mean Mr. Knox?

Mr. FUQUA. No.

Is that the impression among the people that are appraising homes that they are to appraise prefabs higher than conventional homes?

Is that practice still continuing?

Mr. HANKINS. I hope not, sir.

Mr. FUQUA. What have you done about it? Have you issued any statement or memorandum to anyone?

Mr. HANKINS. No, sir. I haven't issued any memorandum.

Mr. FUQUA. It could still be going on?

Mr. HANKINS. It could still be going on, yes, sir, in certain areas.

Mr. FUQUA. And you know it's going on?

Mr. HANKINS. No, sir, not at the present time.

Mr. FUQUA. Do you know that it has stopped? You told Mr. Alexander that it had ceased, but you didn't remember exactly when it was.

Mr. HANKINS. I hope it has ceased.

Mr. FUQUA. How do you know? Did you issue any memorandum or any means of communication to all the county supervisors that this is supposed to cease?

Mr. HANKINS. No, sir. We discussed it once at our district meeting of upgrading appraisals.

Mr. FUQUA. I'm not talking about upgrading appraisals. I'm talking about overappraisals.

Mr. HANKINS. Yes, sir.

Mr. FUQUA. It could still be going on?

Mr. HANKINS. It could, but not to my knowledge.

[NOTE.—Mr. Hankins subsequently stated: "It is not my intention to imply that we overappraised prefabs. Rather, in our efforts to find market value, we appraise all units on the same basis regardless of the method of construction."]

Mr. FUQUA. Thank you, Mr. Chairman.

Mr. FOUNTAIN. Mr. Steelman?

Mr. STEELMAN. Mr. Chairman, I have no questions, but I would like to commend our colleague from Arkansas for his very aggressive pursuit of this matter, and commend him on looking out for the taxpayers of this country.

Mr. BROWN. I would like to echo that sentiment.

Mr. FOUNTAIN. We just had a call for a quorum.

[Discussion off the record.]

Mr. FOUNTAIN. We will recess the subcommittee until 2:30. This subcommittee stands in recess until 2:30.

[Whereupon, at 12:05 p.m., the committee was recessed, to reconvene at 2:30 p.m., the same day.]

AFTERNOON SESSION

Mr. FOUNTAIN. This subcommittee will come to order, a quorum being present.

Mr. Hankins, I think you have answered this question in one form or another, but I want to ask again to more or less refresh my memory. How long have you known Mr. Knox, the county supervisor in St. Francis County?

Mr. HANKINS. I have known him personally, only since the time I became State director. I knew who he was 5 years before this.

Mr. FOUNTAIN. How often had you seen him over that period of time?

Mr. HANKINS. About twice a year.

Mr. FOUNTAIN. Just twice a year?

Mr. HANKINS. Twice a year, as I recall.

Mr. FOUNTAIN. How many conversations would you have had with him during the course of the year about problems, procedures, and what he was doing?

Mr. HANKINS. Perhaps two visits and a few telephone calls.

Mr. FOUNTAIN. Over that period of 4 years, would you have had occasion to call in the county supervisors for conferences—call them over from all over the State to give them general guidelines, or to discuss problems, or to get the benefit of their thinking and have them get the benefit of yours?

Mr. HANKINS. Yes, we have State staff conferences.

Mr. FOUNTAIN. How often?

Mr. HANKINS. Approximately every 2 months.

Mr. FOUNTAIN. Approximately every 2 months?

Mr. HANKINS. Then we have our district people in at this time, and our State staff, and we outline the program objectives and things of this nature. And they carry it back to their respective district.

Usually once a year we will have a State meeting.

Mr. FOUNTAIN. Did anyone else supervise Mr. Knox?

Mr. HANKINS. The district supervisor.

Mr. FOUNTAIN. Who was that?

Mr. HANKINS. Harold Foster.

Mr. FOUNTAIN. Is he here?

Mr. HANKINS. No, sir.

Mr. FOUNTAIN. You say that you call in people like Mr. Knox, in his position, about twice a year?

Mr. HANKINS. Yes, I also visit him in his county.

Mr. FOUNTAIN. How often have you had occasion to visit him since he has been in office and you have been in office?

Mr. HANKINS. I would estimate five times.

Mr. FOUNTAIN. Do you have occasion to go out to dinner with him when you're in the area?

Mr. HANKINS. Yes, I have eaten dinner with him.

Mr. FOUNTAIN. There's nothing wrong with it. I'm just asking the question.

Mr. HANKINS. Yes, I have eaten dinner with him.

Mr. FOUNTAIN. Then you feel that you know him well?

Mr. HANKINS. Yes, sir.

Mr. FOUNTAIN. I get the impression, according to the Inspector General's report that Mr. Alexander has already quoted from, that Mr. Knox was instructed by the State FHA office to appraise prefab dwellings higher than the conventionally built dwellings. Then Mr. Knox gives the reason why.

On page 5, next to the last paragraph, Mr. Knox says that State office personnel assisted him on the Gilmer property appraisal, and on other appraisals of prefab dwellings. He requested that OIG personnel refer all questions on these appraisals to the State office.

Now, when did you learn that Mr. Knox had made a statement to a representative of the Inspector General's Office? I believe it was early in May that you got the report.

Mr. HANKINS. Yes.

Mr. FOUNTAIN. Did you read it as soon as it came in?

Mr. HANKINS. No, sir. It was a few days before I read it. I was out of the office on the farmer loan programs.

Mr. FOUNTAIN. Can you approximate about when you first read it? I realize it is not always easy to remember the exact day. Anyway, you said you read it a few days after it came in?

Mr. HANKINS. Yes, sir.

Mr. FOUNTAIN. Did that particular paragraph make any impression on you, or arouse any concern on your part?

Mr. HANKINS. Yes, sir. I talked to the State office people that were involved and wanted to know who had given him authority to do this.

Mr. FOUNTAIN. Who are some of the people in the State office that you discussed this with?

Mr. HANKINS. I discussed it with Mr. Cook, Mr. Williams.

Mr. FOUNTAIN. Who else in the State office would normally have an opportunity to at least convey a policy decision, even if he didn't have the authority to make it?

Mr. HANKINS. It would be the Rural Housing Chief, Mr. Rogers.

Mr. FOUNTAIN. You discussed it with them, and each of them stated that he had given no such instructions, and had enunciated no such policy?

Mr. HANKINS. Yes, sir.

Mr. FOUNTAIN. Have you talked to Mr. Knox about it?

Mr. HANKINS. No, sir.

Mr. FOUNTAIN. Can you please tell this subcommittee why you have not contacted Mr. Knox to ask him where he got his information and why he made this statement?

Mr. HANKINS. Well, sir, we were extremely busy and were waiting until we got this situation finalized, so we could check out the facts.

Mr. FOUNTAIN. I know how busy you are, because you are getting problems coming in from all over the State. But this paragraph did not concern you enough or this allegation did not concern you enough to prompt you to pick up a telephone at any time to ask Mr. Knox where he got any such instructions?

Mr. HANKINS. No, sir. I should have.

Mr. FOUNTAIN. You are saying now that you gave no such instructions.

Mr. HANKINS. I did not give such instructions, sir.

Mr. FOUNTAIN. The policy does seem to have been adopted, is that right, of placing a higher valuation on prefabs?

Mr. HANKINS. All of our appraisals on conditional commitment-type housing were brought up to market value including those on prefab homes.

Mr. FOUNTAIN. When did you first learn that prefab housing was being evaluated $3,000 to $4,000 higher than the other houses?

Mr. HANKINS. As I mentioned before, this may have occurred during the period when we were updating our appraisal approach.

Mr. FOUNTAIN. Did that raise any question in your mind about the validity of it? Had you raised any questions as to whether or not that might be appropriate and proper?

Mr. HANKINS. No, sir. I hadn't.

Mr. FOUNTAIN. You had not?

Mr. HANKINS. No, sir.

Mr. FOUNTAIN. What about you, Mr. Cook, or you, Mr. Williams, in response to the same question?

Mr. WILLIAMS. Could you repeat the question, sir?

Mr. FOUNTAIN. Did you have occasion or did you assume the responsibility of discussing this matter with Mr. Knox?

Mr. WILLIAMS. No, sir. I did not make the firm statement, as indicated by the auditor in his report.

Mr. FOUNTAIN. What discussion did you have with him as it relates to the subject matter here?

Mr. WILLIAMS. In my visits to St. Francis County to assist Mr. Knox in various phases of the housing program, including appraisals, my purpose was to instruct him in the new phases of our housing program, which included some adjustments in our appraisal system.

It is possible that with the right type of leading question from the OIG representative, Mr. Knox could have made this kind of statement, even though nobody directed him to do this, sir.

Mr. FOUNTAIN. Do you recall any conversation that you may have had with Mr. Knox about appraisals, that might have led him to believe that it was your policy or would be the policy to place a different value on prefab rather than conventional housing?

Do you recall any particular conversation?

Mr. WILLIAMS. I do not recall any conversation that I had with him, that should have led him to this conclusion.

Mr. FOUNTAIN. That might have?

Mr. WILLIAMS. From his standpoint he might have reached that conclusion. I cannot speak for him. I could see where he might get this impression because I was there to help him in appraising of prefabricated housing. He may have concluded that I was speaking only of prefabricated housing, when actually my comments also applied to conventional housing.

Mr. FOUNTAIN. Will you describe that situation to us? Maybe that will throw some light on the whole picture.

Mr. WILLIAMS. The report mentions the fact that I did assist Mr. Knox with the appraisal of some property, which included prefabricated housing. I believe it refers to Dogwood Acres subdivision.

Mr. FOUNTAIN. Where is that?

Mr. WILLIAMS. Dogwood subdivision?

Mr. FOUNTAIN. Is that in the last paragraph?

Mr. WILLIAMS. I believe that's on page 5, the last paragraph. The report mentions this, sir.

Mr. FOUNTAIN. It says "On June 5, 1970, Sherman Williams, former Rural Housing Specialist, Arkansas State FHA Office, now a District Supervisor, made an appraisal on a prefab dwelling located in the FHA-financed Dogwood Acres Subdivision at Madison, Ark., in St. Francis County. This prefab was of the same size, design, and construction as the prefab previously mentioned as having been appraised by Mr. Knox. Mr. Williams appraised this prefab at $11,350."

Now, was that particular appraisal in excess of conventional housing?

Mr. WILLIAMS. In this context, sir, until this time, which was 1970, in the past we had dealt with conventional housing on isolated lots or sites, scattered throughout the counties. It was true that our appraisal, as we looked at it, had not fully reflected current market conditions.

Mr. Chairman, we had established loan values on isolated lots for homes that were of conventional construction.

Now, we were moving into prefabricated housing. This, I should mention, was not the only type of housing that we were dealing with under these conditions and terms. The prefabricated homes, however, are the only ones mentioned in this report.

We did deal in conventional housing in subdivisions developed by larger builders and developers. We applied the same values, appraisal procedures, and methods to those homes as were used for prefabricated housing.

In dealing with this specific instance which involved a prefabricated home, Mr. Knox could have obtained the impression or inadvertently stated to the OIG representative that we were telling him to appraise prefabricated houses higher than conventional. The report referred to conventional housing that was already built and not conventional housing that was being appraised along with prefabricated housing at the same time.

Mr. FOUNTAIN. What is the difference now between the two?

Mr. WILLIAMS. There is virtually no difference, sir. There hasn't been since about 1970 when this occurred. We were moving into a different type of housing production with larger builders, developers, and subdivisions.

Incidentally, one point should be cleared up. The OIG representative indicates, or leaves the impression, that we've financed subdivisions. We do not finance subdivisions, sir.

We do make loans to finance housing that developers build in subdivisions, and the applicants do buy from these builders. That is the only type of financing involved in subdivisions. We do not finance subdivisions for private builders.

This has been indicated in two different cases in this report, that I noticed. This should be clear; we do not finance subdivisions.

Mr. NAUGHTON. While you do not finance subdivisions, Mr. Williams, do you have regulations with respect to the type of construction of roads, sewage disposal, water systems, and so forth that must be provided in the subdivision before FHA will finance houses in that subdivision?

Mr. WILLIAMS. We do at this time. There was a point back there—and I can't say when this began to creep into our procedures and policies. But when we first started, and subdivisions were new to us, and we did not have such detailed procedures at that time.

We attempted to obtain the best subdivisions we could. We now have specific instructions and procedures which tell us what the requirements are with respect to streets, what arrangements must be made for maintenance after they are developed, and similar items.

Mr. FOUNTAIN. Where did you get those procedures?

Mr. WILLIAMS. We had general but less complete guidelines. The community services program was involved with some community facilities. They had an exhibit attached to their procedures. This was made applicable to housing.

I guess this would be roughly 2 years ago. Since that time, we have specific procedures that have been rewritten and have come out from the national office, outlining the requirements for subdivisions. These procedures include the requirements for streets, drainage, utility lines, easements, water and sewage systems, and things of this sort.

We do have complete and specific procedures now. At that time, we did not.

Mr. NAUGHTON. Mr. Williams, at the Dogwood Acres subdivision and the Magnolia Acres subdivision that we discussed, are there any homes that are not financed by FHA?

Mr. WILLIAMS. I could not answer that, sir.

Mr. NAUGHTON. My information is——

Mr. WILLIAMS. There's no reason why there should not be homes financed by others. If somebody wanted to finance a home they could. We did not want total control over subdivisions.

Mr. NAUGHTON. If you finance every house in a subdivision, even though technically, you may not be financing the subdivision itself, you are providing all the money that goes to pay for that subdivision, are you not?

Mr. WILLIAMS. We may be in most cases, sir, but not necessarily.

Mr. NAUGHTON. If you also have regulations, at least now, that must be observed in terms of construction of the subdivision—the sewers, the water, the roads—and you pay all the money that goes to pay the cost of all the homes in that subdivision, isn't the effect about the same as though you were actually financing that subdivision?

Mr. WILLIAMS. I do not think the two statements are synonymous, sir.

Mr. NAUGHTON. Are you speaking now of the fact——

Mr. WILLIAMS. The fact that we finance the houses is not, in my opinion, synonymous with financing the subdivision.

Mr. NAUGHTON. In other words, the developer has to provide his own financing for the roads, the water, et cetera. After he does that, if he sells all the houses under FHA financing, you in effect have put up the money that goes to pay for the whole subdivision.

Mr. WILLIAMS. Indirectly, this would be true, sir.

Mr. FOUNTAIN. The prefab where you made the appraisal of $11,350 was on a one-fourth acre lot and the report says had paved streets, public water facilities, and a septic tank disposal system. Does the availability of those facilities have an impact on the appraisal value of the house?

Mr. WILLIAMS. As compared to what?

Mr. FOUNTAIN. As compared to an area where you do not have public water facilities and don't have a paved street.

Mr. WILLIAMS. It could with all other items being equal. It would be assumed that if a public sewage system was available and properly operated, the property might be considered more desirable than one without this facility. There might be other extenuating circumstances that also would influence value.

Mr. FOUNTAIN. The next part of the statement said Mr. William's appraisal was intended to be used as a guide. I assume that is based on Mr. Knox's statement.

Mr. WILLIAMS. It is in Mr. Knox's area; yes, sir.

Mr. FOUNTAIN. Can you tell us where he might have gotten that impression?

Mr. WILLIAMS. What impression are you talking about?

Mr. FOUNTAIN. Why would the report state that the appraisal of $11,350 was intended to be used as a guide? Then the report goes on to state that Mr. Williams' appraisal was copied for all appraisals made in the FHA financed Dogwood Acres and Magnolia Acres subdivision.

Then it says that the FHA subsequently made approximately 53 loans on the prefab dwellings in the two subdivisions approximating $600,000. What about those 53 loans? What kind of evaluation did you give to the properties in those cases?

Mr. WILLIAMS. I would not be in a position to answer that. I would not have knowledge of that.

Back to the original portion of your comments relative to my appraisal being used as a guideline. My purpose was to assist Mr. Knox. We were moving into subdivisions for the first time.

My purpose here was to assist him in developing an appraisal-formulating system or process. The inputs into this type of appraisal were new to our people at this time, because we were just moving into it. It was never intended that this appraisal be copied. It might come out the same on another dwelling but it should not have been copied.

He might continue with the same values, but not necessarily. This appraisal attempted to set a guide for him. When this was done—we were out in an open field. Nothing had been built. We had plans that had been approved; the prefabricated plan in this case was approved by our architect out of our State office.

Mr. FOUNTAIN. The circumstances, from what you tell us, were such that there would be no justification for Mr. Knox concluding that this particular appraisal was intended to be a guide?

Mr. WILLIAMS. I'm not sure what you mean by guide. I had gone through the processes with him. Then he, I would assume, would reach his own conclusion.

Mr. FOUNTAIN. It says here that he did.

Mr. WILLIAMS. I don't know if this was a true statement. I couldn't verify that. It is not intended that any appraisal be copied verbatim,

although it could be the same in the same area, with the same conditions.

When the first appraisal was made, there was no chance to evaluate quality control on this. We don't know how good a job the builder's going to do until the first house is produced.

Mr. FOUNTAIN. What you are saying is that you did not tell him that your suggested appraisal in this particular situation was to be used as a guide. Did you say anything that in your opinion could be construed by him as giving him authority to place prefab valuations way above your conventional valuations?

Mr. WILLIAMS. That is right, sir.

Mr. FOUNTAIN. Mr. Naughton?

Mr. NAUGHTON. Mr. Williams, if you make an appraisal of the initial prefabricated dwelling in a subdivision, and it is an accurate appraisal, and if all the other buildings in that subdivision are identical prefabrcated buildings on essentially the same sized lot in the same location; would you not expect the appraisers coming after, unless they saw something to distinguish it, to follow the initial appraisal?

Mr. WILLIAMS. Yes, sir. That would be the logical course for Mr. Knox or anyone else, unless there were changes in the design or construction or other features that could affect the value. If it were the same property, the same house, and the construction was satisfactory, you could expect a similar result.

Mr. NAUGHTON. If you appraised the initial dwelling at $11,500, wouldn't Mr. Knox properly feel that he would have questions to answer from the State Office if he appraised identical structures at $8,500 instead of $11,500?

Mr. WILLIAMS. It is likely that he would, yes, sir.

Mr. FOUNTAIN. I just can't understand why someone didn't call Mr. Knox. What you have just told us would indicate at least a possibility that Mr. Knox got the impression on the basis of your appraisal, if he didn't otherwise get some instructions. Did Mr. Knox have a lot of experience in appraising?

Mr. WILLIAMS. Let's see. He would have had several years, 3, 4, 5 years, in this area.

Mr. FOUNTAIN. On page 9 of the report, the third paragraph from the top, says "Mr. Lyle H. Rogers, Chief of the Rural Housing, Arkansas State office stated that in order to increase the volume of rural housing construction in the State and meet the demand for rural housing loans, they had to appraise the prefab dwellings higher than conventionally constructed dwellings. He said that this increased appraisal was intended to cover increased costs that prefab builders incurred in 'packaging applications' and the costs of interim financing incurred by builders building under the conditional commitment procedures."

Here I assume that whoever interviewed Mr. Rogers is stating what Mr. Rogers told him. Would you identify Mr. Rogers again?

Mr. WILLIAMS. Mr. Rogers is now the Housing Chief.

Mr. FOUNTAIN. As of that time?

Mr. WILLIAMS. At the time of the interview, yes, he would have been.

Mr. FOUNTAIN. This to some extent supports the report by the Office of Inspector General of the interview with Mr. Knox.

Mr. WILLIAMS. As it's written, it does, sir. I don't know if this is what Mr. Rogers said in the beginning. I would take issue with the terminology used here by the OIG representative, when he mentions only prefabricated housing—prefabs, as he refers to them.

Mr. FOUNTAIN. Excuse me for interrupting. It looks like Mr. Rogers got the same impression that Mr. Knox got from some source, doesn't it?

Mr. WILLIAMS. You would gather that from reading this document, sir.

Mr. FOUNTAIN. If this document is an accurate statement of what actually was said by Mr. Rogers and Mr. Knox to the investigators.

Mr. WILLIAMS. If it was an accurate statement of what Mr. Rogers said.

Mr. FOUNTAIN. You also read in the Inspector General's report the statement of Mr. Rogers and Mr. Knox, did you not?

Mr. WILLIAMS. The report before us?

Mr. FOUNTAIN. Yes.

Mr. WILLIAMS. I saw it and read it for the first time about 12 o'clock last night.

Mr. FOUNTAIN. You had not seen it before?

Mr. WILLIAMS. No, sir. I had seen it Monday afternoon. I believe I was in the State office.

Mr. FOUNTAIN. What's your position in the State office?

Mr. WILLIAMS. District supervisor, sir. District 3, located at Pargould, Ark.

Mr. FOUNTAIN. You are not at the main office, sir?

Mr. WILLIAMS. No, sir.

Mr. FOUNTAIN. What about you, Mr. Cook?

Mr. COOK. Yes, I've seen it before.

Mr. FOUNTAIN. When did you first see it?

Mr. COOK. I saw the rough draft that was presented on April 10, I believe, the first time that Mr. Stuckey and Mr. Martin——

Mr. FOUNTAIN. Did you see the report when it came out?

Mr. COOK. Some few days later; I didn't see it when it was initially received in the State office.

Mr. FOUNTAIN. You read what both Mr. Knox and Mr. Rogers said?

Mr. COOK. Yes.

Mr. FOUNTAIN. Did you think to call either one of them and ask them where they got their impressions?

Mr. COOK. I have talked to Mr. Rogers.

Mr. FOUNTAIN. What did Mr. Rogers say?

Mr. COOK. He denies making this statement.

Mr. FOUNTAIN. He does?

Mr. COOK. Yes, sir.

Mr. ELLIOTT. Mr. Chairman, this is my concern, the inconsistencies in the report, and the reason for our investigation into all aspects of this report.

Mr. FOUNTAIN. I think this will be helpful to you in your own investigation.

Mr. ELLIOTT. Yes, sir.

Mr. FOUNTAIN. This may make your investigation a little harder.

Mr. ELLIOTT. It's going to make it quite severe.

Mr. FOUNTAIN. I think it will make it much more thorough.

Mr. ELLIOTT. Yes, sir.

Mr. FOUNTAIN. What was Mr. Rogers' reply? He said he did not make the statement?

Mr. COOK. He denies making the statement as written in the report.

Mr. FOUNTAIN. I assume in your own investigation, you will talk to Mr. Rogers.

Mr. ELLIOTT. Yes, sir. This, sir, as you know, is an audit. An investigator has to find facts.

Mr. FOUNTAIN. Did you discuss it with Mr. Rogers, Mr. Hankins?

Mr. HANKINS. Yes, sir. He stated to me that this was not his statement.

Mr. FOUNTAIN. Is that right?

Mr. HANKINS. Yes, sir.

Mr. FOUNTAIN. What did he say?

Mr. HANKINS. In his statement to me, Mr. Rogers said that in order to increase the volume of rural housing construction in the State, and meet the demands for rural housing loans, he had to appraise conditional commitment houses higher than homes built previously by the small builder without conditional commitments.

This increase in appraisal was intended to reflect replacement costs of comparable properties and to cover costs such as packaging applications and the cost of interim financing incurred by builders under the conditional commitment procedure.

Mr. FOUNTAIN. Mr. Naughton?

Mr. NAUGHTON. When was it decided to put this increased appraisal policy, as referred to by Mr. Rogers, into effect?

I take it that the point of Mr. Rogers' disagreement, as you relayed it, is not to deny there was a policy for increased appraisals, but to say it applied to conditional commitments rather than prefabs.

Mr. HANKINS. 1969 or 1970.

Let me confer with Mr. Williams a minute please.

[Pause.]

Mr. HANKINS. The national office emphasized the need to make appraisals based on the value of comparable properties sold on the open market.

Mr. WILLIAMS. It took some time, really, to get this concept into operation. It was during this period that we're talking about.

Mr. NAUGHTON. Is there documentary evidence of exactly what this policy is, and when it went into effect?

Mr. ELLIOTT. That is a germaine question, and we will have the investigator document that for your committee.

[See app. 12.]

Mr. NAUGHTON. Let me ask you; are you aware of any documents?

Mr. WILLIAMS. Are you asking me, sir?

Mr. NAUGHTON. Yes.

Mr. WILLIAMS. Would you repeat the question, please?

Mr. NAUGHTON. Is there any document in which the nature of this higher appraisal policy is reflected, and any instructions to put it into effect as set forth?

Mr. WILLIAMS. It would have been one of our regular revisions of our procedure that we know as 422.3, which is the appraisal procedure for rural housing loans. It would outline procedural requirements for appraisal.

Not everything can be written in procedures. There would also be discussions of the policies and training meetings. Group training meetings are a method used by the national office to disseminate information.

Mr. NAUGHTON. Are you saying that these higher appraisals are a national policy rather than a State policy?

Mr. WILLIAMS. I'm coming to this.

The procedure does not come out and say, go out and make these higher appraisals. It says we recognize certain costs involved in the development of property that we have not in Arkansas heretofore recognized. Such costs as marketing expenses, which customarily would be reflected in open market sales.

It costs money to close a loan, but we never included this in our appraisal of property. Now, we do.

There are possibly other costs, such as surveys. We never used to include this as a cost of developing property in establishing loan value. In about 1969 or 1970, we started recognizing that these additional costs were reflected in the replacement cost of comparable buildings.

Now our appraisal form has been changed to provide spaces for these items. We are trying, by the dissemination of information, through meetings, training sessions, and through visits to counties, to familiarize our field staff with current appraisal policies.

This goes back to the statement that is alleged to Mr. Knox that somebody told him to raise the appraisal on prefabricated houses $3,000.

This appraisal training was going on all over the State, not only with Mr. Knox, in group meetings and individual sessions on conventionally constructed and prefab houses.

Mr. FOUNTAIN. All over the State?

Mr. WILLIAMS. Yes, sir. We were in the process of including additional inputs that he had not recognized heretofore. But most of our housing, most of our values, which were loan values, were established mostly on the basis of reasonable cost estimates. We had not recognized certain costs in the past that are reflected in the open market price of houses.

That may be the reason why an OIG representative concluded that we had raised the price $3,000 on prefabricated housing. This is not true, sir.

The prefabricated housing values were established at a higher level than conventional housing appraised during recent years because we were phasing into the updated appraisal approach.

In some of our procedures, we were encouraging greater involvement of the "private sector," that included the builders, realtors, and packagers who could put the essential information together, and bring it to us and save us time. We were short of personnel. While we were trying to move into a large housing program after 1968.

We either had to have a lot more personnel, or change our system to bring in the private sector. We had some resistance, as you might imagine, among our county people to this kind of approach. This was totally new to us.

It was similar to the approach used by HUD Federal housing and we had never handled our business in this manner.

Mr. FOUNTAIN. The reason I am asking these questions, in all fairness, is I am trying to see if there can be some reconciling of the rea-

sons for these statements. I asked Mr. Cook awhile ago if he talked to Mr. Rogers about this statement, and this report.

I believe you said, Mr. Cook, that Mr. Rogers said he did not make this statement.

Mr. COOK. He denied making the statement as it is written.

Mr. FOUNTAIN. I would like you to read again the statement that you said Mr. Rogers did make to you; then tell me the difference between that statement and the statement as it is included in the report.

Mr. HANKINS. Mr. Rogers states that in order to increase the volume of rural housing construction in the State, and meet the demand for rural housing loans, they had to appraise conditional commitment houses higher than homes built previously by the small builder without conditional commitments.

This increased appraisal was intended to reflect replacement costs of comparable properties and to cover costs such as packaging applications and the cost of interim financing incurred by builders under the conditional commitment procedures.

Mr. FOUNTAIN. I see some difference in the statement as you read it, and as it is written, but I'm not sure I quite understand the difference.

Would you tell the subcommittee what the difference is?

Mr. HANKINS. Will it be all right for Mr. Williams to take it?

Mr. WILLIAMS. The difference is, "they had to appraise the prefab dwelling higher than conventional construction."

Mr. FOUNTAIN. It doesn't say prefab in the statement; it says conditional commitment.

Mr. WILLIAMS. Conditional commitments covered all types of housing, not just prefab. A small portion of conditional commitments involved prefabricated housing. Most houses are now being built under conditional commitment.

The phrase, "they are to appraise the prefab dwelling higher than the conventional dwelling," is the main difference that Mr. Rogers took exception to.

Mr. NAUGHTON. Would you provide for the record or to the subcommittee please those instructions or any documentation that reflects this? Would you also help us by underlining those portions of it that you think refer most directly to the reasons for increasing the appraisals?

[See app. 12.]

Mr. FOUNTAIN. I believe you said there's no written policy or statement.

Mr. WILLIAMS. There was no policy as such stating to increase value on properties.

Mr. FOUNTAIN. Was there a policy that reflects the statement Mr. Rogers gave to Mr. Hankins when he was talking to him about the statement to the Inspector General?

Mr. WILLIAMS. Relative to appraising properties higher under the conditional commitment system?

Mr. FOUNTAIN. Anything in writing to that effect?

Mr. WILLIAMS. There were bulletins. There were memoranda. There was some reference to this, I believe. I am trying to recall, sir, where it specifically says in our national procedures, that we would have to, as I stated, recognize certain imputs as being a part of the cost of producing property. That was not brought out here, that in most instances we would consider the cost of developing a property. This would in-

clude the type of imputs that we have just been talking about—marketing costs, and interim financing. These costs would be reflected in non-FHA financed sales.

It is an assumption, of course, that the builder will do a good job of putting the property together, that it is well located and is in a market area that will absorb this type of property.

Mr. FOUNTAIN. Let's get down to Mr. Knox's office. He is in charge of the St. Francis County office. Is that right?

Mr. WILLIAMS. Yes, sir.

Mr. FOUNTAIN. Does he have the power to approve without going to the State office?

Mr. WILLIAMS. Yes, sir. He has that authority.

Mr. FOUNTAIN. Does he have to have the facts in each case before he approves, or can he go ahead and make a conditional approval?

Mr. WILLIAMS. If I understand you right, sir, before approving a loan, the appraisal of the property must be made. That is the valuation that determines our maximum loan. After this is established, if we have an eligible applicant who meets certain requirements, the county supervisor can approve a loan up to the value established for the property.

Mr. FOUNTAIN. In the OIG report on St. Francis County, it states on page 2——

> Rural Housing loans were being made to applicants with poor credit ratings and unstable incomes. RH loans were made to some applicants who had as many as ten delinquent accounts shown on their credit reports. These borrowers subsequently became delinquent on their RH accounts.

How could that happen?

Mr. WILLIAMS. Mr. Chairman, it could be a misplaced judgment, if there was an absence of the ability to repay a loan. Again, if you would refer to Mr. Cook's statement that said that under this system builders and developers found their own purchasers for houses, put the application together; brought it to our office, and then we, in turn, attempted to check it out through various means.

When the loans mentioned in the OIG report were made, FHA procedure required the county committee to determine eligibility. This is no longer required in all cases. Along with the determination of eligibility, the county committee determined the applicant has the potential to repay the loan.

Mr. FOUNTAIN. You're not disturbed about such credit reports?

Mr. WILLIAMS. Yes. If it is of a serious nature.

Mr. FOUNTAIN. It says that these borrowers subsequently became delinquent on their RH accounts. It would indicate that whatever their delinquency pattern was, it followed when they got their homes.

Mr. WILLIAMS. I have no knowledge of these borrowers' credit reports. Based on the OIG representative's statement, it could well be that these people were delinquent and in retrospect, we should not have made the loans.

Mr. FOUNTAIN. Mr. Hankins, I wonder if you will submit to the subcommittee what information you found in connection with this statement.

Mr. HANKINS. Yes, sir.

[The material referred to follows:]

We are attaching inserts from our response to the OIG audit report dated March 20, 1973, of the Farmers Home Administration program, St. Francis County FHA office, Forrest City, Ark. This OIG report is identified by No. 412–233–T. This attachment concerns applicant eligibility in connection with the OIG allegations that loans were made to applicants with poor debt repayment records and unstable incomes.

The cited cases have been reviewed in the State office and the following information is provided in addition to the comments made by the district supervisor:

Borrower "A". Information in the file indicates the applicant had verified annual income of $2,097 and the wife had anticipated income of $1,600. Based on the instructions and policy in effect at the time of loan approval, we feel this applicant had a marginal amount of income, but would have been considered eligible from the standpoint of income. The credit report does show collection items for $26 and $6. Also, the report shows a high credit item of $392 with nothing past due. The file contains a reference letter dated March 31, 1971, from Parker Furniture Co. This letter gives a good report for the past 5 years.

The reports of the district supervisor indicate the action that has been taken to prevent the recurrence of such loans.

Borrower "B". A review of the file revealed the credit report did show delinquent and current accounts. It appears the district supervisor has discussed this and similar cases with the county supervisor and there is an understanding that no loans will be approved to applicants with a questionable credit report.

Borrower "C". Material in the report concerning this borrower appears to be essentially correct. The running case record reveals a discussion with the family about the slow payment on their bills. The family felt the financial condition was brought about by medical bills associated with the birth of two children and they are now able to pay their debts. It appears the county supervisor was of the opinion the conditions had changed enough to warrant the approval of a loan.

Borrower "D". The running case record shows a credit report was discussed with the applicant on April 23, 1971. He stated his wife had gone to work and their financial situation had improved. The auditor and the district supervisor refer to a credit report; however, we could not find a report in the file. The county office was unable to give any information on the whereabouts of the credit report. We do not question the existence of a report. It does appear this was a questionable applicant and we concur in the statement made on this case by the district supervisor.

Borrower "E". The running case record shows a contact on September 17, 1970, with Mr. Kenny Jones, Gilbert-Jones Furniture Co. Mr. Jones stated credit history with the family began in June 1967, and they are honest and make their payments fairly regularly. The file does not reveal any additional information regarding the family resources or debt repayment record.

We are also including the following comments from our district supervisor concerning his investigation in this OIG report.

This problem arose when a large volume of rural housing loans were being processed with builders participating in packaging applications. This question of eligibility was not understood by county office personnel when welfare, food stamps, and part-time employment was considered stable income to qualify for interest credit loans. Since that time this has been clearly explained and this has been corrected.

This county has instituted a systematic servicing policy toward families not keeping insurance, taxes, and monthly payments current. Transfer procedures, liquidation actions are being recommended to upgrade families receiving FHA assistance. Notices are going out regularly to those families not concerned with maintaining a good credit balance.

New applicants are screened carefully and told readily what the requirements are toward meeting FHA debts. This has reduced the number of applicants filing for FHA assistance. Collection action has been accelerated to bring the delinquency ratio in this county in line with other counties in the State.

The following cases were cited:

Borrower "A"—Income is as stated in report. It was the opinion of approving official that his employment had improved and would have sufficient income to meet payments with assistance of other members of his family. Experience has proven that credit report information should be adhered to in determining ability to repay loan.

Borrower "B"—Income verified and credit report obtained. Applicant determined eligible even though credit report showed poor debt record. Good judgment

was not exhibited in approving loan under these conditions. Procedure has been changed to eliminate this type error in judgment.

Borrower "C"—Income is as stated in report. The failure to occupy the house is also given. At the time this borrower received the loan much credit was given to family receiving food stamps to help with food cost and he would use cash to make housing payments. Procedure in dealing with eligibility has been strengthened and this should prevent recurrence in the future.

Borrower "D"—This applicant and wife verified income of $8,073 total. The family consisted of husband, wife and three small children. Since receiving the loan family problems have arisen and they just were not able to keep payments up. The credit report indicated poor debt repayment. They stated affirmatively that they would pay this debt for housing. The county supervisor could see the need and sufficient income to repay a loan at time of approval.

Borrower "E"—Insufficient investigation to determine dependable income to repay loan. Failure to investigate debt repayment resulted in borrower being in debt for a rural housing loan with a poor credit rating. Procedure has been strengthened in determining eligibility and should prevent this type error in future.

Eligibility requirements were reviewed with county supervisor. He agrees that he was not as thorough or strict as he should have been, but in the future he will be very careful and seek advice in questionable cases involving eligibility. I believe that eligibility is clearly understood and procedure will be followed in future cases.

[NOTE.—Names of borrowers were deleted by the subcommittee.]

Mr. FOUNTAIN. Mr. Hankins, has any overall investigation been made to determine whether or not proper procedures were followed in approving borrowers' applications for loans to buy homes manufactured by Pacific?

In other words, were any of the borrowers actually ineligible but approved anyway?

Mr. HANKINS. Not to my knowledge, sir.

Mr. FOUNTAIN. Would you have knowledge of it?

Mr. HANKINS. Yes, sir, but only if the file is submitted as a problem case.

Mr. FOUNTAIN. None to your knowledge?

Mr. HANKINS. None.

Mr. NAUGHTON. Have you reviewed any of those files, Mr. Hankins?

Mr. HANKINS. Yes, we have reviewed some of them that have come to the State office.

Mr. NAUGHTON. If there are 350 homes, just using a figure that might be reasonable, manufactured by Pacific homes that have been financed by FHA in Arkansas in the last 3 years, how many of those files have been reviewed by the State office to determine whether or not the application was in order, and the borrower truly was a good credit risk, and satisfied other provisions required to be met for eligibility?

Mr. HANKINS. The only files that were reviewed were those that came in as foreclosures or problem cases.

Mr. NAUGHTON. Were these people good credit risks if you're getting 47 out of 72 of these homes back?

Mr. HANKINS. Mr. Cook?

Mr. COOK. There has been some review in some of these counties, and a determination was made that we were making loans to some people with not enough income to meet all of their obligations. We issued a State instruction providing guidelines for a minimum amount of income. This situation has leveled off, and improved considerably.

Mr. NAUGHTON. Then you do have evidence that some of the county offices apparently did not follow proper procedures in approving some loans based on these Pacific homes, and perhaps some others, too?

Mr. COOK. Yes, others, too.

Mr. FOUNTAIN. Even if you had no procedures, at least there is a probability they might not have exercised good judgment.

Mr. COOK. The interest credit type loans that we made were to low-income people.

As far as eligibility was concerned, they appeared to be eligible. But there is more to home ownership than paying principal and interest. They also have to pay taxes, insurance, and to maintain their house.

If these low-income people have unexpected expenses, a crisis could arise; one emergency and they could be in trouble. Their income is such that there isn't room to recover such cost. If the loan became delinquent, some borrowers would become discouraged.

Mr. NAUGHTON. Do you allow people to continue living in these homes indefinitely if they do not pay or otherwise can't make the payments?

Mr. COOK. We have to go through the liquidation procedures, and that does take time. Our Federal courts——

Mr. FOUNTAIN. Sometimes it's a little easier to wait a little, while hoping.

Mr. COOK. We try to work the problem out, but, if he remains delinquent, he may move out or he may stay there. There is little we can do if he decides to stay. If there is foreclosure action, the marshals may force him to vacate the house.

Mr. NAUGHTON. I am not suggesting that you have a harsh eviction policy. What I'm trying to establish is, does the borrower eventually have to pay up or get out?

Mr. COOK. We are trying to improve the servicing of loans and be firm with these people by trying to have a better understanding with the family at the outset, by counseling them more at the beginning.

We tell our field staff that they can do a lot of loan servicing with a borrower when they close his loan by telling him what we expect of him and what's going to happen if he doesn't meet his obligations.

Mr. NAUGHTON. You are not doing a man any favor if there's a pretty good chance he's not going to make it, and you approve a loan that you should not have approved. Eventually, you're going to kick him out, or he's going to have to move out.

Mr. COOK. That's correct, sir.

Mr. NAUGHTON. Am I correct in understanding from the prior testimony that the policy that resulted in higher appraisals than had been historically made is a national policy rather than a State policy and you were simply carrying out national policy in doing this.

Mr. WILLIAMS. Yes, sir. That is correct, as I have explained, it was an effort to also recognize the current market value of properties other than those we finance. This was a national policy and carried out by the State.

Mr. NAUGHTON. That brings up questions on national policy. How do you determine the maximum amount that FHA will loan on a single dwelling? It is by appraisal, isn't it?

Mr. NEVILLE. Yes.

Mr. NAUGHTON. Do you make loans up to 100 percent of the appraisal?

Mr. NEVILLE. Yes, sir. We can.

Mr. NAUGHTON. Who normally makes appraisals for the Farmers Home Administration? Would it be either the county supervisor——

Mr. NEVILLE. The assistant county supervisor or the county supervisor.

Mr. NAUGHTON. What are the instructions given to your appraisers as to how they are to arrive at the appraised value of a particular house?

Mr. NEVILLE. The instructions on appraisal have been outstanding for a good number of years. The type of instructions outstanding are those typical to the appraisal profession.

I might inject, the big question going around today is prefabricated versus conventionally constructed homes. In many areas, as you probably know, the prefabricated industry is just starting to come into its own. This was 1969 and 1970. The number of houses being produced by the manufactured home industry was relatively small in comparison to what it is today.

As a result, there was an antipathy toward the home by individuals, that is homeowners themselves were not in favor of buying them. They felt that they were marked as a manufactured home. Likewise, you had the same type of a feeling on the part of appraisers.

The manufactured home coming out of the plant in many instances, and maybe in most instances, is good construction. It is well engineered and well designed. So it is entitled, everything being equal, to the same appraisal as a house that is stick built.

The two factors that we have for determining appraisals are cost and comparables. You go in the market and find comparable sales. If the manufactured home goes for $10,500 and you find similar stick built houses for $10,500, the appraisal on both of them should be the same.

We have situations where the manufacturer of homes is looking for a higher appraisal then what we are finding. The appraisal should be only what the market will support.

Some of the items Mr. Williams made reference to, I think, can be understood. I may want to check this out.

When the appraisers were talking to the staff, they were saying, "Look boys, you have to get away from the old method of doing business. We want to develop houses in rural America." The legislation says "* * * as soon as feasible, a decent home and suitable living environment for every American family." Additional moneys were made available. They were endeavoring to bring the program in line and to respond to the legislative fiat that was given.

The items Mr. Williams mentioned are actually a cost of producing a house. It is part of the replacement cost. If I have to spend $25 or $50 for a survey, it's a cost. If I have to spend $50 for a conditional commitment, it's a cost.

There were other items the builder was not receiving credit for which should have been recognized as part of the replacement cost of a particular property, whether it was built as a manufactured home, or as a stick-built home.

Mr. NAUGHTON. You use cost along with comparables in order to assist you in arriving at what you believe is the closest you can get to the actual price for which that house will sell on the market.

Mr. NEVILLE. That's right.

Mr. NAUGHTON. If you had a house that cost $100,000 and couldn't possibly sell for more than $35,000, your appraisal would be $35,000?

Mr. NEVILLE. If that's all the market will pay for it, that's all.

Mr. NAUGHTON. I take it that your appraisers are not permitted to deliberately overappraise houses in order to encourage greater construction activity or for any other reason?

Mr. NEVILLE. Under no circumstances.

Mr. NAUGHTON. Do you have any procedures to try to insure that appraisals on similar dwellings are uniform, and that they fairly reflect the true value of the dwelling in different States, and within States?

Mr. NEVILLE. You can find a difference in the appraisal within 2 or 3 miles—for instance, the location itself. The same physical structure, if it were on Capitol Hill today, would bring about $10,000 more than it would be in Southeast Washington.

Mr. NAUGHTON. I understand that.

Mr. FOUNTAIN. I can think of places in my own home town where within ten blocks, and about three different directions, you'll find a variation from $1,000 to $3,000 a lot.

Mr. NEVILLE. Easily. In some areas—to cite an example, in Philadelphia—some of the ethnic groups like to live in their own community and among themselves. Some of the houses produced for the market there will sell for as much as $2,000 to $5,000 more than a similar type house would sell within ten blocks of it.

Mr. NAUGHTON. I understand what you are saying.

Mr. NEVILLE. We have been asked by the home builders to give them one price throughout a State for a typical house. We say no. The location itself, the value of the land, the environmental surroundings, and the acceptability of the house by the market all go into an appraisal so standardization and uniformity are not there.

Mr. NAUGHTON. I'm not suggesting that prices should be uniform. Obviously, they should not be. But the procedures should be uniform so they would fairly reflect the different prices in different areas.

Mr. NEVILLE. That's right. The appraisal techniques that the Farmers Home Administration has are national.

Mr. NAUGHTON. Getting back briefly to the Arkansas houses, if they were fairly appraised in the first place on the basis of market value, why is it that the reappraisals apparently have been showing reductions of about $3,000 or so?

Mr. HANKINS. This is not the case in all instances, but it is in some instances. Of course, in some areas of Lee County, it was the boycott, bad publicity, and the closing of the schools which adversely affected the values of the homes as reflected in the current appraisals.

Mr. NAUGHTON. The same thing happened in other areas of the State where you did not have the boycott, didn't it?

Mr. HANKINS. This is true.

Mr. NAUGHTON. One last question of Mr. Elliott. Do you think that the situation that we are discussing here today, of these appraisals that appear to be far above what the market will now bring, is a situation unique to Arkansas, or do you think you have some problems of similar magnitude elsewhere?

Mr. ELLIOTT. I am given to understand that we probably do have appraisal problems elsewhere. I am rapidly learning that while we have general guidelines for making appraisals, there are many vari-

ables that must be considered, as was pointed out, from block to block, city to city, county to county.

As I have previously pointed out, our field employees have had to adjust to added programs of sophistication beyond their individual expertise, experience, and background. A man of Mr. Knox's background, who had worked in the rural area with the farmer programs, emergency programs, rural housing programs, suddenly found himself in a new dimension of houses being sold in development areas where there are input costs that had never been a consideration before in coming up with an appraisal.

Suddenly, they find they have a new dimension and a new learning experience to cope with.

I know that across the board in the Farmers Home Administration appraisals may be open to question. Our employees are now learning to put into appraisals those elements of cost that are all inclusive, rather than leave them out to the detriment of the builder, who in the case of the minister/son, as Mr. Fuqua pointed out, has now gone out of business because true costs were not built into their estimates. They are no longer able to compete in the marketplace.

We probably do have an appraisal problem in many places, but we are dealing with it by education and training.

Mr. NAUGHTON. The OIG report estimates losses of $140,000 on homes that have come back into inventory. Is there any reason to believe that this estimate is not a reasonable one?

Mr. ELLIOTT. I have no reason to believe any estimate to be unreasonable. I accept it as the best estimate until proven otherwise.

Mr. NAUGHTON. Can you provide to the committee any information that you may have concerning losses in any other area in the thousands of dollars, or tens of thousands of dollars resulting from appraisal situations that could be in any way compared to the Arkansas situation?

Mr. ELLIOTT. We could try. If you expect precision in that type of estimate, you might find us unable to support it. I do not know of my own knowledge how one appraiser works in Wyoming as compared to Montgomery, Ala. I can only give you our best estimate. Because of the former more rural way of appraising as compared to the new approach needed in appraising development areas, it may be difficult to determine what the true loss might or might not be.

[The information follows:]

LOSSES INCURRED BY ERRORS IN APPRAISALS AS BROUGHT OUT IN THE ARKANSAS REVIEW

In any volume housing program, there will be foreclosures and ultimately some acquired properties. The reasons for these foreclosures vary and do not necessarily indicate errors in appraising or processing the loan. Many foreclosures result from circumstances outside the loanmaking and servicing functions. Some of these reasons are: (a) Death of the breadwinner, (b) serious sickness of the breadwinner or a member of his family which imposes an unexpected financial drain on the limited family income, especially in the case of low-income mortgagors, (c) divorce or abandonment of the family, (d) a decline in the economy of a particular area because of the shutdown of a major industry which is the main source of employment of an applicant. In these cases, the applicant or his survivor has not the financial means to carry the mortgage and the result is foreclosure.

Foreclosures can sometimes be attributed to overestimation of the market, overappraising or misjudgment of the applicant's ability to carry the loan.

FmHA is in the process of determining the extent of foreclosures within the agency, their probable cause and the possible losses which may result. This knowl-

edge will be used to train our personnel to recognize the causes of foreclosures and to avoid, where possible, foreclosures due to errors in processing.

Mr. NAUGHTON. The acid test comes at resale. It appears that the appraisals in Arkansas, based on the information that we have about sales and the inability to resell even after a substantial, downward reappraisal, have failed that acid test.

Mr. ELLIOTT. It depends on what the market is. If I made an appraisal on a house on Kalorama Road in Washington, D.C., where my family used to live, the cost of that house and the appraisal value at that time for tax purposes was considerably higher. As the neighborhood shifted and situations occurred in that area, the appraised value of that house changed to meet the test of the marketplace. You could buy it for less.

I have no trouble in understanding that if I appraise a house in Arkansas at a given price, and 2 years later various social situations occur in that community, the house would no longer be salable at what I had previously appraised it.

Does that answer your question?

I will try to supply for the record what you asked. I think you are asking a question that if you expect precision——

Mr. NAUGHTON. Not precision.

Mr. ELLIOTT. I will give you our very best estimate, Mr. Chairman.

Mr. FOUNTAIN. We are concerned about correcting these deficiencies.

Mr. ELLIOTT. I understand this, Mr. Chairman. The point I made at the beginning is that our three biggest problems are: (1) to develop systems, procedures, and instructions to permit us to do this job well; (2) to train our people; and (3) to try to find and keep people who can learn, adapt, and cope with these added responsibilities, and eliminate those that just can't stay with the program.

Mr. FOUNTAIN. I was going to ask you about eliminating those that can't stay with it. If they're untrainable, or because of moral turpitude or have conflicts of interest of the kind that are meaningful or have participated in kickbacks or anything dishonest, I assume you expect to get rid of them if you find them.

Mr. ELLIOTT. If I catch the rascal, I will drum him out of the corps.

Mr. FOUNTAIN. Mr. Thompson?

Mr. THOMPSON. Thank you, Mr. Chairman.

This is directed to Mr. Cook and Mr. Hankins concerning the evaluation of the income level of the people that were receiving approval on applications. How did you determine that there was a decrease in the income of a larger group of people receiving these loans?

I believe that's a statement you made.

Mr. COOK. A decrease in income?

Mr. THOMPSON. Right. You were approving loans for a group of people with lower incomes. Did you make that statement earlier?

Mr. COOK. If I said the decrease in income, it was an error. As it developed, we made loans to some families who were unable to meet their family obligations, living expenses, pay debts, and meet responsibilities of homeownership.

Mr. THOMPSON. Perhaps I misunderstood you, but this was a lower average than had been the case. Wasn't there some change?

Mr. COOK. It was reflected in some problems that developed, especially increased delinquencies. To help correct the situation, we issued a State procedure.

Mr. THOMPSON. Who initiated it?

Mr. COOK. Our housing section.

Mr. THOMPSON. Who would that be?

Mr. COOK. Mr. Overton, housing specialist, Mr. Rogers, and myself. I was in the housing section at that time. This happened some time in 1972, I believe. I'm not real sure on this.

Mr. ELLIOTT. May I address this question on a national scale? Remember, first of all, the social strata and the economic strata that we deal with. We eliminate those that can find credit elsewhere. We have also had problems making loans. We loan on the high-risk margin which is a social as well as a financial exercise.

The county agent and county committee that passes on these loans live right in the same area as our borrowers. Often times they err in the direction of trying to get them into a house, although they may not be doing them a favor.

If there should be a sickness in the family, or there should be any other unforeseen financial stress placed upon this marginal income and they default on the mortgage, it becomes a difficult problem, both socially and emotionally, for all the people involved.

The other thing that I think you should know, in order to protect the interest of the Government, we try to minimize the delinquency rates of failure to pay mortgages and we try to institute the necessary actions that have social implications to foreclose where it is just hopeless.

Again, when you are in that rural community dealing with a real family, face-to-face, these people have an emotional problem of decisionmaking. I would like to commend the State director, and I would like the record to show that these people have accomplished an amazing growth in programs, both in dollar value and loans. They are trying hard to learn and to cope with the new sophisticated programs and they are doing it to the credit of the Farmers Home Administration.

As I hear the story unfold here I think we should give due credit at the same time that we take a critical look at the problems. It is a remarkable accomplishment by people that have adopted and adjusted to an ever-increasing program in a rural area considering the emotional and social values involved.

Mr. THOMPSON. I think your social policy is very commendable, and I'm sure the committee feels that way, too. I was more interested in the administrative procedures in the decisionmaking process.

The investigation was initiated at the State level?

Mr. COOK. Yes, sir.

Mr. THOMPSON. Was it for all the districts of the State?

Mr. COOK. The procedure that was issued applied to the entire State. It was a State instruction. This was followed up with training meetings.

Mr. THOMPSON. Who reviewed the records to determine this? Was it done at the county levels?

Mr. COOK. It was performed in the county office by the rural housing specialists.

Mr. THOMPSON. Were these the people that made the decisions initially to grant the loans?

Mr. COOK. No.

Mr. THOMPSON. They were not?

Mr. COOK. The decisionmaking and the loan approval by and large is at the county level by the county supervisor. He has the authority to determine eligibility with the assistance of the county committee. He approves the loan. It never comes to the State office until there's something wrong with it.

Mr. THOMPSON. Did you review the findings of this particular investigation?

Mr. COOK. You mean go into the county myself?

Mr. THOMPSON. Yes.

Mr. COOK. No, sir.

Mr. THOMPSON. Did you review the statewide findings?

Mr. COOK. No, sir. We reviewed the situation in a session with the chief of the rural housing. Several staff members go into a county and make what we call a delinquency review, or a rural housing review in the county.

When we complete the review of the delinquencies in the particular county, and compare them with the income level of families involved, there seemed to be a correlation. Since implementation of the Arkansas instruction on income, we can see a trend that more consideration is being given to the debt-paying ability of applicants.

It resulted in rejecting more applicants who were seeking Farmers Home Administration financial assistance, and we got some squawks from builders.

Mr. THOMPSON. Thank you, Mr. Chairman.

Mr. FOUNTAIN. We have a vote on the Department of State authorization.

Do you want to vote quickly, and see if we can come back and finish up?

Mr. ALEXANDER. Yes.

Mr. FOUNTAIN. We will take a 10-minute recess. I'm trying to avoid you all coming back tomorrow if we can.

[A brief recess was taken.]

Mr. FOUNTAIN. Mr. Elliott, in your statement you described a January 1973 moratorium on housing loans. I wonder if you can tell the subcommittee who made the decision with respect to this action.

Mr. ELLIOTT. I could not, sir, but I could get that for the record. I believe it came from the Executive Office.

[See app. 13.]

Mr. FOUNTAIN. The Office of Management and Budget?

Mr. ELLIOTT. I cannot say that, but I believe it was made as a matter of policy that we declare the moratorium. As you can see, we are overexpanded, and we have had problems, both in urban as well as rural areas. It is time to back off to see how we can regroup and do a better job and reorder our priorities.

Mr. FOUNTAIN. Was FHA consulted in advance about the decision?

Mr. ELLIOTT. I do not believe anybody was, sir. It was just the recognition that there were problems in all of the housing programs. The decision was made at the Executive Office to review all housing and come up with a better overall program.

Mr. FOUNTAIN. When that decision was made, was anything put in writing to that effect?

Mr. ELLIOTT. Not that I know of, sir, but if it was, I will supply it for the record.

[See app. 13.]

Mr. FOUNTAIN. In your statement, you refer to a study or an evaluation of the Federal housing program. When, how and from whom did FHA first learn that such a study was contemplated?

Mr. ELLIOTT. We were asked to participate in the total study with Assistant Secretary Michael Moskow of HUD. He is in charge of plans in that department.

Mr. Neville, who's our housing expert, has worked with the committee in the study. We have people from our field offices and the national office with expertise in the area of housing who are working with this committee on their various task forces.

Mr. FOUNTAIN. Is it your opinion that the study could not be conducted without halting some or all of the programs involved?

Mr. ELLIOTT. Sir, that was not my judgment to make.

Mr. FOUNTAIN. When did you first learn about the study?

Mr. ELLIOTT. I became Acting Administrator on March 20. Was it before then?

Mr. NEVILLE. It was before then. After the President indicated that a study of the housing situation should be made, I, as the Assistant Administrator for Housing, initiated the study in the Farmers Home Administration. It was on the way.

We were then asked to participate by Secretary Lynn in the national study. We were very anxious to do so, so that the area of rural housing and rural America would not be overlooked in the study that was being conducted. We wanted to have an input so that the end result would include not only urban and suburban areas, but rural as well.

Mr. FOUNTAIN. It may take too long here to do it, but I wonder if you would provide the subcommittee with such information as you have concerning the nature of the study, who is directing it, and the projected timetable for its completion.

We would be interested, not only as a subcommittee, but I think we are interested as Members of Congress, particularly those of us that come from rural America.

Mr. ELLIOTT. I will check and provide it for the record.

[The information referred to follows:]

INFORMATION ON NATIONAL HOUSING STUDY

Following the subsidized housing moratorium placed into effect on January 8, 1973, by President Nixon, a national study of subsidized housing programs was initiated under Secretary Lynn and supervised by Mr. Michael H. Moskow, Assistant Secretary for Policy Development and Research, Department of Housing and Urban Development. The U.S. Department of Agriculture, even though conducting its own within-house review under the supervision of Mr. James F. Neville, Assistant Administrator, Farmers Home Administration, is participating in the overall study. Five FHA State directors and two housing Chiefs have been participating. In addition, other FHA personnel (part time for about 10 employees) and representatives of the USDA's Secretary's Office have assisted. The FHA, on June 15, 1973, completed an internal review of the rural housing programs, which has been forwarded to Mr. Moskow for use in preparing the final report.

The intent of Mr. Moskow's committee is to have a completed study with recommendations on which needed legislation would be based, by midsummer of 1973, so that by September 6, 1973, the Administration would provide Congress with proposed legislation to improve housing programs.

Mr. FOUNTAIN. Mr. Hankins, does Pacific Homes sell houses directly to the borrower, or does it operate through local distributors or builders?

Mr. HANKINS. They operate through local distributors or builders to the best of my knowledge.

Mr. FOUNTAIN. Do you have an opinion as to how many Arkansas firms sell houses manufactured by Pacific Homes?

Mr. HANKINS. It would be an estimate. I can get it for you, and enter it into the record.

[The information referred to follows:]

FIRMS THAT SELL HOUSING MANUFACTURED BY PACIFIC HOMES, INC., AND FINANCED BY FARMERS HOME ADMINISTRATION IN ARKANSAS

Name and address of local builder or developer	County	Number of dwellings
New Building, Inc., West Helena, Ark	Arkansas	56
	Phillips	18
Reed-Joseph Continental Co., Greenville, Miss	Chicot	45
Red-Val Industries, Inc., Garland, Ark	Columbia	9
	Hempstead	3
	Lafayette	29
	Miller	43
	Nevada	6
New Lee Builders, Inc., Marianna, Ark	Lee	27
Pleasant Homes, Inc., Little Rock, Ark	Conway	26
	Johnson	14
	Lonoke	27
	Pope	15
New-Mer Building Co., Forrest City, Ark	Monroe	11
	St. Francis	74
	Woodruff	6
Carl Giles, Forrest City, Ark	Craighead	1
Home Development Co., Earle, Ark	Crittenden	19
Bernard Builders, Inc., Earle, Ark	do	31
New Modern Bilt Homes, Walnut Ridge, Ark	Lawrence	8
B. & H. Homes, Coy, Ark	Lonoke	6
Shields & Whisenhunt, Blytheville, Ark	Mississippi	4
Carnathan Truck Stop, West Helena, Ark	Phillips	5
Carnathan-Waters No. 1, West Helena, Ark	do	11
Carnathan-Waters-Batchlor, West Helena, Ark	do	16
R. L. Crawford, Harrisburg, Ark	Poinsett	21
A. O. Harmon, Town & Country, Inc., Marked Tree, Ark	do	39
Paul Winters, Poinsett Builders, Harrisburg, Ark	do	2
Total		572

Note: 18 firms sold housing manufactured by Pacific Homes, Inc., Marks, Miss., and financed by Farmers Home Administration in Arkansas from June 1, 1969, to June 7, 1973.

Mr. FOUNTAIN. I will address the next question for the record to all three of the witnesses.

Mr. ALEXANDER. Mr. Chairman, excuse me. Will the gentleman yield?

Mr. FOUNTAIN. Yes.

Mr. ALEXANDER. Mr. Hankins, Pacific Homes is a corporation, is that true?

Mr. HANKINS. It is my understanding, yes, sir.

Mr. ALEXANDER. Do you know who is the executive officer of that corporation?

Mr. HANKINS. No, sir. I do not.

Mr. ALEXANDER. Have you ever had any dealings with a representative claiming to represent Pacific Homes as an entity?

Mr. HANKINS. He has been in my office, but I don't remember his name.

Mr. ALEXANDER. Is he from Arkansas, or outside the State?

Mr. HANKINS. I do not know. I assume he is from Mississippi.

Mr. ALEXANDER. Do you know by name any person or persons that are either executive officers or stockholders in Pacific Homes, Inc.?

Mr. HANKINS. I have met Henry Self. I think he is a stockholder.

Mr. ALEXANDER. Who is Mr. Self?

Mr. HANKINS. Well, he's one of the Self brothers.

Mr. ALEXANDER. Who are the Self brothers?

Mr. HANKINS. They are farmers in Marks, Miss.

Mr. ALEXANDER. Are you saying Mr. Self is a stockholder in Pacific Homes, Inc.?

Mr. HANKINS. That is my understanding.

Mr. ALEXANDER. Do you know any other stockholders in Pacific Homes, Inc.?

Mr. HANKINS. I have met Mr. Self's brother. I can't think of his first name, but I have met him.

Mr. ALEXANDER. Outside of the two Selfs, that you referred to, are there any others that you have knowledge of that are stockholders in Pacific Homes?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. Are there persons that are executive officers in one capacity or another with whom you have personal knowledge and acquaintance that are representatives of Pacific Homes?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Who is that person or persons?

Mr. HANKINS. I am acquainted with Mr. Bankston Waters.

Mr. ALEXANDER. What is his capacity with Pacific?

Mr. HANKINS. He's a salesman or owner in some of these subdivisions that we have financed. He's been in my office on occasion to discuss appraisals and things of this nature.

Mr. FOUNTAIN. Have you established a close, personal friendship, or does he just visit your office?

Mr. HANKINS. No; we are not close, personal friends, no, sir.

Mr. FOUNTAIN. Have you ever visited his home, or he yours?

Mr. HANKINS. I have been in his place of business, but I've never been in his home.

Mr. FOUNTAIN. Where is his place of business?

Mr. HANKINS. West Helena, Ark.

Mr. FOUNTAIN. We might ask the same questions of the other witnesses.

Mr. Alexander?

Mr. ALEXANDER. You want me to take that line?

Mr. FOUNTAIN. Go ahead.

Mr. ALEXANDER. Before I proceed further with that relationship, I would like to ask the other gentlemen here, Mr. Williams, if you know any of the officers or representatives of Pacific Homes.

Mr. WILLIAMS. No, I do not, sir, that I am aware of.

Mr. ALEXANDER. Do you know any of the stockholders?

Mr. WILLIAMS. No, sir, not that I am aware of.

Mr. ALEXANDER. Mr. Williams, I will direct this question to both of you; have you or Mr. Cook ever had any dealings with officers, executives or representatives of Pacific Homes, Inc., of Marks, Miss?

If so, who, and on what occasion?

Mr. WILLIAMS. Representatives?

Mr. ALEXANDER. Stockholders, executive officers, or representatives.

Mr. WILLIAMS. I met two representatives of the company. I do not know whether they're stockholders or not.

Mr. ALEXANDER. What are their names, and what are the occasions for your meeting with them?

Mr. WILLIAMS. I believe one name was Mr. Walters. I don't know his capacity or connection, although I do know he was representing——

Mr. ALEXANDER. Is that different from Waters?

Mr. WILLIAMS. Yes, it is. I believe the gentleman with him, as I recall, was an engineer with the company, I believe his name was Johnson. I couldn't be sure of this.

I saw these two people one time.

Mr. ALEXANDER. Mr. Cook, would you answer the same question, please?

Mr. COOK. Mr. Alexander, I do not know any stockholders—I don't know who they are. I have met Mr. Bankston Waters. I have met Mr. Virgil Merrill; whether or not these people are representatives of Pacific Homes, I don't know.

Mr. ALEXANDER. Mr. Hankins, based on your reference a minute ago to Mr. Bankston Waters of Helena, Ark., are you saying he is a representative for Pacific Homes in Arkansas?

Mr. HANKINS. It is my understanding that he sells their houses and possibly owns some of these subdivisions with some other people. I don't know how true this is.

Mr. ALEXANDER. Are we referring to those subdivisions that have been made reference to here in Lee County, that would be the Town and Country subdivision? Are those the subdivisions that we had reference to?

Mr. HANKINS. Yes.

Mr. ALEXANDER. St. Francis County—the Dogwood Acres?

Mr. HANKINS. I don't know.

Mr. ALEXANDER. How about Madison, where we had all the trouble?

Mr. HANKINS. I don't know.

Mr. ALEXANDER. Do you know of any other interest that Mr. Waters has in any other developments that are financed by Farmers Home Administration in Arkansas?

Mr. HANKINS. I believe that he is involved in a development in Walnut Ridge.

Mr. ALEXANDER. Lawrence County?

Mr. HANKINS. Yes.

Mr. ALEXANDER. Do you know if he's involved in any other counties administered by the Farmers Home Administration? How about Miller and Lafayette?

Mr. HANKINS. I don't believe so.

Mr. ALEXANDER. Miller and Lafayette Counties have been supplied with prefab housing from Pacific Homes. Is that correct?

Mr. HANKINS. This is my understanding; yes, sir.

Mr. ALEXANDER. If Mr. Waters did not sell those prefab houses in those counties, do you know who did?

Mr. HANKINS. It is my understanding that Mr. Everett Ham——

Mr. ALEXANDER. What is his address?

Mr. HANKINS. He lives in Little Rock.

Mr. ALEXANDER. Little Rock?

Mr. HANKINS. Yes.

Mr. ALEXANDER. Do you know whether Mr. Ham and Mr. Waters are associated in business?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. They are not associated, or you do not know?

Mr. HANKINS. I don't know.

Mr. ALEXANDER. Have you had occasion to be with Mr. Ham and Mr. Waters when they were together in your presence?

Mr. HANKINS. Yes.

Mr. ALEXANDER. What was the occasion for their being together in your presence?

Mr. HANKINS. Let's see.

Mr. ALEXANDER. Were you discussing housing?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. Were you discussing water and sewer loans?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. What were you discussing?

Mr. HANKINS. It was at a Republican meeting prior to selecting a State chairman.

Mr. ALEXANDER. When was that occasion?

Mr. HANKINS. It was at the last election of the Republican chairman in Arkansas.

Mr. ALEXANDER. Who is that chairman?

Mr. HANKINS. Jim Caldwell.

Mr. ALEXANDER. Is he in the housing business?

Mr. HANKINS. Not to my knowledge, not financed through the Farmers Home Administration, if he is.

Mr. ALEXANDER. When was the Republican fundraising dinner? You say the last election. Last fall—November?

Mr. HANKINS. I'm referring to the Republican chairman election.

Mr. ALEXANDER. When do you normally elect your chairman?

Mr. HANKINS. Every 2 years.

Mr. ALEXANDER. You elected him when—this year?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. You saw these two gentlemen together on this occasion in 1973?

Mr. HANKINS. Yes.

Mr. ALEXANDER. Have you been with them since them?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. Have you been with any of them prior to that time?

Mr. HANKINS. Yes, sir, I have been with them prior to that time.

Mr. ALEXANDER. What was the occasion for you to be with them prior to that time?

Mr. HANKINS. They had been by the office on business to discuss housing loans and appraisals and things of this nature.

Mr. ALEXANDER. I see.

I misunderstood you a minute ago. I understood you to say that they had not discussed housing with you.

Mr. HANKINS. I mean other than on Government time.

Mr. ALEXANDER. Explain to me what you mean by on other than Government time.

Mr. HANKINS. 8 to 5.

Mr. ALEXANDER. After 5 o'clock, you have met with Mr. Ham and Mr. Waters. You have met with them after 5 o'clock, not on Government time, but on your own time.

Mr. HANKINS. Right.

Mr. ALEXANDER. You met at your home?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. Did you meet there at Little Rock?

Mr. HANKINS. We were at this Republican meeting.

Mr. ALEXANDER. We have already established that. Other than the Republican meeting? You testified here that you met with Mr. Waters and Mr. Ham not on Government time but at times other than the Republican meeting.

I want you to explain to this committee when you met with them. Let me ask you this. Have you met with them in June?

Mr. HANKINS. No.

Mr. ALEXANDER. Have you seen either one of them in June?

Mr. HANKINS. No.

Mr. ALEXANDER. Have you talked to either one of them on the telephone?

Mr. HANKINS. I believe Mr. Ham called the other day on the phone.

Mr. ALEXANDER. What did you discuss?

Mr. HANKINS. It was something to do with a house in Lafayette County.

Mr. ALEXANDER. Was it any of these prefab houses that we referred to in the OIG report?

Mr. HANKINS. I don't know, sir.

Mr. ALEXANDER. You don't know?

Mr. HANKINS. No, sir. It was not one that was referred to in the OIG report.

Mr. ALEXANDER. What project was it?

Mr. HANKINS. I can't think of the name of the town.

Mr. ALEXANDER. Would it be Garland City?

Mr. HANKINS. No. That's in Miller County. This is in Lafayette County.

Mr. ALEXANDER. What was the nature of your discussion with Mr. Ham?

Mr. HANKINS. He was discussing a commitment with me on this individual house.

Mr. ALEXANDER. Do you remember anything about the discussion, other than the fact that you had one?

Mr. HANKINS. He wanted a price on it, and I didn't feel we could appraise the house for that amount.

Mr. ALEXANDER. What value did he want?

Mr. HANKINS. I don't remember.

Mr. ALEXANDER. Was it a $11,500 value?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. More or less than that?

Mr. HANKINS. Less than that.

Mr. ALEXANDER. How much less?

Mr. HANKINS. I was thinking somewhere in the neighborhood of $8,500.

Mr. ALEXANDER. Was that a prefab house?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. You were valuing that at $8,500?

Mr. HANKINS. I believe this is correct.

Mr. ALEXANDER. Is that prefab house different from those in Garland City?

Mr. HANKINS. I don't know. I've never seen the house.

Mr. ALEXANDER. Would it be approximately the same type of dwelling?

Mr. HANKINS. I have never seen the house. I wouldn't know.

Mr. ALEXANDER. How could you discuss a valuation, Mr. Hankins, if you didn't know about the house?

Mr. HANKINS. I was discussing our housing appraisal system.

Mr. ALEXANDER. I see.

Would you tell us what you did discuss with reference to the aspects of the valuation system? As I understand it, Mr. Ham called you.

Mr. HANKINS. Right.

Mr. ALEXANDER. About an appraisal of a type of house in Miller or Lafayette County?

Mr. HANKINS. Lafayette County.

Mr. ALEXANDER. You were telling him that he wanted too much value?

Mr. HANKINS. This was my opinion.

Mr. ALEXANDER. Your opinion, that you did not think—how much value did he want?

Mr. HANKINS. About $8,500 was the way we were prepared to appraise the loan.

Mr. ALEXANDER. How much did he want?

Mr. HANKINS. I don't remember.

Mr. ALEXANDER. You don't remember?

Mr. HANKINS. Somewhere in the neighborhood of $9,000.

Mr. ALEXANDER. Somewhere in the neighborhood of $9,000. You thought he should get about $8,500?

Mr. HANKINS. Yes.

Mr. ALEXANDER. You've never seen the plans?

Mr. HANKINS. Yes, sir. We've seen the plans for similar type buildings.

Mr. ALEXANDER. I see.

How would those plans for that prefab house relate to the other prefab houses in the OIG report? Would they be approximately the same area, the same type of house, or would they be different? If so, how different?

Mr. HANKINS. I don't know.

Mr. ALEXANDER. You don't know?

Mr. HANKINS. No.

Mr. ALEXANDER. If you don't know, Mr. Hankins, then I respectfully ask you, how could you discuss valuation with the man?

How could you tell me that you told him that what he was asking was too much valuation when you did not know what he was referring to?

Mr. HANKINS. This was my opinion that it was too much.

Mr. ALEXANDER. I see.

You had not seen the plans?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. Let's go to the month of May. Did you talk to Mr. Ham or Mr. Waters during the month of May?

Mr. HANKINS. Not that I remember.

Mr. ALEXANDER. Did you talk to them during the month of April, either one of them, by telephone or in person? Did you have any correspondence with either one of them?

Mr. HANKINS. I would have to check that out, Mr. Alexander.

Mr. ALEXANDER. You may have or may not have. It's possible in other words?

Mr. HANKINS. Yes.

Mr. ALEXANDER. How about the month before that? During the month of March, did you have contacts with either one of them before that?

Mr. HANKINS. It's very seldom that I see either of them.

Mr. ALEXANDER. How about talking to them on the phone? That's what I have reference to. Did you talk to either one of them on the telephone?

Mr. HANKINS. No, sir, not that I recall.

Mr. ALEXANDER. Not during the month of March?

Mr. HANKINS. Not that I remember.

Mr. ALEXANDER. Not that you remember?

Mr. HANKINS. No.

Mr. ALEXANDER. During the year 1973, and based on your approximation at this time, how many times have you talked to Mr. Ham on the telephone? One or two times, or eight or 10 times?

Mr. HANKINS. Four or five times perhaps.

Mr. ALEXANDER. Four or five times?

Mr. HANKINS. Yes.

Mr. ALEXANDER. How many times have you talked to Mr. Waters?

Mr. HANKINS. I don't believe I talked to Mr. Waters on the phone during this period of time. I don't remember if I have.

Mr. ALEXANDER. Let's just say before 1973, say during the year 1972, did you ever talk to Mr. Waters on the telephone?

Mr. HANKINS. On occasion, I have.

Mr. ALEXANDER. Would you approximate, just generally, were there few occasions or many occasions?

Mr. HANKINS. It would be a few. I have not had much association with Mr. Waters.

Mr. ALEXANDER. Four or five times during 1972, would that be about right?

Mr. HANKINS. It would not be that many.

Mr. ALEXANDER. Two or three?

Mr. HANKINS. Two or three.

Mr. ALEXANDER. Would that include the dinner you had reference to a minute ago?

Mr. HANKINS. No, sir. It would not include the dinner.

Mr. ALEXANDER. I see.

How many times would you have had personal contact with Mr. Waters, or Mr. Ham, during 1972?

Mr. HANKINS. Very little with Mr. Waters; I might have had a little more with Mr. Ham. I have known him for years. He's from my part of the country.

Mr. ALEXANDER. You are good friends, and you are political friends, is that right?

Mr. HANKINS. Right.

Mr. ALEXANDER. In other words, you go to the same party meetings, and you support the same candidates and that sort of thing?

Mr. HANKINS. We support the same candidates, but it's very seldom that I go to party meetings.

Mr. ALEXANDER. Don't misunderstand, Mr. Hankins, I'm not objecting to supporting party meetings and fundraising, and things of that type.

Mr. HANKINS. I understand.

Mr. ALEXANDER. I'm trying to establish your friendship with Mr. Ham and Mr. Waters. You say you're good friends with Mr. Ham?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. How long have you been acquainted with Mr. Ham?

Mr. HANKINS. I first met Mr. Ham in approximately 1952 or 1953.

Mr. ALEXANDER. I see.

Mr. HANKINS. He used to work for the Department of Agriculture.

Mr. ALEXANDER. Was he with the Farmers Home Administration?

Mr. HANKINS. No, he was with the ASCS.

Mr. ALEXANDER. How about Mr. Waters, Mr. Bankston Waters? Would you say you're casually acquainted, well acquainted, or you are not very acquainted?

Mr. HANKINS. Casually.

Mr. ALEXANDER. You know one another to speak, to say hello, to converse on the telephone?

Mr. HANKINS. Right.

Mr. ALEXANDER. In other words, if he were to call your office, you would probably answer his call, and talk to him about whatever he had on his mind. Is that correct?

Mr. HANKINS. This is true.

Mr. ALEXANDER. When he called you—I'm referring to Mr. Bankston Waters, who is the representative for Pacific Homes—you normally talk about these prefab houses; is that correct?

Mr. HANKINS. This would be if he wanted to know something about prefab housing.

Mr. ALEXANDER. Do you ever recall talking to Mr. Bankston Waters about prefab housing that was constructed in Lee County, Ark.?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Did you talk to him about any of the houses in the Town and Country subdivision I or II?

Mr. HANKINS. What county is that?

Mr. ALEXANDER. That is in Lee County.

Mr. HANKINS. Yes, sir. We talked about the subdivision.

Mr. ALEXANDER. Would you tell this committee what you talked about?

Mr. HANKINS. One thing that I remember we talked about, the last time he talked to me, was the low appraisals. He had applications for several properties. I sent Mr. Cook down to appraise them. We put lower values on the properties than he wanted. He wanted me to see about this appraisal.

Mr. ALEXANDER. What was the property that he referred to?

Mr. HANKINS. Would it be proper to ask Mr. Cook what subdivision it was in?

Mr. ALEXANDER. Yes, sir.

Mr. HANKINS. What subdivision was it?

Mr. COOK. It was one property in each subdivision. I think the properties are listed in the audit report.

Mr. ALEXANDER. Would you find that for us, Mr. Cook?

Mr. COOK. On page 9, sir, the second paragraph.

Mr. ALEXANDER. How are they listed there? How are they identified in that report on page 9?

Mr. COOK. The paragraph reads:

On March 7, 1973, Mr. Cook, assistant State director, completed an appraisal of Town and Country subdivision No. 1, and found that the same type prefab dwelling that FHA appraised for $10,500 in 1971, Mr. Cook appraised this dwelling at $8,500.

Let me correct the record. He mentioned only one of the appraisals that I made. I performed two appraisals on this visit.

Mr. ALEXANDER. Mr. Hankins, would you go on and explain to us the conversation—what he had on his mind?

Mr. HANKINS. If I remember correctly, after I did not satisfy him on the phone, he came in and visited with me and my staff about it. He wanted us to increase the appraisal, but we would not do this.

Mr. ALEXANDER. That was an $8,500 appraisal?

Mr. HANKINS. Right. He wanted us to go up on the appraisal, and we would not do this.

Mr. ALEXANDER. This was in 1972, is that correct?

Mr. HANKINS. 1973.

Mr. ALEXANDER. 1973?

Mr. HANKINS. Yes.

Mr. FOUNTAIN. What were his reasons for wanting you to go up on the appraisal?

Mr. HANKINS. He thought it was worth more money. Builders generally want us to raise the appraisals, and we refuse to do so unless an upward revision is justified.

Mr. ALEXANDER. Had that property been appraised prior to that time for more money?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. How much was it appraised for prior to that time?

Mr. HANKINS. $10,500.

Mr. COOK. Mr. Alexander, let me correct the record. The property had not been appraised as such. The formal appraisals you're talking about are the two appraisals that I made?

Mr. ALEXANDER. Yes.

Mr. COOK. To my knowledge, there was no formal appraisal on these two properties. These are properties that this company still has in these subdivisions, and they're trying to liquidate them.

Mr. ALEXANDER. What was the reason, Mr. Hankins, or Mr. Cook, or Mr. Williams, for the difference in the two appraisals—between the $10,500 appraisal and the $8,500 appraisal? Why the extreme difference? We are talking about 20 percent of the value of the house.

Mr. COOK. This is true. There are two or three things that contribute to this. These houses are approximately 2, or some more than 2 years old, and they have been vandalized even though they have not been occupied. They have been torn up.

The demand was also a consideration. I couldn't establish that I had a sufficiently strong demand that would warrant giving $10,500 for this house today. I appraised the house on the basis of how I analyzed the market on March 7, 1973.

Mr. ALEXANDER. Mr. Hankins, are these houses the same prefab dwelling that was generally appraised at more than $10,000?

Mr. HANKINS. Yes, sir. They are in the same subdivision.

Mr. ALEXANDER. The same, identical subdivision?

Mr. HANKINS. Right.

Mr. ALEXANDER. Going back to other occasions, what other occasions did you have to talk to Mr. Waters?

Mr. HANKINS. I visited with him briefly maybe at some homebuilders meetings, and there were several builders present. We just talked about housing in general.

Mr. ALEXANDER. How many homebuilders meetings would you say generally?

Mr. HANKINS. Two, that I can think of.

Mr. ALEXANDER. Prior to 1972, that is in 1971, did you have occasion to be with Mr. Waters or Mr. Ham?

Mr. HANKINS. I had a few occasions to be with Mr. Ham. I don't remember about Mr. Waters. Probably, he called me about something a time or two, or came by.

Mr. ALEXANDER. Going back to 1970, how about answering the same question during that year. Did you ever see Mr. Waters or talk to him in 1970?

Mr. HANKINS. I probably did.

Mr. ALEXANDER. How about 1969?

Mr. HANKINS. I don't believe so, but I could have once or twice.

Mr. ALEXANDER. It is possible, but to the best of your recollection, your first association with Mr. Waters began in 1970?

Mr. HANKINS. Yes, I would say that.

Mr. ALEXANDER. When did you first become informed about the availability of prefab homes from Pacific Homes, Inc.?

Mr. HANKINS. We had started with Pacific in 1970, I guess; I think that was when we started.

Mr. ALEXANDER. About the same time that you became acquainted with Mr. Waters?

Mr. HANKINS. Yes, sir. I believe they were building some prefab homes when I became State director. Mr. Alexander, it escapes me at the moment, but I believe there were some Pacific homes being financed about the time I became State director.

Mr. ALEXANDER. Are you confident now, Mr. Hankins, that what you have told us about your association with Mr. Waters and with Mr. Ham is generally correct?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. That your association would not excessively exceed the general definition that you have described to us today?

Mr. HANKINS. On one occasion, we had a homebuilders meeting in Marianna—no, it was Helena—and Mr. Waters was there. We went to eat after the meeting was over, and he picked up the tab.

Mr. ALEXANDER. Outside of that——

Mr. HANKINS. I did not feel too good about this, so the next time I ran into him in Little Rock, I bought his dinner to even it up. As far as I know, those are the only two times that we ever spent any money on each other.

Mr. ALEXANDER. You are sure of that?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Mr. Chairman, would you want to continue?

Mr. FOUNTAIN. Since you asked that question, for the record, have you ever received any gifts of any kind, or nature or description, from him?

Mr. HANKINS. No, sir, not from him or any other builder or contractor.

Mr. FOUNTAIN. Not from any other builder?

Mr. HANKINS. No.

Mr. FOUNTAIN. These builders usually contact the county supervisor, is that right?

Mr. HANKINS. Yes, sir.

Mr. FOUNTAIN. They are the ones the builders deal with primarily?

Mr. HANKINS. Yes, sir. He deals primarily——

Mr. FOUNTAIN. Why did he come primarily to see you? Had he been to the county supervisor, and the county supervisor——

Mr. HANKINS. In the beginning, I have to go back in my mind, he had some subdivision plans that had to be approved by our architect, probably these in Lee County, Mr. Alexander. He brought these in and worked with the housing section on the subdivision.

Is that correct, Mr. Williams?

Mr. WILLIAMS. I'm sure he was in several times relative to the subject Mr. Hankins mentioned. This was not unusual.

Mr. HANKINS. They go and come all the time with these plans, because our architect is in the State office.

Mr. FOUNTAIN. You mentioned Mr. Ham. Who did you say he was? I didn't get that.

Mr. HANKINS. He is a builder. In fact, he built these homes at Garland City.

Mr. FOUNTAIN. Does he have any interest in Pacific that you know anything about?

Mr. HANKINS. I don't know anything about that. He represents Pacific in Lafayette and Garland Counties.

Mr. FOUNTAIN. I believe you said that at one time Mr. Ham was in the Department of Agriculture.

Mr. HANKINS. Right.

Mr. FOUNTAIN. What was his position?

Mr. HANKINS. He was district fieldman for the ASCS Office, and I was county supervisor for FHA at the time.

Mr. FOUNTAIN. Were you county supervisor for the Farmers Home Administration at the time that you were appointed State director?

Mr. HANKINS. Yes, sir.

Mr. FOUNTAIN. How long had you served in that capacity?

Mr. HANKINS. About 13 years.

Mr. FOUNTAIN. About 13 years?

Mr. HANKINS. Yes, sir. Actually, I believe it is about 11 years.

Mr. FOUNTAIN. Do you know when Mr. Ham left the Department of Agriculture?

Mr. HANKINS. Whenever Mr. Kennedy came in, he departed. He was in a position that it changed whenever the administration changed.

Mr. ALEXANDER. Is the gentleman saying that Mr. Ham was an Eisenhower appointee?

Mr. HANKINS. Yes, you could say that.

Mr. ALEXANDER. He lost his position when President Kennedy came in?

Mr. HANKINS. This is my understanding. That is just rhetoric I picked up.

Mr. NAUGHTON. Mr. Hankins, and Mr. Cook and Mr. Williams, I will ask you the same question; are you acquainted with any officials or employees of either Lee Builders or New Lee Builders?

Mr. HANKINS. Lee Builders?

Mr. NAUGHTON. I believe they've built homes manufactured by Pacific Homes in the Lee County area.

Mr. COOK. I have met Mr. Walter Kuzneitcow, who's a builder. It's my understanding that he is the local representative who is handling these houses for New Lee Builders in Lee County at the present time.

I visited with him when I appraised and inspected these properties and discussed with him the planned rehabilitation or corrections or restoration of these houses that my appraisal report indicated would be required.

Mr. NAUGHTON. Were you acquainted with Mr. Kuzneitcow before meeting him in connection with the business that you just described?

Mr. COOK. No, sir. If I were to meet the man down the hall, I wouldn't know him.

Mr. NAUGHTON. Do you know who the principals are in the firm of New Lee Builders or Lee Builders, other than Mr. Kuzneitcow?

Mr. COOK. No.

Mr. NAUGHTON. Mr. Hankins?

Mr. HANKINS. I understand that at one time, the man who was burned, J. D. Sisk, Jr., was a member of this firm. I don't how true this is.

Mr. ALEXANDER. Who's Mr. Sisk? Mr. Hankins, would you describe who he is?

Mr. HANKINS. As far as I know, he's a local farmer at Marianna.

Mr. ALEXANDER. Did you have any contact with Mr. Sisk other than the building business?

Mr. HANKINS. No, sir. I ran into him one night. I visited with him and his wife in a restaurant in Little Rock.

Mr. ALEXANDER. Did you ever run into him at any other place or time?

Mr. HANKINS. No, sir; not that I can think of right now.

Mr. ALEXANDER. How about this meeting you referred to a minute ago? Did you ever run into him there?

Mr. HANKINS. No, sir. He was not there that night.

Mr. ALEXANDER. Should he have been there?

Mr. HANKINS. I don't know.

Mr. ALEXANDER. Are you referring to the Mr. Sisk that was a Republican candidate for the State legislature in Lee and Phillips County?

Mr. HANKINS. It is my understanding that he had run for office at one time. Yes, sir.

Mr. ALEXANDER. Thank you, sir.

Mr. NAUGHTON. Does the name New-Mer Building Co. of St. Francis County mean anything?

Mr. HANKINS. Is that Mr. Virgil Merrill's firm?

Mr. NAUGHTON. They have built some housing manufactured by Pacific Homes in St. Francis County.

Mr. HANKINS. I have met Mr. Merrill. I visited with him a time or two. I don't know much about him.

Mr. NAUGHTON. Were you acquainted with him other than through those contacts?

Mr. HANKINS. Only through the building business.

Mr. NAUGHTON. Are you acquainted with Mr. Merrill?

Mr. COOK. I probably met with him on two occasions.

Mr. NAUGHTON. What were those occasions?

Mr. COOK. We discussed some housing problems.

Mr. NAUGHTON. Both discussions were the discussion of the same general problem?

Mr. COOK. Yes.

Mr. NAUGHTON. When was that? Do you recall?

Mr. COOK. It was calendar year 1972.

Mr. NAUGHTON. What was the nature of the problem?

Mr. COOK. He was developing subdivisions, and he had requested conditional commitments. That was the nature of the discussion.

Mr. NAUGHTON. Excuse me. I missed that.

Mr. COOK. The discussion was in relation to a request for conditional commitments in a subdivision that he had developed.

Mr. NAUGHTON. What was the problem in respect to getting that? Were you unwilling to grant them?

Mr. COOK. We had granted them. But when the time came for the final inspection on those houses, they were not located where the site plans required for them to be located.

Mr. NAUGHTON. What was the appraisal on those?

Mr. COOK. I don't know. I don't have that information.

Mr. NAUGHTON. What was the final outcome?

Mr. COOK. He still has the houses.

Mr. NAUGHTON. You did not approve them?

Mr. COOK. We have not closed any loans in this subdivision, to my knowledge. The county supervisor has been instructed to not close any loans without authority from the rural housing State staff.

Mr. NAUGHTON. Is there a process now working that may result in your financing those homes?

Mr. COOK. It is possible.

Mr. NAUGHTON. Has your office given approval allowing for the financing of these homes? Did you recommend favorably?

Mr. COOK. We have given Mr. Merrill the conditions under which we would consider processing these loans to eligible applicants, if the applicants wanted to buy the houses.

Mr. NAUGHTON. Can you provide details on that for the record.

Mr. COOK. Yes, sir.

[The information referred to follows:]

This attachment will begin by further explaining line 13 on page 316 of the transcript. Mr. Cook finds that he only met Mr. Merrill on one occasion in early 1972. The other discussion was by telephone prior to this time. We will address the visit first.

This visit with Mr. Virgil Merrill was in connection with the Garrett Grove subdivision, which was developed by New-Mer Building Co. of Forrest City, Ark., of which Mr. Merrill is the principal owner. The visit was on January 5, 1972, by Mr. Lee Cook and Mr. Lyle Rogers of the FHA State office staff.

New-Mer Building Co. was issued conditional commitments for eight houses in the Garrett Grove subdivision. Seven of these commitments were for $10,500 on each house and one was for $11,500. Three of the houses were not located where the site plan required them to be: therefore, State office personnel were requested to assist in this matter by Mr. Vernice Gamble, district supervisor.

On December 1, 1971, Mr. Merrill requested the county supervisor to process loans to purchase houses in the Garrett Grove subdivision, except for the three houses in question. His request was forwarded to the State office. By memorandum dated December 9, 1971, the State office authorized the county supervisor to proceed with processing of loans in the subdivision, except for the three houses in question located on the county road; however, no loans were approved as the buildings were not complete.

Mr. Merrill was advised by Mr. Cook and Mr. Rogers that some agreement had to be reached concerning the houses in the Garrett Grove subdivision if he expected Farmers Home Administration to make loans for purchase of the houses, especially the three houses next to the county road where they were too close to the road ditch. There was a verbal agreement reached at this meeting whereby New-Mer Building Co., agreed to the following in addition to the requirements of the conditional commitments:

1. Grade the yards for proper drainage.
2. Work with the county road supervisor in completing the county drainage ditch (at New-Mer's expense) in order to divert the bulk of waterflow.
3. Install additional (or larger) culverts on lots 2 and 3 if necessary as determined by the county road supervisor and New-Mer's engineer.
4. Install at New-Mer's expense a 60-foot decorative electric yard light with automatic day/night control.
5. Plant ivy ground cover along the ditch bank of lots 1, 2, and 3.
6. Plant extra shrubs and trees on these three lots.

Mr. Merrill confirmed this agreement by letter to the State director dated January 6, 1972. Upon receipt of this letter from Mr. Merrill, the State office once again by memorandum dated January 10, 1972, authorized the county supervisor to approve loans in the Garrett Grove subdivision, provided all requirements of the conditional commitments had been met and the planned improvements in Mr. Merrill's letter were complete. However, to date no loans have been closed in the Garrett Grove subdivision.

The original conditional commitments were extended 6 months. The extension of the last commitment expired in December 1972; therefore, the situation in Garrett Grove will be reevaluated before any rural housing loans can be approved to eligible applicants to purchase the houses.

The second discussion between Mr. Cook and Mr. Merrill was by telephone in late 1971. This discussion was about appraisals of properties in the Redbud Acres subdivision, approximately 1 mile south of Palestine, St. Francis County. Mr. Cook made six appraisals in connection with a request for conditional commitments. Mr. Merrill had requested that 12 houses be allowed in this subdivision. Based on the Arkansas State Board of Health recommendation, we were willing to go with only six, and Mr. Cook's appraisals required that two lots be provided for an adequate building site. This disturbed Mr. Merrill some, so he requested Mr. Cook to raise his appraisals on these properties, since he was requiring two lots. The appraisals were not raised as he requested.

These properties were appraised for $12,500. They are brick veneer dwellings with the frame components furnished by Pacific Homes, Inc. of Marks, Miss. Mr. Merrill has developed these six properties and four were sold and financed by Farmers Home Administration loans. The remaining two are still owned by New-Mer Building Co., and cannot be purchased with Farmers Home Administration loans until deficiencies in the subdivision are corrected. These deficiencies are malfunctioning septic systems and questionable street construction.

There is no personal acquaintance between FHA personnel and employees of New-Mer Building Co., other than what is necessary to conduct the normal business in connection with loans made to applicants for purchasing homes that New-Mer Building Co. has developed.

Mr. NAUGHTON. You indicated or the report indicates that on March 7, 1973, you completed an appraisal on Town and Country subdivision No. 1, and you told us there were actually two dwellings. This covered the same type, prefab dwelling that FHA appraised at $10,500 in 1971, and you appraised it at $8,500.

Was that a recently constructed dwelling?

Mr. COOK. No, sir.

Mr. NAUGHTON. Had that been previously financed?

Mr. COOK. No, sir. This subdivision is north of Marianna in the community of Haynes, and not Town and County No. 1 and No. 2.

There were 17 houses constructed in this subdivision initially.

Farmers Home Administration made five loans in this subdivision. We still have those five loans at the present time, and there are two or three of them which I understand are delinquent. There's no indication that we will foreclose these. They seem to be workable situations.

The appraisal that I made for $8,500 is for one of the remaining 12 houses in the subdivision. The builder, New Lee Builders, still owns them. The houses are more than 2 years old and are badly vandalized.

Mr. NAUGHTON. Why didn't they finance them all under FHA in the first place? Were they unable to find eligible borrowers on a packaging concept?

Mr. COOK. Mr. Naughton, let me point out one thing here. At the time that the five houses were originally purchased, I was not in the State office. The purchases were made in 1970.

During 1971, the boycott and economic troubles occurred in the county. We discontinued these loans some time in 1971. I am not sure of the date. We have correspondence instructing the county supervisors not to approve any additional loans in this subdivision without authorization from the State office housing staff.

Mr. NAUGHTON. Was it because of the condition of the dwellings that you felt that they were not eligible for financing?

Mr. COOK. They had some poor workmanship in them, and we had to come to an understanding as to what deficiencies had to be corrected before we could go any further on those houses.

Mr. NAUGHTON. Is the reason why only 5 dwellings out of the 17 had been initially financed because of questions of the conditions of the houses; the workmanship? Did the others fail to pass inspection?

Mr. COOK. Sir, I don't know. At this time, I don't know when the 17 houses were actually completed. I don't know when the five loans were made.

Mr. NAUGHTON. I'm not talking about the five loans. I am talking about why they didn't continue to get additional loans on the other 12.

Mr. COOK. At the time that the five were made?

Mr. NAUGHTON. After the five had been made.

Mr. COOK. I can't answer this question right now. I wasn't on the scene at that time.

Mr. NAUGHTON. The dwellings that had been financed were appraised at $10,500?

Mr. COOK. According to the OIG report, this is true. I don't remember.

Mr. NAUGHTON. I just have one more question for Mr. Hankins.

Mr. Hankins, did you personally prepare the May 22 reply that was sent into Washington concerning the OIG report?

Mr. HANKINS. No, sir.

Mr. NAUGHTON. Who did?

Mr. HANKINS. Mr. Jim Grady and Mr. Lyle Rogers.

Mr. NAUGHTON. Did you have a staff meeting or a consultation before approving, or did you just sign it?

Mr. HANKINS. I read it and signed it. I was on the farmer program. I had some problems in the First Congressional District.

Mr. ALEXANDER. We've had a lot of problems over that, haven't we, Mr. Hankins?

Mr. HANKINS. That's right, and I realize that I was wrong. I should have looked at it more closely.

Mr. ALEXANDER. Will the gentleman yield on that question?

Mr. NAUGHTON. Yes.

Mr. ALEXANDER. Mr. Hankins, we all have to have help with our correspondence.

Mr. HANKINS. I'm glad you brought that up.

Mr. ALEXANDER. I'd be glad to hear anything you have to say about it. You say Mr. Grady and Mr. Rogers helped you to prepare this response that you executed on May 22 in reply to the May 3 OIG report.

I am constrained to ask this question. Mr. Hankins, do you know whether or not either of these gentlemen conferred with the Washington office in their deliberations prerequisite to preparing this report?

Mr. HANKINS. No, sir. I do not.

Mr. ALEXANDER. Did you have any discussions with the Washington office prior to the execution of this report?

Mr. HANKINS. No, sir, other than the Washington office called and wanted this report in the national office.

Mr. ALEXANDER. To your knowledge, nobody in the Washington office conferred with either of these gentlemen, and made any input or contribution to the report that you executed on May 22?

Mr. HANKINS. I don't think so.

Mr. ALEXANDER. Mr. Hankins, would you inquire and advise me if you discover any information to the contrary?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Thank you.

Mr. ELLIOTT. We will advise the committee, Mr. Chairman.

[No information to the contrary was communicated.]

Mr. NAUGHTON. Were the two gentlemen that prepared the response given any instructions on what to put in it, or told to go ahead and respond to it as they saw fit?

Mr. HANKINS. Yes, I was out in the field at the time when the request from the national office for the interim report came in. They went ahead and worked on it prior to my coming in.

Mr. NAUGHTON. Mr. Cook, did you give these gentlemen any guidance as to what to put in that report?

Mr. COOK. Yes, sir.

Mr. NAUGHTON. What did you tell them to put in it?

Mr. COOK. To my understanding, there have been two telephone calls from the national office requesting information from our office. I received one of the calls. Also, a secretary gave me a note relative to another call. I have her note requesting information to be furnished to Mr. Mark Nestle's department as to what we were going to do about the OIG report, and the corrective action that we were planning to take.

There had been no discussion on this report. I gave it to Mr. Rogers with instructions for him to draft the reply. He and his staff prepared information to be sent to the national office so that they would have information available at these hearings.

Mr. THOMPSON. Who requested this?

Mr. COOK. The secretary said Mr. Nestle's office. I personally had a call from a secretary in Mr. Nestle's office. I don't remember her name.

I took this call. They were asking again for this information. I told her, we wanted to argue a little bit on this audit report. Those are the words that I used.

Mr. THOMPSON. You had read the report?

Mr. COOK. Yes, sir. I had read the report.

I told her we would provide interim information that we had available, and what we had done and what we thought we would do about the problems in the audit report.

Mr. NAUGHTON. Mr. Nestle's job is to follow up on OIG reports to see what action is taken to follow recommendations in them. Am I correct?

Mr. ELLIOTT. That is correct, sir.

Mr. NAUGHTON. Did you give any instructions to the gentlemen that prepared the reply as to what they should put in it, or did you essentially, in effect, hand the report to them and say respond to this?

Mr. COOK. I told them that the national office wanted something—that we are going to correct this situation. We knew we had problems.

Mr. FOUNTAIN. They wanted an answer, and you wanted to give them an answer?

Mr. COOK. We wanted to give them something on what we had done, and what we were going to do. I did instruct them that we were going to pursue this problem that had been identified, and satisfy ourselves.

Mr. FOUNTAIN. Is that one of the reasons that you avoided attempting to discuss in your reply many of those areas in the Inspector General's report with which you might have disagreed?

Mr. COOK. In my opinion, sir, I didn't think that the interim reply was the time to challenge the OIG report.

Mr. FOUNTAIN. I notice in the last paragraph of your letter, you said that an in-depth analysis is being made and a complete report will be submitted in the future.

Mr. COOK. Yes, sir. The audit itself requires a reply no later than July 2, I believe.

Mr. THOMPSON. Who is directing that analysis?

Mr. COOK. The housing chief at the present time. The housing staff will work on this analysis. The State director and I will probably assess the analysis.

Mr. FOUNTAIN. In other words, your office has the responsibility of giving a complete and detailed answer to all of the allegations contained in the report of the Office of Inspector General.

Mr. COOK. That is correct. It is due July 2.

Mr. FOUNTAIN. Are you going to have time to get it in?

Mr. COOK. We are going to try.

Mr. HANKINS. I talked to the housing chief this morning and he is working on this report at the present time.

Mr. FOUNTAIN. I would appreciate your supplying us with a copy when it does come in.

Mr. ELLIOTT. Yes, sir.

[See app. 9(C).]

Mr. THOMPSON. What is the housing inspector's name?

Mr. HANKINS. Lyle Rogers.

Mr. THOMPSON. That is the gentleman you referred to several times concerning conflicting statements?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Mr. Chairman, may I ask Mr. Hankins one question which was requested of me?

Mr. FOUNTAIN. Go right ahead.

Mr. ALEXANDER. Mr. Hankins, I was requested to ask you if you knew Mr. Clark Reed?

Mr. HANKINS. No, sir. I do not know Mr. Reed; I have talked to Mr. Reed on the phone. As to meeting him, I did see him at a distance at Cotton Day in Mississippi awhile back when he was introduced to the audience.

Mr. ALEXANDER. What did you talk to Mr. Reed about on the telephone?

Mr. HANKINS. About houses.

Mr. ALEXANDER. Do you know who Mr. Reed is?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Will you tell this subcommittee who he is?

Mr. HANKINS. It is my understanding that he is the Republican Chairman of Mississippi.

Mr. ALEXANDER. Do you know whether or not Mr. Reed has any association with Pacific Homes of Mississippi?

Mr. HANKINS. No, sir, I do not.

Mr. ALEXANDER. Would it surprise you if someone suggested that he did?

Mr. HANKINS. I would have no occasion——

Mr. ALEXANDER. In other words, the discussion that you had with him on the telephone did not have anything to do with Pacific Homes?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. What did it have to do with?

Mr. HANKINS. It had to do with some commitment housing in Chicot County.

Mr. ALEXANDER. Does Mr. Reed have an interest in houses in Chicot County?

Mr. HANKINS. Yes, sir.

Mr. ALEXANDER. Do you know if they are prefab?

Mr. HANKINS. I do not know.

Mr. ALEXANDER. Do you know if they are furnished by Pacfiic Homes?

Mr. HANKINS. I do not know.

Mr. ALEXANDER. Do you know if Mr. Reed has any interest in houses in any other county other than Chicot County?

Mr. HANKINS. No, sir.

Mr. ALEXANDER. Have you ever had occasion to be with Mr. Reed in person?

Mr. HANKINS. No, sir. Only the occasion I was speaking of.

Mr. ALEXANDER. You saw him at a distance?

Mr. HANKINS. I did not talk to him.

Mr. ALEXANDER. Thank you, Mr. Chairman.

Mr. NAUGHTON. In connection with an article that was put in the record earlier today about defective housing being sold through FHA, the name of A. C. Sisk, Jr., was mentioned. The article describes the

complaints about the defective homes. It is in the record where it can be read, but the comment was made by Mr. Sisk which I will quote, "Sisk said the same type of homes, built with the same package of materials, were being constructed by 'good Democrats' in St. Francis and Phillips Counties and that he thought it strange that no investigations were undertaken of those enterprises. He declined to name the companies."

Do you know of anyone that would fit that description that has been building defective homes down there?

Mr. HANKINS. St. Francis and what county?

Mr. FOUNTAIN. St. Francis and Phillips.

Mr. HANKINS. No, sir, I do not.

Mr. COOK. No, sir.

Mr. FOUNTAIN. Incidentally, have you had any problems with the quality of the dwellings manufactured by Pacific Homes?

Mr. COOK. Mr. Chairman, we have had some problems in workmanship in the early days of this home.

Mr. FOUNTAIN. Have they been eliminated?

Mr. COOK. Yes, sir.

Mr. FOUNTAIN. We did not mean to devote so much time to the State of Arkansas. We did want the national office to have an opportunity to give us the benefit of the picture as they see it, and what has been done and what the problems are. I think it is pretty well known that Mr. Alexander has had many complaints and in view of his responsibility as a Congressman has found it necessary to do some checking on his own. Because of his more detailed knowledge of the situation, we used Arkansas as one example.

I imagine that these problems may exist in a lot of sections throughout the country, particularly the problems that were generally described by the Office of Inspector General. I know that there are some real problems in my own home State although I have not had time yet to look at them in detail to see where and how serious.

Mr. ELLIOTT. Mr. Chairman, we recognize we have problems and we have made mistakes. I will assure you we will do everything to rectify them.

Mr. FOUNTAIN. The point that I was going to make is that we are trying to spotlight these problems for your benefit and for our benefit, in the hope that it will help you better administer and monitor this program. Much that is set forth in the report of the Inspector General clearly indicates that there has not been adequate monitoring at the national level, the State level, even at the local level of problems that were occurring in many places in the country. Before it got into housing, I never heard much criticism of the Farmers Home Administration. As a matter of fact, this is one agency that we have praised down our way as being free of much criticism. However, as Mr. Elliott says, you are in a new business here.

It is the kind of business that with a lack of experience and adequate preparation and a lot of money, can result in a lot of honest mistakes. It can also open up the door of opportunity to a lot of people who can see ways and means of making some quick money, particularly if they deal with inexperienced people and sell a bill of goods—sometimes a good bill and sometimes not such a good bill.

Do you have any more questions, Mr. Alexander?

Mr. ALEXANDER. No, sir.

Mr. FOUNTAIN. We have a representative here from South Carolina, do we not?

Mr. ELLIOTT. Yes.

Mr. FOUNTAIN. Because of the limitations of time, do you have any objection if we do not get to you?

Mr. STEWART. No, sir.

Mr. FOUNTAIN. We will submit to you and to Mr. Elliott some questions I had in mind asking about the irregularities and deficiencies that were found in your State of South Carolina, and give you a chance to respond for the record as to what is being done. We will appreciate your filing that for the record.

Again, I say these are examples.

We have used Arkansas as an example because we have a Member of Congress who is particularly interested in that State.

[See app. 14(D).]

Mr. NAUGHTON. Mr. Chairman, I think we should also put into the record the transcript of the TV documentary on Harlingen County.

Mr. FOUNTAIN. Without objection.

[See app. 15.]

Mr. NAUGHTON. We also have some excerpts from State and county office audit reports giving additional details and supplemental information concerning the types of problems discussed in the overall report by the Office of Inspector General which is already in the record, and I think it might be helpful in putting in selected material of that type to provide a little broader perspective.

Mr. FOUNTAIN. Without objection.

[See app. 17.]

Mr. NAUGHTON. We should put the South Carolina audit report in the record, since the questions are based on that.

Mr. FOUNTAIN. Without objection, so ordered.

[See app. 14.]

Mr. NAUGHTON. Perhaps, Mr. Chairman, if there are a few additional questions, to clarify matters in the record, we can avoid another hearing by submitting questions for the record.

[See app. 16.]

Mr. ELLIOTT. We have no objections to the hearings; I have found them educational and enlightening.

Mr. FOUNTAIN. Thank you.

I hope it has not been too tense a situation for some of you who have not been before a congressional committee previously.

Before concluding, I do want to say that it is very refreshing to have the head of a Federal agency read an investigative report about that agency, analyze it, and come to the conclusion that a job needs to be done to correct a lot of unpleasant, sometimes deplorable, situations and to so forthrightly proclaim that he expects to see, insofar as humanly possible, that these things are corrected.

I say refreshing, because whether you know it or not, we have a number of agencies under the jurisdiction of the Committee on Government Operations which will invariably defend the indefensible and try to justify the situation when they could save themselves a lot of trouble if they would simply admit that we are all human beings and we all make mistakes and that the job at hand now is to do something

about them, both from the standpoint of the taxpayers and, primarily, from the standpoint of countless thousands of poor people. I do not like to use the word "poor," but really considering the income of a lot of these people, they are poor and they need housing. They cannot pay high rents, but many of these people are the backbone of rural America and in my opinion have made America what it is.

That is why I so strongly feel that when we talk about the ghettos and the slums of the cities we should not overlook the fact that we have housing problems in rural America that need to be cleaned up. It is an area where there are wide open spaces, where 75 or 80 percent of our population resides on 2 percent of the land. There is still a lot of space that some of our city brethren might find well worthwhile moving to. I think this program is one of the most meaningful programs that we have, and I do hope that all of us working together can clean up any situations that need to be cleaned up and restore the old image that the Farmers Home Administration had.

As you point out, Mr. Elliott, there are many fine things FHA has done. We do not have time to discuss them all. When we have a hearing of this kind, we concentrate our attention on things that have not been done that ought to have been done and the things that have been done that ought not to have been done, and we try to correct them. But there are many fine things that this agency has done and will continue to do. We appreciate the cooperation that you have given us and the forthright commitment that you have made to cooperate, not only with the subcommittee, but in establishing the type of coordinated federalism between Washington and the local level that will make this program not only more efficient from the standpoint of the taxpayers, but more effective and more meaningful to the millions of Americans that are the beneficiaries of them.

Thank you very much for coming. If we have need to call you back, we will do so.

As I said, if there are other questions that we need to ask, in all probability we will simply submit the questions in writing to make our record complete.

[See app. 17.]

Mr. FOUNTAIN. When the record is complete, you will get a copy of it for your own examination. We will also send you a copy of the report the subcommittee recommends to the full committee.

I am hopeful that out of this, we may be able to make some recommendations, in addition to some fine recommendations that have been made by the Office of the Inspector General and the GAO. You may not always agree with the way they recommend it, or find it practical to completely carry out the recommendations, but I am hopeful that the subcommittee can make some suggestions that you will seriously consider that may help you accomplish just what we have been talking about.

Mr. ELLIOTT. We would appreciate it, Mr. Chairman.

Mr. FOUNTAIN. Thank you very much.

The subcommittee stands recessed until the call of the Chair.

[Whereupon, at 6:05 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

APPENDIXES

Appendix 1.—Farmers Home Administration Response to Questions Submitted by the Intergovernmental Relations Subcommittee

1. Please provide background information concerning the Farmers Home Administration (FHA) and its housing-related activities including (a) a brief reference to the origin and history of the agency, (b) a very brief description of each major program currently administered by FHA with a citation to the basic legal authority for such program, (c) more detailed information concerning each major program which is primarily concerned with housing or may have a significant effect on housing, and (d) a brief description of FHA organizational arrangements as related to administration of programs involving housing.

The information follows:

(a) The Farmers Home Administration was preceded by the Farm Security Administration and the Resettlement Administration as Federal agencies to provide rehabilitation and economic development in rural areas. The Resettlement Administration was established in 1935 to assist farmers who needed credit to continue in farming and who were unable to obtain it from conventional sources. This assistance included loans and technical assistance directed at helping the families to help themselves and thereby become rehabilitated on their farms. The loans were for such items as feed, seed, fertilizer, subsistence, and other operating costs to permit them to continue farming. Many farmers also needed credit for the purchase of livestock and equipment and to otherwise improve their farming operation. The Resettlement Administration also developed a number of subsistence homestead and rural resettlement projects which were later liquidated by sale of the properties. A land utilization program to retire submarginal farm land was transferred to other agencies for administration.

The Bankhead-Jones Farm Tenant Act was enacted in 1937. This act authorized the tenant purchase program which provided for loans to buy and develop farms. At about the same time, the name of the Resettlement Administration was changed to the Farm Security Administration. Also in 1937, the Congress passed the act authorizing water facilities loans for rural water development in the arid and semi-arid sections of the country.

In 1946, the Congress passed the Farmers Home Administration Act which consolidated the activities of the Farm Security Administration and the emergency crop and feed loan activities of the Farm Credit Administration. The act authorized farm ownership loans to be made with private capital and insured by the Government to supplement direct loans. In 1949, the disaster loan revolving fund was established for making emergency loans to farmers who had suffered losses as a result of a natural disaster. Also, the Housing Act of 1949 established a direct rural housing loan and grant program to be administered by the agency. In 1954, the water facilities program was broadened to permit loans throughout the United States and to authorize such loans on an insured basis. Also in 1954, watershed loans were authorized by Public Law 83-566 to

be made to local organizations for the local shares of the cost of watershed protection projects.

The Consolidated Farmers Home Administration Act of 1961 consolidated and revised many of the agency's authorities. However, the rural housing authorities and the watershed and flood prevention loan authorizations were not included in the act. The Housing and Urban Development Act of 1965 authorized rural housing loans to be made on an insured basis.

Also, emergency loans were authorized to be made on an insured basis in 1971. The Consolidated Farm and Rural Development Act of 1972 included a number of changes and expansions in previous programs, as well as new loan programs for community facilities and rural industrialization.

This brief history of the development of the Farmers Home Administration excludes a number of laws enacted by the Congress as perfecting legislation and for supplementing program activities.

(b) Programs under 7 U.S.C. 1921–1991.

Farm ownership loans are made to farmers and ranchers for acquiring, enlarging, or improving farms, including dwellings and farm buildings; land and water development, use and conservation; forestry development; recreational facilities; the development of nonfarm enterprises on farms; refinancing indebtedness; and for loan closing costs.

Water and waste disposal loans and development grants are made to associations, including corporations operating on a nonprofit basis, municipalities, certain Indian tribes, and similar organizations, generally designated as public or quasi-public agencies, that propose projects for the development, storage, treatment, purification, and distribution of domestic water or the collection, treatment, or disposal of waste in rural areas.

Operating loans are made to farmers and ranchers for costs incident to establishing a farming system for more profitable operations; for a variety of essential farm expenses such as purchase of livestock, farm equipment, feed, seed, fertilizer, farm supplies, and other essential operating expenses, including cash rent, and costs incident to the production and harvesting of forestry products; for financing land and water development, use and conservation; for recreational uses and facilities; for costs incident to nonfarm enterprises on farms; for refinancing indebtedness; for complying with certain safety standards; for other farm and home needs; for operation of enterprises by rural youths in connection with their participation in 4H clubs, Future Farmers of America and similar organizations, and for loan closing costs.

Emergency loans are made in designated areas largely for the same purpose as operating loans.

Program under 7 U.S.C. 1010–1011.

Resource conservation and development loans are made to sponsors of projects approved for operation by the Soil Conservation Service. Loans are made to local organizations and individuals for planned conservation measures and works of improvement as specified in approved work plans.

(c) Major housing programs under 42 U.S.C. 1471–1490d.

Low- to moderate-income housing loans to individuals are made to enable eligible applicants in rural areas to construct, improve, alter, repair, or replace dwellings and essential farm service buildings. Loans may include funds to buy a house, building site, and farm service buildings, and are made to persons of low- or moderate-incomes if their need for necessary housing cannot be met with financial assistance from other sources, including assistance available under section 235 of the National Housing Act. The loans made by the Farmers Home Administration currently bear interest at 7¼ percent with provision for interest

credits up to 6¼ percent under certain circumstances. Interest credits were authorized in 1968 by Public Law 90–448. Such loans may not exceed amounts necessary to provide adequate housing, modest in size, design, and cost. Insured building loans are made to farm owners, owners of other real estate in rural areas, others who are or will become rural residents, and long-term leaseholders. These loans are repayable in not more than 33 years. Loans are limited to rural areas which include towns, villages, or other rural places with a population up to 10,000, which are not part of an urban area.

Rural rental and cooperative housing loans are made to individuals, corporations, associations, trusts, or partnerships to provide moderate cost rental or cooperative housing and related facilities for elderly persons and other persons of low and moderate incomes in rural areas. These loans are repayable in not more than 50 years and currently bear interest at 7¼ percent with provision for interest credits up to 6¼ percent under certain circumstances. These loans are made only if the need for necessary housing cannot be met with financial assistance from other sources including assistance under section 236 of the National Housing Act. No loan may exceed $750,000. Loans are limited to rural areas which include towns, villages, or other rural places with a population up to 10,000, which are not part of an urban area.

The low- to moderate-income housing program received the greatest emphasis. In 1973, for example, obligations under this program are currently estimated to be $1,858 billion, while rural rental housing is estimated at $138 million, all other housing programs at $31.8 million.

(d) The Farmers Home Administration has three administrative levels; namely, the national, State, and the county offices. Additionally, district supervisors are available to assist county office staffs in their districts of from seven to nine counties.

The focal point for delivery of the agency's services is the local county office. Here all applications are received, and for homeownership loans a determination of the applicant's eligibility is made, properties are appraised, plans and specifications reviewed, homes inspected, and the loans serviced. Loans for multifamily housing are reviewed and approved in the State offices. Some larger and complex loans require prior review by the national office.

The function of the State office is to provide program supervision and management guidance to the county offices.

The national office is responsible for giving administrative direction to all phases of the various programs for which the Farmers Home Administration is responsible.

Financial and program accounting, reporting, sale and repurchase of promissory notes, computer services, and support services to field offices are centered in the FHA National Finance Office in St. Louis.

2. Statistical data.—Please provide a table or tables showing appropriations (or funds otherwise available) for each major program and the amount expended or estimated to be expended for fiscal years 1971 through 1973, together with projections—insofar as feasible—of the amounts expected to be available and expended during fiscal year 1974. (Where appropriate or desirable, additional details should be provided for major housing and housing-related programs.) In addition, please provide statistics showing current and past expenditures by FHA for housing purposes as compared with expenditures for all other purposes, and statistics giving basic information on the nature and extent of FHA housing activities (for example, number of borrowers, average size of loans, et cetera).

The information follows:

U.S. DEPARTMENT OF AGRICULTURE, FARMERS HOME ADMINISTRATION—INITIAL INTEREST CREDIT HOUSING LOANS[1]

[Dollars in thousands]

	Number of loans			Obligations		
	1971	1972	1973[2]	1971	1972	1973
Alabama	2,476	2,918	1,775	$28,092	$36,504	$23,133
Arizona	883	1,435	1,243	12,671	22,606	20,745
Arkansas	2,751	3,066	1,894	31,836	40,106	26,994
California	1,082	1,988	1,636	16,751	33,191	29,071
Nevada	41	49	57	814	998	1,165
Hawaii	156	110	147	3,458	2,612	3,669
Colorado	178	265	229	2,158	3,990	4,013
Florida	874	1,266	1,628	11,621	19,046	26,919
Georgia	2,040	2,812	1,534	26,470	38,880	22,758
Idaho	554	1,015	865	9,104	18,131	16,624
Illinois	104	790	821	1,585	13,274	14,987
Indiana	1,082	1,569	882	15,369	24,678	14,545
Iowa	171	670	525	2,132	9,788	8,148
Kansas	302	346	185	4,379	5,395	2,980
Kentucky	740	1,242	812	10,414	19,085	13,185
Louisiana	543	855	562	6,377	11,535	8,104
Maine	1,016	1,527	1,109	14,844	25,191	20,200
Michigan	707	1,458	1,109	11,033	24,798	20,775
Minnesota	244	422	319	4,025	7,245	5,694
Mississippi	2,424	3,779	2,410	28,442	50,652	35,310
Missouri	1,879	2,442	1,310	24,666	35,169	19,742
Montana	64	106	81	1,017	1,776	1,405
Nebraska	174	183	141	2,786	2,954	2,644
New Jersey	171	238	183	2,577	3,930	3,264
Delaware	108	197	154	1,743	3,348	2,718
Maryland	161	319	222	2,458	5,432	3,945
New Mexico	113	373	336	1,441	5,375	5,117
New York	410	835	664	6,185	15,385	12,157
North Carolina	2,581	3,449	2,349	35,213	53,388	39,231
North Dakota	421	434	260	6,991	7,752	4,860
Ohio	496	1,887	1,479	6,986	30,907	25,786
Oklahoma	802	1,234	646	9,950	16,173	8,942
Oregon	582	534	338	9,208	8,816	5,898
Alaska	13	28	338	302	661	168
Pennsylvania	13	701	705	4,887	12,458	13,722
South Carolina	4,756	4,715	2,110	65,389	69,021	32,705
South Dakota	142	213	121	2,171	3,480	1,925
Tennessee	1,112	2,264	1,351	12,655	29,444	18,633
Texas	1,928	2,400	1,203	24,785	33,805	18,063
Utah	179	411	299	2,710	6,666	5,317
Vermont	235	330	234	3,236	5,051	3,832
Connecticut	77	87	28	1,288	1,471	500
Massachusetts	177	191	144	2,911	3,220	2,443
New Hampshire	272	297	214	4,062	4,642	3,506
Rhode Island	35	50	41	595	882	752
Virginia	1,182	3,932	3,940	15,403	63,462	69,648
Washington	713	972	680	10,930	15,697	11,570
West Virginia	285	752	728	3,965	11,888	12,233
Wisconsin	622	1,084	651	9,989	19,208	12,339
Wyoming	117	142	84	1,704	2,230	1,415
Puerto Rico	752	973	766	11,181	16,073	13,464
Virgin Islands	76	59	13	1,241	1,048	235
Total	39,016	59,464	41,224	532,200	898,517	677,198

[1] All loans are included in table showing all low- to moderate-income initial housing loans.
[2] All 1973 figures are as of Feb. 28, 1973.

U.S. DEPARTMENT OF AGRICULTURE, FARMERS HOME ADMINISTRATION

LOW- TO MODERATE-INCOME HOUSING LOANS INITIAL ONLY

[Dollar amounts in thousands]

	Number of loans			Total obligations			Average loan size		
	1971	1972	1973[1]	1971	1972	1973	1971	1972	1973
Alabama	5,267	4,726	2,851	$61,370	$60,191	$37,863	$12	$13	$13
Arizona	1,785	2,083	1,615	25,453	32,244	25,637	14	15	16
Arkansas	5,289	4,889	2,952	59,313	61,838	40,325	11	13	14
California	1,470	2,356	1,903	22,508	39,153	33,678	15	17	18
Nevada	96	85	75	1,614	1,631	1,533	17	19	20
Hawaii	456	281	277	9,823	6,177	6,646	22	22	24
Colorado	526	519	414	6,507	7,351	6,752	12	14	16
Florida	1,748	1,835	2,210	23,495	27,230	36,218	13	15	16
Georgia	4,977	4,754	2,519	65,993	66,586	37,041	13	14	15
Idaho	1,330	1,722	1,461	20,126	29,039	25,789	15	17	18
Illinois	1,386	2,235	1,779	17,980	32,250	28,968	13	14	16
Indiana	3,944	3,389	1,901	50,273	47,724	28,655	13	14	15
Iowa	1,694	1,965	1,738	19,029	24,291	21,270	11	12	12
Kansas	1,269	985	653	14,269	12,122	8,278	11	12	13
Kentucky	2,701	2,379	1,479	35,572	33,676	21,473	13	14	15
Louisiana	1,428	1,450	896	16,335	18,638	12,291	11	13	14
Maine	1,895	2,180	1,632	24,491	33,011	27,436	13	15	17
Michigan	3,216	3,647	2,530	48,831	60,893	45,517	15	17	18
Minnesota	1,168	1,338	979	15,865	19,871	14,802	14	15	15
Mississippi	5,187	5,726	3,576	60,302	75,547	51,850	12	13	14
Missouri	4,231	3,932	2,166	52,099	54,071	30,217	12	14	14
Montana	231	242	218	3,003	3,404	3,146	13	14	14
Nebraska	642	557	448	7,861	7,199	6,292	12	13	14
New Jersey	990	766	515	15,076	12,589	9,109	15	16	18
Delaware	322	395	265	5,076	6,514	4,611	16	16	17
Maryland	974	833	680	15,009	13,848	10,049	15	17	15
New Mexico	429	689	520	4,942	9,286	7,309	12	13	14
New York	1,855	2,199	1,810	24,721	33,899	28,658	13	15	16
North Carolina	6,872	5,854	4,195	91,908	88,952	69,045	13	15	16
North Dakota	947	935	674	12,311	13,592	9,808	13	15	15
Ohio	2,424	3,655	2,424	32,320	55,994	40,561	13	15	17
Oklahoma	3,093	3,264	1,804	37,637	41,545	23,744	12	13	13
Oregon	825	762	457	12,460	12,023	7,786	15	16	17
Alaska	110	76	20	2,212	1,776	505	20	23	25
Pennsylvania	1,513	1,692	1,882	21,920	27,417	27,020	14	16	14
South Carolina	7,064	6,317	3,066	97,159	92,730	47,442	14	15	15
South Dakota	564	712	599	6,292	8,696	6,271	11	12	10
Tennessee	3,791	4,811	2,820	44,469	62,852	38,609	12	13	14
Texas	5,554	4,681	2,177	67,658	62,717	31,111	12	13	14
Utah	694	783	486	9,604	11,867	7,905	14	15	16
Vermont	682	677	467	8,870	9,568	7,072	13	14	15
Connecticut	290	227	121	4,766	3,841	2,174	16	17	18
Massachusetts	281	259	220	4,514	4,392	3,745	16	17	17
New Hampshire	461	488	380	6,415	7,283	5,972	14	15	16
Rhode Island	60	74	66	877	1,278	1,070	15	17	16
Virginia	3,418	5,654	5,045	44,338	88,552	87,999	13	16	17
Washington	2,017	1,619	1,170	30,506	25,833	19,312	15	16	17
West Virginia	1,910	1,916	1,565	23,946	27,973	24,211	13	15	15
Wisconsin	2,324	2,540	1,601	32,355	38,980	25,583	14	15	16
Wyoming	426	439	261	5,744	6,175	4,096	13	14	16
Puerto Rico	1,230	1,201	907	16,293	18,897	15,241	13	16	17
Virgin Islands	128	85	24	2,055	1,523	428	16	18	18
Total	103,184	106,878	72,493	1,343,565	1,544,729	1,118,123	13	14	15

[1] All 1973 figures are as of Feb. 28, 1973.

U.S. DEPARTMENT OF AGRICULTURE—FARMERS HOME ADMINISTRATION

CHANGES IN ESTIMATED PROGRAM, FISCAL YEAR 1973

[Dollars in thousands]

	1973 column, 1973 budget	1973 column, 1974 budget	Amount appropriated or available	1973 current estimate
Rural housing programs:				
Low income housing loans	$1,050,000	[1] $650,000	$842,000	$842,000
Moderate income housing	1,009,000	[2] 1,084,000	1,016,000	1,016,000
Subtotal	2,059,000	1,734,000	1,858,000	1,858,000
Rural rental housing loans	70,000	30,000	138,000	138,000
Farm labor housing loans	10,000	7,500	10,000	10,000
Farm labor housing grants	5,463	650	3,797	2,176
Rural housing site loans	5,900	5,900	5,900	5,900
Mutual and self-help housing grants	3,729	3,729	3,729	3,729
Very low income housing loans	10,000	10,000	10,000	10,000
Total, rural housing	2,164,092	1,791,779	2,029,426	2,027,805
Farmer programs	729,500	1,054,500	1,674,500	1,674,500
Community programs	381,500	369,500	589,539	469,539
Total, FHA	3,275,092	3,215,779	4,293,465	4,171,844

[1] Interest credit.
[2] Noninterest cred't.

U.S. DEPARTMENT OF AGRICULTURE, FARMERS HOME ADMINISTRATION—PROGRAM LEVELS (FUNDS APPORTIONED AND AVAILABLE FOR OBLIGATION)

[In thousands of dollars]

	1971		1972		1973		
	Apportionment	Actual obligation	Apportionment	Actual obligation	Estimated apportionment	Estimated obligation	1974 estimate
Rural housing programs:							
Insured loans:							
Low-income housing	1,413,000	1,356,485	1,061,171	1,061,171	842,000	842,000	----------
Moderate-income housing			500,049	500,049	1,016,000	1,016,000	1,084,000
Rural rental housing	35,000	25,637	40,118	40,118	138,000	138,000	44,000
Farm labor housing	10,000	474	2,693	2,693	10,000	10,000	----------
Rural housing site	5,000	1,458	966	966	5,000	5,000	5,000
Direct loans:							
Very low income housing	10,000	5,492	10,000	5,399	10,000	10,000	10,000
Low to moderate housing	7,000	5,791	----------	----------	----------	----------	----------
Rural rental housing	2,000	1,152	----------	----------	----------	----------	----------
Self-help housing land development	1,225	150	1,225	79	900	900	900
Grants:							
Rural housing for domestic farm labor	3,700	737	6,730	6,683	2,176	2,176	----------
Mutual and self-help housing loans	2,450	1,721	2,450	1,618	3,729	3,729	3,832
Total, rural housing:							
Loans	1,483,225	1,396,639	[1] 1,616,222	1,610,475	2,021,900	2,021,900	1,143,900
Grants	6,150	2,458	9,180	8,301	5,905	5,905	3,832
Farmer programs: Loans	690,100	679,482	846,100	807,967	1,674,500	1,674,500	804,500
Community services programs:							
Loans	289,555	285,535	324,700	316,096	439,539	439,539	784,500
Grants	44,000	43,998	42,000	42,000	30,000	30,000	----------
Administrative funds	100,365	98,826	115,296	113,563	129,612	129,612	121,830
Total FHA:							
Loans	2,462,880	2,361,656	2,787,022	2,734,538	4,135,939	4,135,939	2,732,900
Grants	50,150	46,456	51,180	50,301	35,905	35,905	3,832
Administrative	100,365	98,826	115,296	113,563	129,612	129,612	121,830

[1] A total of $1,605,000,000 was available for insured housing loans in 1972. Funds were shifted to meet changing requirements and only $3,000 was unused.

U.S. DEPARTMENT OF AGRICULTURE, FARMERS HOME ADMINISTRATION

OBLIGATION HISTORY COMPARING HOUSING AND ALL OTHER PROGRAMS

[Dollar amounts in thousands]

	Obligations, housing program	Obligations, other programs	Total	Percent of total housing	Percent of total other
1972	$1,618,777	$1,166,063	$2,784,840	58.0	42.0
1971	1,399,098	1,009,015	2,408,113	58.0	42.0
1970	793,835	845,915	1,639,750	48.4	51.6
1969	512,090	919,789	1,431,879	35.8	64.2
1968	499,036	862,354	1,356,390	36.4	63.6
1967	442,119	947,969	1,390,088	31.8	68.2
1966	268,549	820,035	1,088,584	24.7	75.3
1965	134,963	665,114	800,077	16.9	83.1
1964	137,343	610,451	747,794	18.4	81.6
1963	187,740	608,445	796,185	23.6	76.4
1962	96,498	540,832	637,330	15.1	84.9
1960	40,736	268,136	308,872	13.2	86.8
1958	33,066	297,097	330,163	10.0	90.0
1956	3,721	304,423	308,144	1.2	98.5
1954	16,068	276,379	292,447	5.5	94.0
1952	21,155	191,119	212,274	10.0	90.0
1950	18,161	162,750	180,911	10.0	90.0
1946		128,275	128,275		100.8

U.S. DEPARTMENT OF AGRICULTURE, FARMERS HOME ADMINISTRATION

NUMBER OF LOANS AND OBLIGATIONS, MISCELLANEOUS HOUSING PROGRAMS

[Dollar amounts in thousands]

	Number of loans			Amount obligated		
	1971	1972	[1] 1973	1971	1972	[1] 1973
Rural rental housing loans	422	515	325	$26,788	$40,118	$34,293
Farm labor housing loans	13	50	50	474	2,693	1,634
Farm labor housing grants	4	10	5	73	6,683	836
Rural housing site loans	22	19	11	1,609	1,045	1,187
Mutual and self-help housing grants	15	9	6	1,721	1,618	1,074
Direct rural housing loans	6,397	3,803	1,972	11,283	5,399	2,789
Total	6,873	4,406	2,369	41,948	57,556	41,813

[1] All 1973 numbers are as of Feb. 28, 1973.

3. Planning and evaluation:

A. Please describe the purpose(s) or goal(s), as stated by Congress, of each major housing related program administered by FHA and any significant action or actions taken by FHA to insure compliance with and promote accomplishment of such purposes or goals.

B. Please describe any significant evaluation activities FHA or USDA has conducted to ascertain the extent of compliance with and accomplishment of the purposes and goals of major housing legislation.

C. Please describe any procedures or criteria used to allocate available housing program resources (a) among States, and (b) within States.

The information follows:

A. The rural housing program was originally authorized under title V of the Housing Act of 1949. This act included a declaration by the Congress as a national housing goal "the realization as soon as feasible of a decent home and a suitable living environment for every American family, thus contributing to the development and redevelopment of communities and to the advancement and growth, welfare and security of the Nation." In 1968, the Congress reaffirmed the national goal of "a decent home and a suitable living environment for every American family."

Against this broad national objective the Farmers Home Administration has, since 1949, carried out its basic mission of increasing the supply of adequate housing and promoting homeownership in rural areas by providing housing credit to families who do not have an adequate home and cannot obtain such loans from other sources. The agency provides this supplemental home mortgage credit at rates and terms the families who want to live in rural areas can afford.

Numerous changes have been made in legislation since it was first enacted in 1949.

The agency has taken specific actions to assure that the objectives of all phases of the rural housing program would be carried out. Such actions have included:

Issuance of appropriate regulations to implement the authorizations in title V of the Housing Act of 1949 and subsequent amendments;

The adoption of construction standards. The standards in current use are the same minimum property standards used by HUD;

Issuance of comprehensive regulations applicable to site development, including subdivisions;

Provided counseling assistance to families, particularly in the area of financial management, who need such assistance in order to help them meet their obligations;

In response to recommendations of the Office of Management and Budget, directed its program primarily toward low-income families. New commitments under the subsidized interest-rate program were suspended as of January 8, 1973; and

Coordination of the rural housing programs with the national housing goals.

Section 502, low and moderate income, single family housing has been the major program placing homes in rural areas. The following are starts—new construction and purchased homes less than 1 year old—for this program since initiation of the national housing goals.

Fiscal year—	*Low and moderate starts*
1968	22,209
1969	23,560
1970	38,085
1971	71,143
1972	77,425
1973 (estimate)	84,000
1974 (estimate)	43,000

B. Each year district or State office personnel review the county office operations to be sure the program is administered in line with current policy and procedures. The review personnel look at office reports and case files and may make personal contacts with borrowers, applicants, or other local citizens.

At the State and national office and in addition to supervisory reviews by program and technical staff personnel, reviews are made of numerous statistical reports to detect any deficiencies or significant deviation from normal standards. Some of the reports analyzed are: size and cost of homes, income levels of families served, and delinquencies.

The agency has recently increased the size of its evaluation and planning staff; consequently, more time will be devoted to evaluation of the housing programs. Also, at this time FHA and the Department of Agriculture are involved in the comprehensive review of all housing programs which is being conducted at the President's request. The overall thrust of this evaluation is: (1) What has been done under existing legislation, (2) what are the housing needs of the Nation, and (3) what role should the Federal Government play in housing and home financing?

The Department's Office of Planning and Evaluation has worked with Farmers Home Administration in many areas such as (1) helping to establish program funding levels, (2) adjusted income limits for eligibility of low- and moderate-income families, (3) redirection to improve utilization of the program to serve more low-income families, and (4) better project coordination and planning when building new homes and developing centralized community water and waste disposal systems. FHA has worked with the Office of Planning and Evaluation in completing various studies for the Department and the Office of Management and Budget use. The following are some of these housing or housing-related studies:

1. Analysis of rural housing loans which do not add to the housing supply.
2. Distribution of FHA water and waste disposal loans and grants.
3. A study of the rural water and waste disposal system programs.
4. An evaluation of the self-help technical assistance program.
5. In process: water and waste disposal loan and grant programs, an evaluation of the relationship of size and cost of community systems to community growth rates by size of community.
6. Farm labor housing in preliminary stage. Release pending upon completion of national housing study.

During fiscal 1971, the Office of the Inspector General made a comprehensive review of Farmers Home Administration activities with emphasis on the rural housing program, which highlighted a number of problem areas. FHA actions taken on the findings and recommendations of this review have significantly strengthened program administration.

C. Rural housing authorizations for the homeownership program under section 502 of the act are distributed after consideration of the following factors:

Number of rural homes;
Condition of rural homes;
Median income of rural families;
Average cost of homes; and
Historical lending patterns of FHA.

The beginning point is the number of substandard houses. The median incomes of families and the average cost of homes also are important considerations. Other factors also are involved such as population increases and movements and opportunities for employment. Some Southern States, for example, have had a significant growth in industry that offered employment opportunities to rural families. These States also rank high in population increase and are low in the quality of housing. The growth of our housing program has been greater in these States than the States where these situations did not exist. The impact of these variables are not subject to precise statistical measurement, but they are reflected in the effective market demand or the historic lending pattern for rural housing loans.

Loans for rental housing are distributed on the basis of need as evidenced, in part by the development of effective demand in States. From time to time during the year adjustments are made in the allocations to reflect current conditions.

Farm labor housing loan and grant authorities also are made available to States on the basis of need. This is a specialized program that has been used primarily in California and Florida where there are extensive needs for housing for farmworkers.

Funds for other housing programs are made available to States in response to needs. Distribution within States is largely at the discretion of the State director.

4. Coordination:

A. Please describe any significant policies or procedures which have been adopted to insure appropriate intra-agency coordination of separate housing-related program operations, indicating whether or not such coordination is considered adequate.

B. Please describe any significant policies or procedures which have been adopted to insure appropriate interagency cooperation and coordination with housing-related programs and activities of other Federal, State and local government agencies.

The information follows:

A. The principal area of coordination within the Farmers Home Administration is between rural housing and water and sewer programs. Our policy is to have housing built on public- or community-owned water and sewer systems whenever practicable. If such facilities are not already available, especially in subdivisions, the possibility of obtaining financing through the community services program of the Farmers Home Administration is explored. In our opinion, there is an adequate understanding between the operating units in the Farmers Home Administration as to the complimentary relationship between housing and water and sewer programs.

B. The rural housing programs are coordinated with other agencies formally and informally. Formally, a memorandum of understanding has been developed between FHA and the Soil Conservation Service which makes available the services of that agency in connection with the evaluation of soil conditions of building sites. Additionally, the Federal Extension Service and the Farmers Home Administration have developed a memorandum of understanding regarding counseling of families.

Informally, the Farmers Home Administration works closely with HUD, particularly in the area of building standards. The Farmers Home Administration has, in fact adopted the HUD minimum property standards for its program. Further, the Farmers Home Administration depends on the technical services of HUD with respect to the evaluation of new materials and new construction systems. More specifically, if new materials or methods or construction are proposed, the Farmers Home Administration depends on the engineering bulletins issued by HUD with respect to acceptance of such methods or materials.

We endeavor to coordinate program approaches to reduce to a minimum the differences so that builders and others can readily do business with both Departments.

5. Administrative changes in program operations:

A. Please describe any significant changes in housing-related program operations for fiscal year 1973 which occurred because of administrative rather than legislative action and describe the effects (or anticipated effects) of any such changes.

The information follows:

A. The 1973 column of the 1973 budget estimated $1.050 billion for low-income housing loans. About 80 percent of this amount ($840 million) would have been loaned on an interest credit basis, an amount comparable to the current estimate of $842 million.

The total low- to moderate-income housing program has been reduced $201 million from the amount originally budgeted. On the basis of the average loan size in 1973, initial noninterest credit loans made will be reduced about 13,000 this fiscal year.

The rural rental housing program is currently estimated at $138 million, a $68 million increase over the budget. This increase will provide about 600 loans. All other housing programs are currently estimated to be carried out at approximately the 1973 budget levels.

In the housing-related water and sewer program, grants have been reduced $12 million below the 1973 budget estimate and $120 million below available funding. These amounts would have provided about 150 and 1,500 grants respectively. However, the estimate for the water and sewer loan program in fiscal year 1973 has been increased by $100 million over the 1973 budget estimate. This increase will allow FHA to make about 400 additional loans.

(NOTE.—Only those funds apportioned by the Office of Management and Budget and the Department are available to FHA. In the major FHA loan programs, fund authorizations, or total funds available for obligation are currently limited only by OMB or departmental action. Grant funds, and some small loan accounts, are authorized by specific appropriations and are further subject to OMB and Department action.)

6. Source and disbursement of housing-related program funds.

If not previously covered, please describe the source(s) of FHA housing-related funds and the manner in which such funds are disbursed and repaid.

The information follows:

FHA housing program funds are provided through the rural housing insurance fund which was established by the Housing and Urban Development Act of 1965 (Public Law 89–117).

Loan funds are disbursed by Treasury check. The note obtained is then sold, at par, to an investor for a fixed period at current market interest rate. The funds thus obtained are then used to make additional loans. FHA also requests annual appropriations to restore deficits of the fund. The 1974 appropriation request for this item is $89,170,000.

This item includes:

(*a*) Deficits as a result of interest credits.

(*b*) Difference between interest paid investors and that paid by borrowers.

(*c*) Losses due to property liquidation.

Repayments are usually made to the FHA Finance Office in St. Louis on essentially a monthly basis, although some borrowers make payments at county offices. The investors receive annual principal and interest payments.

7. Origination of housing loans. Please describe the manner in which FHA housing loans are made to borrowers, including (a) procedures, if any, used by or on behalf of FHA to interest potential borrowers in FHA loans, (b) mandatory restrictions on eligibility of borrowers or on property to be financed, (c) extent of counseling given potential borrowers, if any, (d) any procedures relating to suitability of prospective builder, and (e) loan commitment procedures.

The information follows:

(*a*) The Farmers Home Administration informs the public through press releases, pamphlets, news articles, and radio and television announcements. We also make special efforts to bring information about the programs to families not reached by customary methods of communication. For example, in order to call attention to the changes that were made in labor housing legislation when grants were increased to 90 percent and loan rate reduced to 1 percent, the agency wrote to over 250 organizations and individuals interested in farm labor housing.

As a result, an active interest developed in providing housing for farmworkers. Packagers, who are usually brokers and builders, do actively solicit potential borrowers. The FHA is concerned with the activities of packagers when they supply faulty information or submit packages for unqualified borrowers or unacceptable homes.

(*b*) In order to qualify for a rural housing loan, applicants must be unable to obtain credit from another source at terms they can reasonably be expected to meet. They also must be without adequate housing and have sufficient income to meet all of their obligations which include not only the loan payment but also taxes, insurance, maintenance, and family living expenses as well as other debt obligations. In making this determination, all dependably available income is considered, including welfare payments if they are reasonably assured. Loans are currently limited to families with low or moderate incomes. The maximum income limits are established by the national office.

Under title V of the Housing Act of 1949, as amended, loans to low- and moderate-income families must be for housing which is modest in size, design, and cost. We finance adequate but modest housing and do not provide luxury features. The typical home has about 1,060 square feet of living area, three bedrooms, and a cost of about $16,500. We do, however, allow more space when needed for large families to the extent that they can afford such housing. Specific provisions in this area are laid out in FHA instruction 444.1 (7 CFR 1822).

(*c*) The Farmers Home Administration is responsible, under FHA instruction 410.1, for evaluation of applications and counseling with families. This counseling is primarily in the areas of financial management and home selection; namely, the use of income and credit, in the selection of size and type of house the family can afford, and their obligations under the loan. These relate not only to the payment of financial obligations, taxes and insurance, but also maintain the property and occupy the home.

The county supervisor reviews the plans and specifications for each home as required by FHA instruction 424.1 (7 CFR 1804). He also appraises the property as required by FHA instruction 422.3. If a house being offered by a builder is overpriced, the family is advised to either obtain an acceptable price or to select another home.

(*d*) Applicants who have not selected a contractor before coming to the Farmers Home Administration are informed of the builders who are active in the area. The choice of the contractor is made by the family. FHA instruction 444.12 (7 CFR 1822) provides that contractors who do not perform satisfactorily will be suspended or debarred from doing business with FHA borrowers.

(*e*) The Housing and Urban Development Act of 1969 authorized the Farmers Home Administration to make commitments to builders. Under this authority, detailed in FHA instruction 444.9 (7 CFR 1822), a developer or builder may submit a proposal to the Farmers Home Administration to construct or rehabilitate a home with the expectation that the home will qualify for purchase by a family who may obtain a housing loan from the agency. The builder is expected to submit plans and specifications as well as detailed information about the site and essential services and facilities, and indicate the price at which he plans to sell the house.

If, after reviewing the proposal, the FHA county supervisor finds that the home would meet our lending requirements, he issues the conditional commitment form to the builder. This document is intended to assure him that the home to be constructed or rehabilitated will meet FHA lending requirements if built as proposed and that, subject to the availability of funds, the agency would be willing to make a loan to qualified applicant who may want to buy the home.

Funds are not reserved on the basis of conditional commitments unless the person requesting the commitment simultaneously submits an application package for a family that will buy the home when it is completed. If this is done and the family is found to be eligible, then funds are obligated at that point.

Under a conditional commitment, inspections are made by the FHA at customary times during construction and after completion of the home.

8. *Housing construction:*

A. Please describe any procedures for assuring that FHA-financed dwellings are suitably located on properly prepared sites and that the quality of materials and workmanship is adequate. In addition, please indicate whether or not FHA has procedures calling for warranties on new dwellings and for insuring that warranties are honored.

B. Please give details concerning FHA inspection procedures and resources, including number, level of qualifications, and training of inspectors, et cetera.

C. Do FHA procedures require evidence of satisfactory construction progress prior to payment of loan funds? If so, please give details.

The information follows:

A. Houses must be located to provide a satisfactory living environment and health and santitation requirements must be met. For subdivisions our policy is to encourage central water and waste disposal systems, hard-surfaced streets, adequate drainage and other features necessary to assure a good living environment. The houses financed by the Farmers Home Administration must meet the same minimum property standards that are used by the Federal Housing Administration.

The Farmers Home Administration has comprehensive regulations with respect to site development. These regulations cover drainage and flooding, water and sewer, streets and community services. They apply to both scattered sites and subdivisions. Regulations applicable to subdivisions are different in some respects from those for scattered sites. For example, when a subdivision is in the proposal stage there is first a feasibility study, then preliminary plans are submitted for development of the property for review by the Farmers Home Administration before final development plans are presented. The Farmers Home Administration utilizes, to the extent available, local facilities and services such as health officers and county building and zoning officials.

The regulations require that site development and construction comply with all local ordinances and requirements. The Farmers Home Administration does take into account the quality of local regulatory services. In some areas, such as California, adequate State and local subdivision requirements are in effect. In other areas, however, the Farmers Home Administration must assume primary responsibility to assure proper development of building sites.

Builders are required to provide a 1-year warranty on construction. The builder asserts that the house is built in substantial compliance with the plans and specifications and that he will correct any deviations or any defects that occur within 1 year. If a borrower discovers defects in the house, the county supervisor will check them and request the builder to correct them. Also during the 11th month of the warranty a final check is made to see if any defects have developed. The warranties are also required on existing dwellings that are less than a year old.

The Farmers Home Administration with its review of plans and specifications and inspection procedures makes a diligent effort to protect against shoddy construction. The warranty requires the builder to correct any defects that may occur. Also, after expiration of the warranty, if there are latent defects that result from faulty construction, the Farmers Home Administration will follow up on justifiable complaints. The procedures are included in FHA Instruction 424.3 (7 CFR 1804).

B. Inspections are required at three stages; namely, foundation, open framing, and completion stages. Inspections are made to see that the builder complies with the accepted plans and specifications and meets the minimum property standards.

Most of the inspection work is done by the Farmers Home Administration county supervisors who are trained by State office staff. In addition to county supervisors, the Farmers Home Administration has 204 construction inspectors.

The national office recently gave a comprehensive training course to its State technical staffs and some county personnel. State offices, in turn, carry on continuous training programs which include construction inspection. County supervisors are responsible for the inspection work done by the construction inspectors and the State office reviews the work done by county supervisors.

C. Builders are encouraged to obtain their financing from private sources. If a conditional commitment is involved and a loan has been approved for a family, the Farmers Home Administration will issue a notice to this effect to the builder so that he can more readily obtain private financing. In case a family owns a site and wants to contract with a builder to construct their home, the Farmers Home Administration will notify the builder in such a case that the loan has been approved. Such a notice also will help the builder obtain financing during construction. Loans under these circumstances are closed after the house is built.

A third method of financing involves the Farmers Home Administration making advances during construction. In such a case the loan is closed prior to the time construction starts. Advances are made on the basis of inspections and the presentation of invoices by the builder.

The builder is required to provide an affidavit that all bills have been paid on the house before a loan is closed in the case of a conditional commitment. The title search will reveal any outstanding liens. In other cases, when FHA makes

advances during construction, he may be required to present paid vouchers and bills to assure that all the bills have been paid.

9. Please provide information, if available, concerning use of FHA loans to finance prefabricated or modular-type dwellings, such as the estimated volume of such loans, any significant differences in procedures used, approximate number of different manufacturers involved, any special problems encountered, et cetera.

The information follows:

During the first half of fiscal year 1973 (July 1 to Dec. 31, 1972), FHA financed 6,699 manufactured housing units which is about 12 percent of the total rural housing loans made during that period.

There are two major differences in procedure followed where offsite construction is involved: (a) FHA requires that the manufacturer of the house provide a statement to the contractor or builder-dealer and in turn this statement is given to the borrower certifying that the house was constructed in substantial conformance with the plans and specifications submitted and accepted by our State office architect/engineer; and (b) the FHA requires periodic factory inspections by our State office architect/engineers.

The FHA national office does not have information as to the number of different manufacturers involved in supplying manufactured housing.

Housing manufacturing companies can change the materials used depending on supply and costs. The company may also vary the construction methods without notification. FHA inspectors, therefore, have difficulty in determining day-to-day acceptability of the final product. Quality control in the plants is not adequate in some instances. When the National Association of Building Manufacturers completes its new manufactured housing code, all member companies will be required to secure the services of a qualified quality-control section.

Workmanship at the site erection stage is another problem. This has usually occurred when sectional or modular housing units are set on the foundations. The workmanship of the builder-dealer's erection crews appears to be the problem. We are, therefore, preparing a change in regulations that will require an inspection at the time the house is being erected on the prepared foundation. To avoid misunderstandings, we require a single contract for both the foundation and the house.

10. Loan servicing procedures:

A. Does FHA have, if any, requirements with respect to refinancing of housing loans prior to maturity? If so, please give details and describe any methods used to insure compliance.

B. Please describe any procedures used by FHA to protect against financial loss through impairment or destruction of dwellings securing FHA loans and delinquency or default by borrowers.

The information follows:

A. In order to carry out the statutory requirement that borrowers refinance their housing loans when able to do so, we have developed regulations for use of our field staff. In general, they provide that each year, between October 1 and December 31, the Farmers Home Administration county committee, with the assistance of the county supervisor, review the status of borrowers who have been indebted at least 5 years on their real estate loans. This review might occur within 5 years if the county supervisor has knowledge that a family's financial position has improved sufficiently so that they might be able to obtain credit elsewhere. In making this determination, our field staff is instructed to give consideration to the following factors:

1. Availability of home loans from private sources in the area on reasonable rates and terms.

2. Income of the family and their ability to meet the repayment terms of other lenders.

3. The equity in the property owned.

Borrowers who appear to be able to obtain refinancing credit are sent a letter reminding them of this requirement. This letter should include a request that they inform the county supervisor within 60 days of the progress they are making in obtaining other credit. If a borrower is unnable to secure other credit, he should inform the county supervisor promptly of the efforts he has made and the reasons why other credit is not available. If the information submitted by ing in obtaining other credit. If a borrower is unable to secure other credit, he finance his debt, he will be notified that he will not need to make further efforts toward refinancing for the remainder of the year. If, on the other hand, the borrower has not made a diligent effort to obtain credit elsewhere or does not want to refinance, the case will be referred to the Farmers Home Administration State

office for further consideration and action. In some cases the State offices have granted an extension and in others issued a notice of acceleration.

B. Each home is appraised by the Farmers Home Administration. This is a way of assuring that there is adequate security for the loan. With respect to delinquencies, the Farmers Home Administration has an established procedure under which the accounts of delinquent borrowers are reviewed. At this time decisions are made as to corrective or remedial actions to be taken. The Farmers Home Administration makes a diligent effort to counsel with borrowers and have them remove any delinquencies so they can continue ownership of their home. There are cases, however, where liquidation is necessary.

Most of the Farmers Home Administration rural housing loans are secured by first mortgage. As a general rule the priority of the Federal mortgage is maintained.

Periodic inspections are made of the property to assure that it is adequately maintained. In any case where there is evidence of lack of maintenance, the Farmers Home Administration counsels with the borrower and, in an extreme case, foreclosure action may be needed to protect the interest of the Government.

Additionally, the borrower is required to keep the house insured and the taxes paid.

11. Auditing and Investigative Procedures:

A. Please describe procedures for auditing and reviewing program operations, indicating particularly (a) organizational arrangements, (b) nature, extent, and frequency of program audits and reviews, and (c) whether audit coverage is considered adequate and, if not, what improvement is necessary.

B. Please describe the manner in which results of audits and reviews are used, with particular reference to (a) what analysis, if any, is made and by whom, (b) what procedures, if any, are in effect to insure that significant audit findings are called to the attention of top management, and (c) what procedures, if any, are in effect to insure that prompt corrective action is taken, where appropriate, concerning significant matters disclosed by audits or otherwise coming to the attention of FHA officials.

C. Please describe procedures to be followed when information coming to the attention of FHA officials indicated a reasonable possibility that a criminal violation might have occurred in connection with FHA programs, giving details of any special procedures to be followed in the event the information indicates possible criminal culpability on the part of FHA personnel.

D. Does FHA have any procedures for taking or initiating civil action where warranted? If so, please give details.

The information follows:

A. The Office of the Inspector General, USDA, conducts audits of FHA as follows:

(1) FHA State office:

(*a*) Regular coordinated audit on a 2-year cycle objective. This audit is the consolidation of all county office audits performed in the State.

(*b*) Overview audit is scheduled as needed on a segment of operations—can be on State operations or an aspect of program operations.

(2) FHA county office regular or coordinated audit in each county office on a 4-year cycle objective.

(3) Finance office, St. Louis, Mo., OIG team permanently assigned to conduct audits on segment of operation varying from 1- to 3-year cycles.

(4) All agency organization units, programs, and operations are subject to OIG audit at any time. The most recent audit completed was the review of FHA activities with emphasis on the rural housing program in 1971. The farm and community services programs are scheduled for survey and audit during fiscal 1974.

Also GAO audits are conducted at this discretion on individual FHA programs or aspects of particular programs on a nationwide or regional basis. GAO audits deal mainly with whether FHA programs are achieving the intent of applicable laws governing FHA operations. Based on the audit findings, GAO recommends changes in FHA procedures or recommends that Congress consider amending certain laws in order that program objectives will be achieved.

OIG audit coverage is not adequate due to length of time between audits. In an effort to alert the national office on problems that could evolve between audits, FHA developed the operations review program, which is outlined below. This program was initiated on September 9, 1971.

Further, FHA district supervisors perform an overall review of each county office in their districts annually for the purpose of insuring efficient management

of FHA programs. In addition, the State director will assign State office personnel to conduct reviews on a minimum of two county offices in each district annually for the same purpose. Reviews conducted by the State office will be compared with the county office reviews performed by the district supervisor and will aid the State director in evaluating the administration of FHA programs throughout the State.

B. All audits conducted on FHA programs are analyzed by the FHA evaluation and planning staff which is responsible for calling significant findings to the attention of top management. The audit findings are recorded in an information retrieval system which contains information on all audit findings by State and nationwide. Semiannual reports on audit and investigation findings are prepared and used by the State offices and the national office to analyze program weaknesses and make plans for training and/or procedural revisions.

The State director has a major responsibility for initiating and following up on necessary corrective actions for program weaknesses disclosed in audits and otherwise. The FHA evaluation and planning staff periodically follows up with State directors to assure that all corrective actions are taken. OIG maintains periodic followup with State directors on pending corrective actions.

C. In such instances, the matter is referred to OIG for handling in accordance with the Department's administrative regulations. Depending upon the nature of the allegation, OIG either investigates the matter or refers it to the non-USDA agency which has investigative jurisdiction, e.g., FBI, etc. Upon completion of the investigation, OIG sends copies of the report to USDA's Office of the General Counsel (OGC). If the allegation was substantiated by the investigation, OGC refers the case to the Department of Justice for a determination as to whether prosecution is warranted. FHA withholds any administrative action pending a decision by OGC as to whether the case should be referred to Justice. If the case is referred to Justice, FHA withholds action until either the legal action is complete or the U.S. attorney declines to prosecute.

FHA's administrative action takes into consideration both fiscal and personnel (disciplinary) aspects.

D. Where warranted, FHA may recommend the initiation of civil action to the USDA Office of the General Counsel.

12. Serious problems:

Please describe in some detail what you regard as the more significant and serious types of problems which have occurred in connection with FHA programs involving or relating to housing, including (a) the nature and extent of each such problem, (b) the primary cause(s) or suspected cause(s), (c) a description of the types of corrective and remedial action, and (d) an assessment of the effectiveness of such corrective and remedial action.

The information follows:

The Farmers Home Administration has experienced some problems with its housing program. They were associated primarily with the rapid growth of the program. When major problems did come to our attention, we tried to move aggressively to resolve individual cases and take administrative action to avoid their recurrence. Included among some of the major problems are:

1. Situations came to our attention where loans were made to families who found themselves with inadequate water and waste disposal systems. We took several approaches to solving the problem which have greatly reduced the incidence of inadequate water and waste disposal systems. The actions taken were:

(*a*) Issued comprehensive regulations on site development requirements which describe requirements for facilities such as water and waste disposal systems, surface drainage and streets.

(*b*) Made a concerted effort to work more closely with local, State and Federal agencies such as the local sanitation and State health departments and the local representatives of the Soil Conservation Service.

(*c*) Provided extensive training for our field staffs in the area of site development.

2. Delays in processing applications resulted from having responsibility for a greatly increased housing program with only a limited increase in staff. During the past several years FHA has had a backlog of from 70,000 to 95,000 applications for rural housing loans. The agency took actions it considered to be prudent to expedite and simplify loan processing but in many offices the staff could not keep pace with the applications received.

3. Occasional complaints have been received about making loans to families whose credit needs reportedly could have been met by other lenders. We have checked on complaints and found that few were justified. This criticism is much less frequent now than it was several years ago. We have continued to empha-

size in our relationship with our field staff the importance of diligently maintaining our role as supplementary credit source and the importance of reaching an understanding with the local financial community. The results of this action have greatly reduced the frequency of complaints about making loans to families who might have received credit from other lenders.

4. Complaints have been received from time to time about discriminatory treatment of minority groups. The Farmers Home Administration has constantly emphasized, in our training programs and other contacts with the field, the importance of providing equal opportunity to all in housing. Special training has been held in this area of responsibility. The results, we believe, indicated the effectiveness of this approach. The number of loans made to minority groups is favorable when compared to minority rural population. In 16 Southern States during fiscal year 1972, 21,584 Negroes received rural housing loans or a third of the loans made in these States. This was a 3.8-percent increase in loans to Negroes over the previous year while loans to whites decreased by 4.3 percent in these States.

5. Delinquencies are an area of concern. On January 1, 1973, 15 percent of the rural housing borrowers had not paid the full amount due on their loans. This was up from 12 percent a year earlier. The agency has instructed its field staff to make a comprehensive evaluation in each case and to develop specific followup action for individual loans. We have also emphasized to our field staffs, the need to apply to new applications the lending techniques which were successful with existing loans. This, we believe, will help solve some of the delinquency problems that have existed and help to avoid a repetition of errors in judgment that may have been made in making the loans that are currently delinquent.

Losses in rural housing loans have been small—only six one-hundredths of 1 percent of the amount advanced. Cumulative acquisitions by the Government have been only 3 per 1,000 loans made.

6. Uniformity of building standards was a problem that occurred in some areas. This became particularly evident when the same builders were developing homes for sale through HUD programs and those of the Farmers Home Administration. In order to avoid discrepancies of this type, the Farmers Home Administration adopted the minimum property standards of the Federal Housing Administration. This has greatly reduced the number of discrepancies.

7. The increasing cost of houses, particularly in the past 2 years, makes it increasingly difficult to provide housing for families in the lower income groups. Although the agency has no control over material prices and labor costs, we have continued to emphasize the importance of continuing to finance homes that are modest in size, design, and cost and to include among the homes we finance basic, adequate homes that can be built at a cost that low- and moderate-income families can afford.

8. The recent suspension of new commitments on interest credit loans has created some administrative problems. After the initial suspension on January 8, 1973, we modified our regulations to permit making loans with interest credits on homes for which commitments had been made on or before that date. Applications on hand before January 9 also may be considered for interest credit loans if the families are otherwise eligible. This action, together with a continuation of the nonsubsidized phases of the rural housing program, will permit the FHA to continue an active housing loan program.

9. There have been complaints of conflicts of interest and improper business relationships between FHA employees and builders. When we receive complaints of this type we promptly conduct a comprehensive review of the circumstances and, if the situation warrants, call in the Office of Inspector General. Accusations have been substantiated in only a few cases after an objective evaluation of all the facts was made. Appropriate administrative action was taken.

10. Improper interest credits were extended in some cases. This was the result of several different types of situations. For example:

(*a*) Errors occurred in the computation of interest credits;
(*b*) Inaccurate information was presented by loan packagers;
(*c*) Differences in judgment as to the treatment of overtime; and
(*d*) In some cases we found misrepresentation of information.

We have emphasized with our field staff the need for obtaining verifications of employment and credit reports. We also have issued a regulation on improper interest credit agreements, FHA Instruction 444.17. This regulation provides that borrowers are expected to reimburse the Government for improper interest credits. If the borrower deliberately misrepresented his situation, liquidation action may be waranted. In addition we have given notice to all packagers that

presentation of any false, fictitous or fraudulent statements or representation is a Federal offense.

11. Construction defects have been a frequent complaint. Whenever complaints occur, our field staff investigates their validity. If they are valid, FHA personnel work with the family and the builder in an effort to have the defects corrected. If the builder does not cooperate, he may be subject to suspension or debarment. We have found that many of the structural defect complaints are valid. In some cases, however, complaints have been received that were the result of failure of the borrower to properly maintain the property or to take protective actions.

13. Cameron County, Texas, situation:

A. Please provide a statement concerning the Cameron County, Tex., situation which was the subject of a television documentary, including (but not limited to) (a) the nature and extent of irregularities involved, (b) the manner in which such irregularities became known to FHA officials outside Cameron County (please indicate specifically whether the irregularities became known through regular FHA channels and procedures or otherwise and whether, in your judgment, knowledge of such irregularities should have become known sooner, giving details), and (c) any identified deficiencies in regulations or procedures believed to have contributed substantially to any such irregularities.

B. Please describe in some detail any corrective action taken, such as investigations, personnel actions, attempts to secure repair of construction defects, et cetera.

C. Please indicate whether you believe the situation has been satisfactorily resolved or whether further action is needed, giving details as to the basis for your opinion.

The information follows:

A. (*a*) The irregularities involved (1) general construction defects, (2) mechanical complaints such as plumbing and electrical work, (3) poor brick structure, and (4) septic tank problems.

(*b*) FHA officials were notified of the problem by a petition signed by 36 rural housing borrowers. The State director then requested the USDA Office of the Inspector General to investigate the allegations. The post review of loan files and knowledge of the county office should have alerted the State office staff to the possibility of improper construction and qualifications of applicants.

(*c*) The rural housing caseload in Cameron County more than doubled between June 1970 and June of 1972. To handle this overload, FHA personnel relied heavily on packaging, the preparation and completion of the necessary forms by the contractor and prospective borrower. A closer review and evaluation of information submitted by packagers, development of a better understanding with borrowers and more effective inspections would have avoided some of the problems that developed. In our judgment, the procedures for packaging, evaluation of applications and inspection are adequate. The basic problem in Cameron County is that they were not fully complied with.

B. A special audit dated August 2, 1972, on the rural housing program in Cameron County and an investigation dated May 8, 1972, with a supplement dated September 8, 1972, on alleged collusion and negligence of duty of Wyatt B. Nesbitt, county supervisor, Cameron County, were prepared by OIG and submitted to FHA for consideration and action.

As of May 15, 1973, the following actions have been taken:

(1) Of the 16 borrowers cited in the OIG report, 3 cited cases remain unsettled. Inability to obtain cooperation of the families is the primary reason why the deficiencies in these cases have not been corrected. Seven homes were satisfactorily repaired and six were acquired by the Government.

(2) Action also has been taken on the personnel aspects related to the Cameron County situation. More specifically:

(*a*) The county supervisor requested and was granted a reassignment and demotion.

(*b*) Suspension action is being considered against the county supervisor because of his improper actions.

(*c*) The temporary construction inspector's appointment, which expired on June 10, 1972, was not extended; and

(*d*) Disciplinary action against several other employees because of improper actions is being considered.

C. FHA is concerned that not all construction deficiencies in the homes cited have been corrected. We find that 11 of the original 36 borrowers signing the petition have not had their complaints reconciled. Efforts to resolve the problems that exist will continue.

Appendix 2.—Review by Office of Inspector General of Farmers Home Administration Rural Housing Activities

Title: Review of Farmers Home Administration Activities With Emphasis on the Rural Housing Program (Report No. 6171-2-H)

I. INTRODUCTION AND SUMMARY

A. Introduction

At the request of the Secretary of Agriculture, the Office of the Inspector General (OIG) in August 1970, undertook a review of Farmers Home Administration (FHA) activities to determine areas of weakness in administration of its programs and to make recomendations for needed corrective action. Previous OIG investigations in 1970 had disclosed serious problems involving FHA-financed Rural Housing projects in Itawamba County, Miss.; Madison County, Ala.; and, Indian River County, Fla. (Significant Disclosure Reference 70-41, 70-74, and 71-7).

Phase I of the OIG response to the Secretary was a preliminary survey of FHA operations at 39 county office locations in 19 States. This survey disclosed indications of major program irregularities including: (1) rural housing loans in urban areas; (2) falsified applications for rural housing loans; (3) deficiencies in water, sewage disposal, and drainage systems for FHA-financed housing; (4) apparent conflicts of interest; (5) charges of unfair competition with private lenders; (6) construction defects; and, (7) segregated cluster housing.

Phase II of the OIG response to the Secretary consisted of a review of FHA activities at national, State, and county office levels. This review was directed primarily toward detecting serious program weaknesses and irregularities involving rural housing and related loans, with emphasis on subdivisions, self help housing, purchase of existing housing, sewage disposal, and water system loans. The phase II review included 252 FHA county office audits in 35 States and Puerto Rico, 12 coordinated FHA State office audits, investigations related to the objectives of our review, and follow-up on audit and investigative disclosures at the FHA national office. During the county office audits, 10,271 borrower files were reviewed, and 2,704 borrowers were interviewed. The field work, has been completed. Individual audit reports covering the results of county and State office audits, with appropriate recommendations, have been prepared. Most of these reports have been issued, and the few remaining reports have been submitted in draft form for discussion purposes. Reports have also been prepared and issued covering the results of completed investigations. The field work was performed between September 1970, and May 1971.

This final report covers the overall results of our review. Findings relating to national office management of FHA activities are presented with appropriate recommendations for the FHA Administrator. All other findings and recommendations have either been addressed to lower management levels or have already been discussed with national office officials and will not be repeated in this report. A narrative summary of the results of county office audits and certain investigations related to the objectives of our review is attached as exhibit A.

B. Summary

FHA accomplishments in implementing new programs and making loans are commendable. During the period from 1960 to 1971, loan program funding increased more than 700 percent, with the largest increase in the rural housing program. During the same period, administrative funding increased about 200 percent and resulted in an increase of about 74 percent in the number of FHA employees. New and complex loan programs implemented during this period included: (1) Association Loans for recreation, sewer, water facilities, grazing facilities, and economic opportunity cooperative enterprises; (2) Resource Conservation and Development (RCD) loans; (3) rural housing loans for single and multiple housing units; and, (4) development of FHA-financed subdivisions and cluster housing areas.

Additional efforts and controls are needed to timely detect and correct program weaknesses or irregularities which have developed and/or increased during the period of rapid program growth. There is a need for the FHA national office to exercise more direct authority and control over State and county office operations and to adopt and implement systems for the collection of data from which qualitative analyses can be made regarding the extent to which program objectives are understood, implemented, and accomplished. We believe this will require organizational changes to provide for effective line authority to be exercised at the national office level over State and county office operations. There is an urgent need for FHA to strengthen its staff, both in numbers and technical skills, to keep abreast of its complex and expanding loan programs.

Even though FHA is striving to meet all objectives of its mission, it is not fully meeting its rural housing program objective, to provide safe, decent, and sanitary housing for low to moderate income families. The housing needs of the lower income rural population are not being adequately served in some areas and, at the same time, some affluent, middle-income families are receiving rural housing loans in conflict with the objectives of the rural housing program and the intent of authorizing legislation.

There is a need for FHA to strengthen its guidelines and instructions covering rural housing eligibility and the planning and development of subdivisions and cluster housing areas where rural housing loans will be made. Our audits disclosed a total of 1,424 ineligible rural housing loans amounting to $21 million, and representing more than 13 percent of all FHA borrowers sampled during the audits. FHA financed houses in 62 subdivisions in 14 States which were constructed without adequate planning for overall development of the area, with resulting problems in water supplies, sewage disposal systems, and/or road development. FHA had financed subdivisions and other housing which was located in or closely associated with urban areas which were not rural in character and were not eligible for rural housing loans. In this category, we found 695 of the 1,424 ineligible rural housing loans amounting to $10,200,000 at 37 FHA county offices in 16 States. The remaining 729 ineligible loans, totaling $10,800,000 were determined ineligible due to excessive income, urban residency without rural employment or rural land ownership, and/or the ownership of adequate housing prior to FHA loan approval.

The FHA objectives of providing supervised credit assistance are not being adequately met. This is due, in part, to the rapid growth of FHA loan programs which resulted in making more loans rather than a balanced program which includes adequate supervision and loan servicing, and the need for additional staff. The lack of effective supervision has contributed to the continued or increased delinquency of some borrowers, the extension and continuation of low interest loans to borrowers who could obtain their credit needs from other sources, and inadequate security servicing. Thus, the interests of the Government and FHA borrowers, in some cases, are not being adequately protected, and the overall objectives of FHA loan programs are being subverted.

FHA monitoring of employee activities and financial interests needs strengthening to provide additional controls designed to aid in timely detection and correction of matters constituting actual or apparent conflicts of interest. In connection with recent audits and investigations, at 50 locations in 25 States, allegations were made of employee misconduct, including apparent conflicts of interest.

There is a need for interagency coordination and negotiation of cooperative agreements between FHA, the Office of Economic Opportunity (OEO), and the Department of Labor (DL) concerning projects which are jointly funded by FHA, OEO, and/or DL. The lack of effective coordination between these agencies has, in some instances, resulted in the misuse either of FHA loan funds and/or OEO/DL funds at the expense of some low income FHA borrowers.

II. RECOMMENDATIONS AND DISCUSSION WITH MANAGEMENT

A. Recommendations for the FHA Administrator

1. Make organizational changes which, as a minimum, provide for: (a) a Deputy Administrator for State and county office operations with responsibility for and authority to control State and county office operations, and (b) designating a person on the staff of each FHA State Director with responsibility for and authority to control county office operations. (See details—1.)

2. Effect controls designed to more effectively exercise line authority over State and county operations to assure that policy, procedures, and program objectives are clearly understood and uniformly accomplished. (See details—1.)

3. Adopt and implement a career development plan, and expand staffing, both in numbers and technical capabilities, to strengthen program administration and implementation. (See details—2.)

4. Strengthen training efforts by developing and implementing an intensified training curriculum with staff specialists to provide training on a continuing basis, and include courses for county supervisory personnel on appraisals, inspections, community and subdivision planning, standard for water and waste disposal systems, and association loan planning and processing. (See details—2.)

5. Develop and implement a system of review of program operations from which qualitative data will be obtained and used to evaluate the accomplishment of program objectives. (See details—3 and 4.)

6. Establish priority criteria for processing rural housing loan applications to assist lower income families in obtaining adequate housing. (See details—4.)

7. Strengthen and expand existing training efforts to assure that State and county office personnel understand and adhere to program authorizations and objectives. (See details—4.)

8. Revise existing policy regarding FHA county office grading structure to give additional weighted workload factors for loan making activities, such as interest credit, rural rental housing, self-help housing, and section 504 housing loans, all of which are designed to assist low-income families. (See details—4.)

9. Issue FHA Bulletin No. 3790 (444) as an FHA instruction, and strengthen its requirements covering water supply, sewage disposal systems, and road development. (See details—5.)

10. Require certifications that subdivisions under construction and/or planned for development with rural housing loans are in eligible areas and that proposed rural housing loans will meet program objectives. (See details—5.)

11. Strengthen controls over the packaging of applications by requiring certifications, under oath, both by packagers and applicants that to the best of their knowledge and belief the information supplied on the application is true and correct, and that they have neither altered the applications nor caused to be entered any false or fraudulent information on the application in order to qualify the applicant for a loan. (See details—6.)

12. Assure compliance with the Agency's policy and guidelines on supervised credit vis-a-vis packaged applications so that county supervisory personnel perform the required counseling with packaged applicants concerning the availability of choices concerning size, design, location, developer, and type of construction. (See details—6.)

13. Develop procedures at the field level to achieve a balanced program of loan making and loan servicing. (See details—7.)

14. Clarify existing guidelines covering employee conduct and activities by providing for controls and reviews to assure that actual or potential conflicts of interest are precluded. (See details—8.)

15. Negotiate formal agreements with the Office of Economic Opportunity-funded organizations and the Department of Labor covering jointly funded projects where FHA rural housing loans are involved. (See details—9.)

16. Revise existing guidelines covering rural housing loans for homes constructed by federally subsidized construction firms and self-help organizations to require disclosure of the nature and amount of all Federal subsidies, their intended use, responsibilities of all parties to the agreement, and to make such disclosures a prerequisite to loan approval. (See details—9.)

B. Discussion with management

The findings and recommendations were discussed on July 23, 1971, with the following FHA national office officials:

James V. Smith—Administrator.
Joseph Haspray—Deputy Administrator.
Darrel A. Dunn—Assistant Administrator, Farmer Programs.
G. W. Cavender—Assistant Administrator, Special Programs.
George C. Knapp—Assistant Administrator, Management.
Marshal R. Burkes—Assistant Administrator, Insured Note Marketing.
James F. Neville—Assistant Administrator, Rural Housing.
Denton E. Sprague—Director, Community Services Division.
Harold E. Long—Executive Assistant to Administrator.
Robert H. Macy—Assistant to Administrator.
Mark H. Nestle, Jr.—Operations review officer.

These officials expressed general acceptance of the findings and recommendations as presented.

The Office of the Inspector General was represented at this discussion by Inspector General Nathaniel E. Kossack; Assistant Inspector General, Operations, Broadaway G. Frazier; Deputy Assistant Inspector General T. T. Osasa; and, Supervisor-in-Charge James J. Scott.

III. DETAILS

Organization and operation of the Farmers Home Administration

1. Our audits and investigations highlighted a need for strengthening field operations and program implementation to assure compliance with policy, adherence to procedure, and accomplishment of program objectives. Under current organization and operation, the FHA Administrator supervises 42 FHA State directors in addition to his immediate staff consisting of a Deputy Administrator and six Assistant Administrators. These staff members advise and counsel with FHA State directors and their staffs, but they do not exercise line authority over State and county office operations. Under present organization and operation, there is no effective system by which the FHA national office is routinely and currently informed concerning compliance with policy, adherence to procedure, and accomplishment of program objectives. As a result, the FHA national office was neither exercising effective authority and control over State and county office operations, nor receiving adequate feedback concerning program administration and accomplishments.

There are four Assistant Administrators in the program area—rural housing, farmer programs, community programs, and special programs. We interviewed these Assistant Administrators concerning their job responsibilities, duties, and whether they have or exercise any line authority over State and county operations. Three advised that, in their opinion, program implementation was, and should be, a State office responsibility with minimum interference from the national office. They viewed the national office role substantially as it is now functioning—policy and procedure, advice and counsel, and handling important correspondence. The fourth Assistant Administrator in the program area advised that he believed the national office should exercise more direct authority and control over State and county office operations. He also acknowledged that there is no effective means by which the FHA national office can presently monitor field operations as to program implementation; adherence to policy, procedure, and loan closing conditions; and, accomplishment of program objectives.

Our review of FHA activities covered 252 counties in 35 States and Puerto Rico, 12 FHA State offices, and audit at the FHA national office. Many of the program irregularities and weaknesses disclosed by our audits indicate a need for FHA to strengthen its controls and exercise more authority over field operations. Abstracted below are examples of these audit disclosures:

(*a*) Deficiencies were found in water systems either financed by FHA and/or serving FHA-financed housing in 11 States. A lack of coordination with local health authorities, coupled with inadequate planning and/or followup for overall development of adequate water supplies, contributed to the existence of these deficiencies.

(*b*) Deficiencies were found in sewage disposal systems either financed by FHA and/or serving FHA-financed housing in 17 States. Deficiencies included lack of adequate inspections, lack of coordination with local health and sanitation officials, overflowing septic tanks, sewage backing up in commodes and bathtubs, unpleasant odors, and contamination of water supplies.

(*c*) Our audits disclosed 1,424 ineligible rural housing loans, totaling $21 million, and accounting for more than 13 percent of all borrowers sampled during our audits.

Taking into consideration the nature and extent of program irregularities disclosed and the feedback vacuum at the FHA national office, we concluded there was a need for FHA restructuring to provide effective line authority over State and county office operations, and for adoption of a system of controls which will routinely and currently provide the Administrator and his staff reliable information concerning field operations. We believe that, as a minimum, such changes should provide for the following:

(*a*) Appointing a person on the Administrator's staff to have primary responsibility for and commensurate authority to direct and control State and county office operations.

(*b*) Functional supervision, line inspections, and administrative reviews of State and county office operations to test implementation of policy and procedure, program administration, and accomplishment of program objectives, as an adjunct to OIG audit and investigative activities.

(*c*) Designating a person on the staff of each FHA State director to have primary responsibility for and commensurate authority to direct and control county office operations through district supervisors.

(*d*) Increasing the number of district supervisors and strengthening their roles as managers.

Staffing, career development, and training

2. *Background.*—During the period from 1960 to 1971, loan program funding increased more than 700 percent. Funding for salaries and expenses increased by about 214 percent, representing a staffing increase of only 74 percent during the same period.

In 1960, FHA was a farm-oriented agency dealing primarily in farmer programs. Currently, there are three major program areas in FHA: (1) Rural housing, (2) farmer programs, and (3) community facilities. Rural housing accounts for about 65 percent of current loan program funding; farmer programs, 25 percent; and community facilities, 9-plus percent. Special projects accounts for the balance of program funding. Abstracted below in summary form are major program expenditures (actual or projected) for fiscal years 1970, 1971, and 1972:

PROGRAM EXPENDITURES

[In thousands of dollars]

Summary totals	Fiscal year—		
	Actual, 1970	Estimated, 1971	Estimated, 1972
Rural housing	793, 835	1, 489, 375	1, 622, 422
Community facilities	209, 344	228, 555	245, 400
Farmer programs	631, 424	569, 000	558, 000

As of April 30, 1971, FHA employed more than 7,000 full-time employees, about 4,000 of whom were professionals. Also, 4,123 professional positions were approved, most of which were filled. Most of the professional positions were filled by persons having agricultural management specialist educational backgrounds. Set forth below is a summary of FHA professional positions by location and educational background:

EDUCATIONAL BACKGROUND

	Agricultural management	Engineer	Architect	Other	Total
National office	27	2	2	18	49
State offices	[1] 522	64	34	[2] 244	864
(District supervisors)	(270)			(42)	(312)
County offices	3, 108			102	3, 210
Total	3, 657	66	36	364	4, 123

[1] Includes 270 district supervisory personnel.
[2] Includes 42 district supervisory personnel.

(a) *Staffing and Career Development.*—There is a need for FHA to strengthen its staff both in numbers and technical skills to keep pace with the expansion and complexity of its programs and to improve the effectiveness of program administration and implementation. Although commendable efforts have been made in implementing new programs with existing staff, there is an urgent need for increased numbers of professional employees to timely proces and service greatly expanding loan volumes. Engineers, architects, sanitarians, community planners, and construction specialists are needed in greater numbers to provide the technical skills required for effective administration of the rural housing and community facilities programs.

By reference to the background material hereinbefore in this finding, it is apparent there is an imbalance between the technical skills available and the level at which major FHA programs are currently funded. As you will note, farmer programs are expected to decline in fiscal year 1972 while rural housing and community facilities programs are expected to have substantial increases in fiscal year 1972. The farmer programs account for only 25 percent of total current FHA loan

program expenditures. However, more than 88 percent of the total FHA professional staff has educational background in agricultural management. At the county office level, where the mismatch between technical skills and loan programs reflects itself in performance effectiveness, more than 96 percent of the professional staff has educational background in agricultural management.

The primary thrust of FHA in recent years has been on loan making. During this period, loan planning, technical services, and account servicing and supervision have been neglected due to heavy workloads and the lack of time. As a result, there are widespread deficiencies in loan servicing and supervision after loans are made.

Attached to this report as exhibit A is a narrative summary of audit and investigative findings disclosed in connection with our current review of FHA activities. Many of the program irregularities/weaknesses are attributable, in part, to inadequate numbers and/or technical capabilities of professional staff. Findings which have particular relevance in this connection include those dealing with: (1) water and sewage disposal systems; (2) subdivision planning and development; (3) inspection or construction defects/irregularities; (4) appraisal problems; and (5) supervisory and loan servicing deficiencies.

Based on current loan program funding, the numbers and technical capabilities of FHA professional staff, and on the nature and extent of program irregularities/weaknesses disclosed by our audits and investigations, we concluded that FHA should expand its staff, both in numbers and technical capabilities, to strengthen program administration and implementation.

There is a need for FHA to adopt and implement a career development plan (CDP) to assure a cadre of trained managers and to provide employees a system through which career goals may be attained. The CDP should be designed to identify employees with potential managerial ability and to move them systematically and progressively into managerial positions of greater responsibility. Under current operations, personnel are selected for a specific job and location without any definite CDP for advancement to positions of greater responsibility and authority. Additionally, there is no adequate system for identification and development of managerial talent.

A CDP would benefit both the agency and the professional employees by: (1) systematically grooming professional employees for FHA management positions; and (2) providing a system within which professional employees can work toward specific career development goals with reasonable expectancy for attainment. Under current operations, professional employees are frequently moved into managerial positions for which they have had no grooming or training, and FHA has no specific plan for training replacements for its State and National office key managers, many of whom are eligible for retirement.

(b) *Training.*—Intensive training efforts are needed for county office employees to assure that they understand and implement policy and procedure, and to assist them in accomplishing FHA program objectives. Under current operations, national office training efforts are directed exclusively to State directors and State office staff specialists. Each State office is then responsible for disseminating the training to county office personnel. There are wide variances in the understanding and interpretation of the training received by the personnel attending national office-sponsored training sessions. Hence, widely differing training is provided county office personnel through State office-sponsored training sessions. Training received by county office personnel varies from State to State, and within the same State, depending on the understanding and interpretation of State office employees providing the training. As a result, there is a wide disparity in the quality of training received by county office personnel, and FHA cannot be adequately assured that its policies, procedures, and training instructions have been effectively conveyed to county office personnel.

In recent county office audits, performed nationwide, there were widespread indications of a lack of uniformity in the understanding, interpretation, and implementation of policy, procedure, and/or training including:

(1) Local interpretation, or lack of understanding of instructions related to the rural housing program in the areas of:

(*a*) Low-moderate interest rate classification.
(*b*) Modest housing features.
(*c*) Income criteria for eligibility purposes.
(*d*) Use of total family income for interest credit loans.
(*e*) Definition of a rural area.
(*f*) Use of construction contracts.

(*g*) Performing construction inspections.
(*h*) Accurate completion of necessary loan documents.

(2) Disproportionate implementation of:
(*a*) Housing programs designed to reach low-income families (interest credit, self-help housing, et cetera).
(*b*) The packaging concept.
(*c*) News releases and other promotional activity.
(*d*) Graduation reviews.
(*e*) Delinquency and problem case reviews.
(*f*) Loan servicing activities.
(*g*) Supervision of borrowers.

Based on the above, we concluded that current training efforts are not satisfactory. We believe the FHA National Office, as a minimum, should: (1) develop and implement an intensified training curriculum with staff specialists to provide training on a continuing basis to national, State, and county office personnel; (2) include in the curriculum for county supervisory personnel such annual short-courses as, real estate appraisals, inspections of construction in process, basic construction terminology, appraisals of existing housing, standards for water supplies and sewage disposal systems, overall planning of subdivisions and communities, association loan planning and processing—determining need and feasibility of planned facilities; (3) utilize training courses offered by the Civil Service Commission, Federal Housing Administration, and other agencies, when the courses provide training needed by FHA staff; and, (4) provide management training to State and county office personnel identified through a CDP as having potential for managerial positions.

Monitoring field operations and reporting program accomplishments

3. There is a need for improved monitoring of field operations by the FHA National Office and for strengthening the system by which the results of program accomplishments are reported. Under current operations, there is no adequate system by which the FHA National Office monitors implementation of policy and procedure or accomplishment of program objectives at the field level. National Office officials make field visits in connection with meetings, training sessions, policy matters, and special projects. The travel is designed for specific, limited objectives, rather than as a device for monitoring field operations. However, some monitoring of field operations results as a byproduct of the travel. In addition, the system used for reporting results of field operations, which provide statistical information on program implementation, does not provide adequate information for making qualitative evaluations of program accomplishments. As a result, the FHA National Office is not adequately monitoring field operations, nor does it receive adequate information concerning field operations through existing reporting procedures.

The principal source of information concerning field operations and FHA loan programs is the fund analysis form. This form is prepared in connection with each FHA loan, and reflects information concerning:

(*a*) Kind and amount of loan.
(*b*) Whether direct, insured, initial, or subsequent.
(*c*) Location—farm or nonfarm.
(*d*) Security to be pledged for the loan.
(*e*) Name, age, and race of applicant, and number in household.
(*f*) Planned use of loan funds.
(*g*) Income, net worth, cash contribution to be made by applicant, and related data.

Copies of the fund analysis forms for each loan are routed through the appropriate FHA State office to the FHA national finance office, where the data is fed into a computer. The information from these forms can be retrieved from the computer through printouts, as needed.

Our audit disclosed there is no routine testing of the validity of the information reported on the fund analysis forms, either by the FHA State offices, or by the national office. Our audit also disclosed that some of the information reported on these forms is unreliable and cannot be reconciled, either with the borrower's application for a loan and/or his actual financial condition as determined by the audit. The areas in which unreliable (inaccurate) information are most often reported include: Income, assets, net worth, prior residence, employment, and location (farm or nonfarm).

During the audit, we reviewed fund analysis forms and computer printouts of data taken from these forms. We concluded that the information, which is statistical in nature, provides no adequate basis for making qualitative evaluations concerning program implementation or accomplishment of FHA program objectives.

Recent audit and investigative findings (see exhibit A attached) disclosed many program irregularities/weaknesses which indicate the FHA national office is not adequately informed concerning field operations. Findings indicative of this condition include those dealing with: (1) Deficiencies in water and sewage disposal systems; (2) rural housing loans in urban areas; (3) subdivision planning and development; and (4) employee misconduct and apparent conflicts of interest.

Based on the nature and extent of recent audit and investigative disclosures, and on the lack of national office monitoring, we concluded the FHA national office was not sufficiently informed concerning field operations, program implementation, and accomplishment of program objectives. Currently, there is no assurance that reports based on data taken from the fund analysis forms are accurate.

We concluded there is a need for improved monitoring of field operations and strengthening the system used for reporting the results of program accomplishments. We believe that, as a minimum, the FHA national office should:

(*a*) Adopt and implement a system for monitoring State and county office operations on a continuing basis. The system should be designed to provide feedback, routinely and timely, on adherence to policy and procedure, program implementation, and accomplishment of program objectives.

(*b*) Strengthen the existing system for reporting the results of program accomplishments to include data which, in conjunction with feedback provided under "*a*" above, will provide the FHA national office information from which qualitative evaluations can be made concerning program implementation and accomplishment of program objectives.

Meeting rural housing program objectives

4. FHA is not adequately meeting its rural housing program objective of providing safe, decent, and sanitary housing for low- to moderate-income families. This is occurring because: (1) the objectives of the currently funded rural housing program are neither clearly understood nor fully accepted at State and county levels in some locations; and, (2) currently there is neither adequate national office monitoring of field operations nor an effective system for qualitatively measuring the extent to which program objectives are understood and accomplished. As a result, the housing needs of lower income families, in some areas, are not being adequately served, and housing loans are being made to some affluent, middle-income families in conflict with the objectives of the program and the intent of authorizing legislation.

Exhibit A, attached, summarizes the results of our FHA county office audits performed between September 1970 and May 1971, and the results of certain investigations related to the objectives of our special review of FHA activities. During the audits, 10,271 borrower files were reviewed, and 2,704 borrowers were interviewed. These audits disclosed many instances of ineligible applicants receiving rural housing loans and/or rural housing loans being made in ineligible areas in, or closely associated with, urban centers. In 155 of the county office audits involving 32 States and Puerto Rico, we found 729 rural housing loans totaling $10,800,000 made to ineligible applicants. In 37 of the county office audits involving 16 States, we found 695 rural housing loans totaling $10,200,000 made in or near urban centers which exceeded the population limitations and/or other eligibility criteria for rural housing loans. In total, the 252 audits disclosed 1,424 ineligible rural housing loans amounting to $21,000,000, and accounting for more than 13 percent of all borrowers sampled during the audits.

Our audits and investigations disclosed several instances of rural housing borrowers living in housing which was not safe, decent, and/or sanitary (see exhibit A). In North Carolina, rural housing borrowers' homes were connected to sewer lines which emptied into an open catch basin on an incomplete system which was not authorized nor approved by State and local health officials. In Florida, raw sewage was found in the streets of a subdivision containing FHA-financed homes. Some of the borrowers in this subdivision had sewage backing up into commodes in their homes. In 55 county office audits involving 17 States, we found numerous problems in individual septic tank/sewage disposal systems serving rural housing

borrowers. In some cases, raw sewage had collected in pools on the ground, and contamination of water supplies was feared.

Our audits disclosed that some county supervisory personnel directed their primary efforts to processing rural housing loans for families whose incomes were above moderate. In some cases, the average family incomes of rural housing borrowers in our audit samples were double the average family income for the county, as reflected in the county profiles prepared by the Office of Economic Opportunity. Our audits also disclosed instances where only limited use was being made of the interest credit, self-help housing, rural rental housing, and/or section 504 loan programs to assist low-income families. In 98 county office audits involving 25 States, we found the intent of the interest credit provisions of the rural housing program was misunderstood, abused in some cases, and/or was improperly administered. We found that inconsistent interpretation of instructions resulted in some families receiving interest credit allowances, while other families with similar financial conditions did not.

In some counties, we found the news media was not being used as a promotional or educational device to publicize the availability of housing assistance for the lower income segment of the population. Also, little effort had been made to coordinate and/or cooperate with local agencies oriented to the social needs of people to provide information concerning the availability of loan assistance for their clientele.

Our audits disclosed that applications for rural housing loans are processed on a first-come, first-served basis. We found that no system of priority criteria is used by FHA to expedite the processing of applications from low-income families or other applicants who are without adequate housing (owned or rented) at the time their applications are filed.

Based on the nature and extent of audit and investigative findings relating to rural housing, we concluded that FHA was not adequately meeting its program objective of providing safe, decent, and sanitary housing for low- to moderate-income rural families. We believe that, as a minimum, FHA should: (1) establish priority criteria for processing applications for rural housing loans aimed at providing housing for low-income families and/or applicants who neither own nor rent adequate housing; (2) strengthen and expand existing training efforts to assure that State and county office personnel understand, implement, and adhere to program authorizations and objectives, and to assist them in using their time and efforts for optimum accomplishment of program objectives; (3) develop and implement a system of review and analysis of program operations from which qualitative data can be used to evaluate the extent to which program objectives are understood, implemented, and met; and, (4) revise existing policy regarding FHA county office grading structure to give additional weighted workload factors for loanmaking activities, such as interest credit, rural rental housing, self-help housing, and section 504 housing loans, all of which are designed to assist low-income families.

Subdivision planning and development

5. There is a need for strengthening FHA instructions and national office guidance with respect to planning and development of subdivisions where housing will be financed through rural housing loans. Recent audits and investigations disclosed the following major problems in connection with FHA-financed subdivisions: (1) subdivisions being developed in close proximity to urban areas; (2) inadequate water supplies which failed to comply with State regulations governing the installation and operation of water systems and/or failed to meet minimum standards recommended by the State departments of health and the U.S. Public Health Service; (3) individual septic and/or community sewage disposal systems which were inadequate in size, design, or treatment facilities, resulting in unpleasant odors, possible contamination of water supplies, and potential health hazards; and, (4) inadequate road development, with unpaved surfaces and without dedication to or acceptance by local highway authorities for perpetual maintenance. As a result, rural housing loans were being made in ineligible areas which were not rural in character, and FHA was financing subdivision developments with the potential to develop serious health hazards. Both conditions reflect adversely on the agency and the department.

Our review of FHA activities disclosed major problems in FHA-financed houses in 62 subdivisions in 14 States (see Exh. A attached). Set forth below under appropriate captions are examples of the results of our reviews of FHA-financed subdivisions:

(a) College Grove Subdivision, Union County, N.C.—This subdivision consisted of 55 homes, 54 of which were FHA-financed and built by the same contractor. All the homes were occupied by Negro families. The developer provided a community water and sewer system. Borrowers complained of faulty housing construction, leaking sewers, contaminated water, and roads which were never completed and were occasionally impassable. In August 1970, the Union County Health Department (UCHD) tested water samples from the subdivision's wells and found the presence of coliform bacteria. The UCHD director stated that the majority of wells in Union County were contaminated in a like manner due to the lack of soil percolation, causing septic tanks to overflow during heavy rains, contaminating the water table with effluent.

State health officials advised that the contractor had failed to comply with their regulations governing the installation and operation of sewer and water systems; had to add to or modify the systems before they would meet State standards. The water and sewage systems were not installed in accordance with a set of plans and specifications prepared by an engineering firm. When the plumbing contractor began construction, it was found that the plans were not workable but the systems were installed, anyway.

Several loans were processed to applicants to purchase homes in this subdivision even though the sewage system was incomplete and the sewage drained into an open catch basin rather than into a completed digestion plant. The county supervisor stated that FHA regulations stipulate that adequate sewer and water facilities must be provided for RH loans and that he processed these loans on the assumption that the sewage system would some day be adequate. He also stated that he was not familiar with sewage systems and relied completely on the contractor's familiarity with such systems.

Loan files in the FHA office contained no documentation concerning the adequacy of water and sewer systems. There was no reference to the quantity and quality of the water supply or the ability of the sewer system to handle the number of homes in the subdivision. There was no documentation to indicate any assurance that the contractor would continue to operate the systems or evidence as to fees he charged to the subdivision residents.

Roads were never completed and were occasionally impassable due to mud. The county supervisor stated that it is not the responsibility of FHA to provide roads or even negotiate on the issue. He assumed that the State would pave the roads.

Additional disclosures included the fact that 53 of 54 borrowers were not familiar with taxes, water bills, home maintenance, and some were not even familiar with bathroom facilities. The contractor charged $25 to assist applicants in preparing FHA applications; the attorney for the contractor was also the FHA-designated attorney, performed loan closings and collected $45 in advance of performing any legal services.

(b) Vero Beach, Indian River County, Fla.—Rural housing loans were made to 43 minority borrowers in two subdivisions developed by Burks-Howder Co., Inc. The sewage system installed and operated by Burks-Howder was not working in one subdivision wth nine FHA homes valued at $100,000. Raw sewage was in the streets and backed up in commodes. In addition, the subdivision had an unauthorized, untested, inadequate water system initially installed to provide water for construction purposes, not human consumpion. FHA took no action on this matter although more than 2 months had passed and they were aware of the problem. A State office official reasoned that the FHA borrowers alone were responsible for resolving this situation with the contractor. The Florida FHA State office developed a plan to lower the water table within the subdivision to permit installation of individual wells and septic systems at a projected cost of $15,000. Cost of the project will be absorbed by the Government.

The above could have been prevented had FHA initially given proper supervision to this project. During the OIG investigation of this matter, the county sanitation director, Indian River County Health Department, advised in substance as follows:

> In all his professional career, he had not seen such a mismanaged and poorly planned water and sewer facility. He had never seen a Government agency as careless as FHA. Evidently, they were eager to get loan money out. This was the first time he had heard of a Government agency approving construction without a county health permit on septic tanks or an approved water and sewage plant.

(c) El Paso, Culberson, and Hudspeth Counties at El Paso, Tex.—FHA-financed rural housing loans in subdivisions in close proximity to El Paso, Tex., an urban area with a population in excess of 200,000. These subdivisions were being constructed without adequate planning for the overall development of the area and provisions for adequate water supplies, sewage disposal systems, and completion of road development. One FHA-financed subdivision (Borderland) was being developed within 1,500 feet of the city limits of El Paso. Three other FHA-financed subdivisions (Hermosa Vista, Pinckard, and San Elizario) were being developed within 2 to 4 miles of the El Paso city limits. Examples of the conditions follow:

(1) *Pinckard subdivision.*—This subdivision located 2 miles from the El Paso city limits contained 25 FHA-financed homes. Neither the water supplies nor the septic systems to any of the houses met minimum standards of the U.S. Public Health Service or the Texas Health Department. Borrowers interviewed during the audit complained that they had to haul water for drinking and cooking because of the unpleasant odor and bad taste of their well water and continuous upset stomachs were caused by drinking water from their wells. They also complained of corroded and ruined washing machines, refrigerator icemakers, the water killing garden vegetables, fruit trees, and grass, and the cost of maintaining their water supplies. For example, one borrower advised that he installed a water softener at a cost of $500 and the water continued to deteriorate in quality after the softener was installed. Other borrowers complained of having to replace water pumps frequently due to corrosion and fouling by the mineral content of the water. One borrower had his water well deepened at an additional cost of $200, but there was no subsequent improvement in water quality. These expenditures were in addition to initial installation cost of approximately $700 per well. We obtained samples from the water supplies of two borrowers and had chemical analyses made. The analyses showed the water was unsatisfactory for domestic use and even unsuitable for irrigation.

Roads were incomplete and a plat of the area had not been dedicated, approved, and filed by the appropriate officials, nor had the county accepted responsibility for maintaining the roads.

The conditions complained about in this subdivision resulted from inadequate planning for overall development of the area prior to approving loans and starting construction of individual houses. Each loan had been treated as a separate nonfarm tract, rather than as an integral part of a planned subdivison community. The conditions existing in this subdivision are inherent problems which may be encountered in any subdivision which is developed piecemeal without an overall plan for community development, including adequate water supply, sewage disposal system, and enforceable covenants for the completion of road development and perpetual maintenance through dedication to and acceptance by local highway officials for maintenance.

(2) *Hermosa Vista subdivision.*—This subdivision was located about 2 miles from the city limits of El Paso and contained 15 completed homes, all financed by FHA. Adequate domestic water supply, sewage disposal systems, and road development have neither been planned, nor provided, in this subdivision. Neither the domestic water wells nor the septic sewage systems met either the U.S. Public Health Service standards or the Texas Health Department recommended minimum standards for domestic water supply and sewage disposal. Borrowers complained to the developer and FHA about unfit water, inadequate sewage disposal systems, and inadequate road development.

A borrower complained to us about the quality of water. She said the developer had told her the water would clear up after a few days of use; however, she said it was still unsatisfactory. A sample of this water was taken by OIG and the test analysis showed that it was unsatisfactory for domestic use. FHA has had complaints about unsatisfactory water from other borrowers living in this area. Another borrower complained that his sewage system had not functioned properly since he moved into the house. This house was constructed on a speculative basis and was not inspected during construction. FHA personnel said they were unaware of this complaint.

The subdivision had been appropriately dedicated, approved, and filed. The internal roads had been graveled but not paved. FHA had no written plans or agreements for developing or maintaining the roads.

(3) *Borderland subdivision.*—This subdivision was located about 1,500 feet from the city limits of El Paso and contained 71 FHA-financed houses. There was no intervening space or other separation between Borderland and the El Paso city limits that made this subdivision rural in character. The subdivision was

supplied with city water and each home had a septic tank and seepage pit sewage disposal system. There were no fire hydrants in the subdivision. Problems had occurred with the individual sewage disposal systems in the older homes because of undersized septic tanks (less than one-half the minimum size recommended by the State of Texas Department of Health). For recently constructed homes, the city-county health department had approved the size of the septic tank and facilities as being adequate.

The subdivision plat plan had been dedicated, approved, and filed with appropriate officials. The dedication stated, "These streets will be maintained by the county only after they are paved by the developer or property owners and accepted by the county engineering department." Two roads had been asphalted and one had been graveled. However, FHA did not have any specific plans or agreements with the developer or county for completing and maintaining these roads. The county supervisor said the developer had verbally informed him that he would build the roads after all the houses were constructed to prevent unnecessary damage to the roads during construction. We were informed at the El Paso city-county road and engineering department that they would probably, eventually, be obligated to maintain these roads in the condition they were found. They implied that, if the roads had to be improved or constructed to specifications, the county would assess each property owner the cost incurred.

We reviewed current FHA guidelines consisting of: (1) the FHA Construction Guide; and, (2) FHA Bulletin No. 3790 (444), Guidelines for Rural Housing Sites, dated November 23, 1970. Both publications address themselves to the problems of water supply and waste disposal systems and road development. However, based on our review, we concluded these guidelines were advisory rather than mandatory and, therefore, inadequate to assure satisfactory subdivision development with respect to water supply, waste disposal, road development, and the management and maintenance of these facilities.

We concluded that FHA Bulletin No. 3790 (444) should be issued as an FHA instruction and its contents strengthened by making mandatory, as a minimum, that no rural housing loans will be approved for construction in a subdivision or cluster housing area until: (1) an overall plan for community development has been submitted and approved; (2) enforceable covenants have been executed to assure an adequate water supply and sewage disposal system, to be tested and approved by local health authorities and/or to meet the minimum standards of the U.S. Public Health Service; and, where appropriate, arrangements have been made for the perpetual maintenance and management of the facilities; (3) enforceable covenants have been executed to assure completion of road development, including the dedication to and acceptance by local highway officials for perpetual maintenance; and (4) roads are brought to "all weather" conditions before delivery of homes to rural housing borrowers.

We further concluded that FHA should require certifications that subdivisions under construction and/or planned for development through rural housing loans are in eligible areas under current FHA instructions, and that proposed rural housing loans in these subdivisions will meet the objectives of the program and the intent of the law.

Loan packaging

6. There is a need for FHA to reevaluate use of the loan packaging concept to determine whether the advantages of continuing its use outweigh the disadvantages and risks involved. Our review of FHA activities disclosed that implementation of the loan packaging concept was not uniform. Implementation varied from nonuse, in some States, to abuse in others. In some States where the loan packaging concept has been implemented, there are indications that packagers may be usurping the authority of the county supervisor in administration of the rural housing program. Packagers in one State discouraged county supervisors from contacting "packaged applicants" or counseling them concerning style, size, design, cost, or other housing options open to them. We also found that some county supervisory personnel were not verifying the information furnished by the packagers. As a result, the intent of the loan packaging concept is being subverted, the authority of FHA is being usurped, loans are being made based on falsified applications, and borrowers are not always counseled as to the options open to them.

Exhibit A, attached, summarizes the results of audit and investigative findings disclosed in connection with our review. Set forth below are examples of irregularities in the use of loan packaging:

(*a*) *In El Paso, Tex.*, we reviewed applications and supporting documentation for 40 rural housing loans. Most of the applications had been prepared by packagers and signed by the applicants. About one-third of the applications failed to show where the applicant lived, whether he owned or rented his home, or whether the residence was adequate to his needs. We noted many alterations, erasures, and interdelineations in the sections covering assets, debts owed, salary, prior year's income, expenses, residence, employment, and other items which could affect the eligibility of the applicants. We also found that FHA personnel had not adequately verified the information on the applications to reasonably establish the borrowers' eligibility and need for housing. An investigation has been scheduled to determine, among other matters, whether applications received by this county office have been falsified in order to qualify applicants for loans.

(*b*) *In Modesto, Calif.*, in connection with an OIG investigation, we reviewed 21 applications submitted by one packager and found that 14 of these showed false rural addresses. Of these, 12 borrowers signed statements stating that the packager had asked them whether they had friends or relatives living in rural areas, and where they did, these rural addresses were inserted on the loan applications as the applicants' home addresses. This packager has been notified by FHA that no further applications will be accepted pending disposition of the OIG investigation.

(*c*) *In South Carolina*, loan packagers have usurped the authority of county supervisory personnel in administration of the Rural Housing Program. As the packaging system functions in South Carolina, FHA county supervisors are discouraged by packagers, and the FHA State office, from counseling or advising "packaged applicants" with respect to location, type, size, and design features of houses, and any other aspect of the loan that might interfere with the private business relationship between applicants and packagers. Packagers rarely handle more than one house style (usually manufactured) and can seldom offer a location in more than one subdivision. As a result, low-income, poorly educated applicants are sometimes placed in new housing that does not necessarily represent the most desirable location for a home and frequently does not meet their needs for housing in terms of style, size, design features, and/or cost.

We reviewed the FHA publication, "Packaging Applications for Rural Housing Loans," and FHA Instruction 444.1, Exhibit B, "Information Required to Package Applications for Section 502 Rural Housing Loans." These materials described the packaging concept, eligibility requirements, and information required of the packager concerning applicants and/or the housing to be built, purchased, or rehabilitated. The primary thrust of these materials appeared to be to facilitate the making of more loans. We concluded there was a need for FHA to reevaluate use of the packaging concept to determine whether the advantages of continuing its use outweigh the risks hereinabove cited.

Based on our review of the applications packaged by developers, and taking into consideration both the number and kinds of omissions and alterations on applications, we concluded that continued use of the packaging concept would require considerable strengthening to insure that all transactions are credible. Such strengthening should include, as a minimum:

(*a*) Certification by the packager that, to the best of his knowledge, the information contained on the applications is complete, true and correct, and that under oath he swears or affirms that he has not altered or caused to be inserted false and fraudulent information on the application in order to qualify the applicant for a loan.

(*b*) Certification by the applicant that, to the best of his knowledge, the information presented to the packager was complete, true and correct, and that under oath he swears or affirms that he has not entered nor caused to be entered false and fraudulent information on the application in order to qualify for an FHA loan.

FHA should verify, on a sampling basis, the information submitted by packagers to test its validity. Applicants, packagers, and FHA county office personnel should be put on notice through a printed addition to applicable forms that it is a criminal violation (18 United States Code 1001) to make false, fictitious, or fraudulent statements or representations in any matter within the jurisdiction of any Department or agency of the United States Government or make or use any false writing or document knowing the same to contain any false, fictitious, or fraudulent statement or entry, and that such violations are punishable by fines of not more than $10,000 or imprisonment for not more than 5 years, or both.

We also concluded that the FHA Administrator should assure compliance with the Agency's policy and guidelines on supervised credit vis-a-vis packaged applications so that county supervisory personnel perform the required counseling with packaged rural housing applicants regarding the availability of choices of size, design, location, developer, and type of construction.

Supervision and loan servicing

7. FHA's objective of providing supervised credit assistance is not being adequately met, and the interests of the Government and FHA borrowers, in some cases, are not being adequately protected. The primary thrust of FHA emphasis and efforts in recent years has been on loanmaking, to the detriment of supervision and loan servicing. Borrower progress has been adversely affected in many cases due to the lack of timely and effective supervision at the county office level. This has resulted because of inadequate identification of borrowers needing supervision and the type of supervisory assistance required. Other contributing factors include: (1) ineffective or nonexistent delinquent and problem case reviews; (2) ineffective or nonexistent graduation reviews; and, (3) lack of time by county supervisory personnel to provide effective supervision and loan servicing and stay abreast of loanmaking activities. The lack of effective supervision has contributed to the continuing or increased delinquency of some borrowers. It has also resulted in the extension and continuation of low interest loans to borrowers who could obtain their credit needs from other sources. Additionally, it has resulted in inadequate security servicing and declining protection of the interests of the Government and borrowers.

FHA loans are designed to assist borrowers to attain specific objectives. The primary objectives of supervised credit are to assist borrowers in: (1) making profitable adjustments and improvements in their operations; (2) improving their standards of living; (3) obtaining safe, decent, and sanitary housing; (4) using assets, income, and credit wisely; (5) earning sufficient income for debt repayment to build equity in their property and pay current living expenses; (6) graduation to other credit sources within a reasonable period of time; and, (7) meeting responsibilities and duties to their community. The ultimate success of many borrowers depends upon a balanced combination of the right kinds and amounts of credit with effective supervisory assistance. Without this combination of supervision and credit, many borrowers will be unable to attain the objectives for which their loans were made.

Recent audits and investigations (see exhibit A attached) disclosed many deficiencies in the area of supervision and loan servicing. At 186 FHA county offices involving 34 States and Puerto Rico, we found deficiencies including such items as inadequate supervision and servicing of delinquent and problem case borrowers, insurance coverage deficiencies, and inadequate attention to borrower graduation. Set forth below are specific examples of deficiencies indicating a need for strengthening supervision and loan servicing:

(*a*) In 18 States, 38 cases of unauthorized disposition of mortgaged property are either scheduled for or are under investigation by OIG.

(*b*) In 11 States involving 27 FHA county offices, graduation reviews either were not performed or were performed in a perfunctory manner and were considered meaningless. In a New Jersey county, the 1968 and 1969 graduation reviews were not performed at all and, when performed in 1970, included a number of delinquent borrowers and were accomplished without participation by the county committee. In an Oklahoma county, we considered 16 borrowers eligible for graduation, but none had ever been requested to refinance his loan.

(*c*) In 7 States, at 21 county offices, the delinquency and problem case reviews were not sufficient to assure timely collection efforts and proper servicing of problem borrowers. In many instances where problem case reviews were performed, the recommended actions were never taken, and there was no follow-through by county supervisory personnel. In a New Jersey county, 132 borrowers were included in the 1969 review. Our reviews disclosed an additional 328 borrowers that should have been included in this review. A similar omission had occurred in 1968. Also, in the State of New Jersey, a significant number of active farm loan borrowers had discontinued farming and, in some cases, moved away from the farm. However, action has not been taken to refinance or otherwise liquidate these loans, and security servicing has been limited. Initial tests disclosed such borrowers had approximate unpaid balances of about $600,000, of which more than $183,000 was delinquent.

(*d*) In 15 States, at 25 county offices, funds were retained in supervised bank accounts (SBA's) for periods ranging from 6 to 85 months with little or no

county supervisory efforts to have the funds utilized. Other control weaknesses noted included failure to reconcile accounts, retention of inactive SBA balances for delinquent borrowers, and processing vouchers without clearing dormant SBA balances.

(*e*) In 9 States, at 15 county offices, management had not adhered to contract payment clauses, resulting in improper disbursements to contractors. Disbursements were made when work had not been performed, without completion of necessary inspections and/or for final payment when homes were incomplete or had obvious deficiencies in their construction.

(*f*) Other discrepancies disclosed include: (1) disbursal of loan funds prior to loan closing and/or prior to filing security instruments for record; (2) inadequate insurance coverage; (3) premature ordering of loan checks and/or the holding of loan checks in excess of prescribed time limits; (4) limited use made of the liquidated damage provisions in construction contracts and, where used, the contract terms provided only token damages; and (5) contractors building under the contract method without executing formal construction contracts with the borrowers.

We recognize that FHA, through publications and training meetings, has stated and restated the need for adequate loan supervision. However, implementation of this principle at the State and county office levels has been limited because the primary emphasis in recent years has been on loanmaking. We concluded that this emphasis, coupled with lack of time and sufficient staff to maintain a meaningful balance between supervision and loanmaking, has reached a critical point. We further concluded there is an urgent need for FHA to develop procedures at the field level to achieve a balanced program of loanmaking and loan servicing.

Employee conduct and activities

8. FHA monitoring of employee activities and financial interests needs strengthening to provide adequate controls for detecting and correcting possible conflicts of interest. Some FHA personnel, including county committeemen, are engaged in activities or have financial interests which give the appearance of, or could lead to, possible conflicts of interest. This has resulted because existing FHA controls in this area are not adequate to prevent and/or detect and correct situations that contribute to or may result in conflicts of interest.

In connection with recent audits and investigations (see exhibit A attached), at 50 locations, in 25 States, allegations of employee misconduct, including apparent conflicts of interest, were made. These allegations are scheduled for, or are currently under, investigation and include allegations of: (1) questionable business relationships between FHA personnel and building contractors; (2) FHA personnel conducting business with FHA borrowers; (3) nepotism; (4) financial or employment interests in concerns doing business through FHA; (5) FHA county committeemen selling real estate to borrowers, although they had participated in the loan certification for such borrowers; and, (6) kickbacks. Most of these situations could have been precluded had FHA top management been more aware of employee activities and interests.

Expressing his concern for conflicts of interest, the Secretary, in a letter to agency heads dated January 18, 1971, said in part:

"There are few things which can so shake public confidence in the integrity of Government employees as a situation in which the private interests of a Government employee conflict, or appear to conflict, with his official duties and responsibilities. The mere existence of such a situation, regardless of whether or not it has resulted in any actual wrongdoing, has the potential to cause serious embarrassment and damage, not only to the particular Department or agency concerned, but also to the Government as a whole."

In addition, in 1969, a task force of representatives from the Department of Agriculture was set up to study its procedures and practices in the conflict of interest area and determine where and how they could be improved. The committee determined the need to impress on all the necessity for: (1) an appreciation of the importance and sensitivity of the conflict-of-interest question; and, (2) direct involvement on the part of high-level officials. The Department's regulations on employee responsibility and conduct, which include the regulatory provisions dealing with conflict of interest, were subsequently revised and reissued. The primary substantive changes were intended to clarify procedures for dealing with the conflict-of-interest problem.

The foregoing is indicative of the interest and priorities placed on eliminating conflicts of interest and maintaining the high standards of integrity expected of USDA officials and employees. Therefore, the prevention and timely resolution

of conflict-of-interest situations is an integral part of an agency mission, and requires the personal attention of responsible agency officials.

Current agency guidelines do not require nor provide for: (1) reports on financial interests and/or other employment from some FHA personnel, including all county committeemen; (2) annual counseling sessions to discuss conflict-of-interest situations and the penalties for violations; or, (3) procedures designed to timely inform employees of prohibited activities and/or interests, or to timely detect possible conflicts.

In view of the interest of the Secretary and other departmental officials, and of the inherent dangers in a program which involves profit-motivated contractors and others, FHA should have more stringent controls to assure compliance with conflict-of-interest statutes and departmental guidelines.

Matters which exemplify the need for additional controls follow:

(*a*) An FHA county committeewoman participated in the certification of applicants to receive rural housing loans. These loans were made to purchase building lots from the committeewoman and her husband, and to construct homes through a company owned by her husband. She said that prohibited activities had never been discussed with her, and she was unaware of any prohibitions against the matters in which she was involved. The case cited has been referred to the Federal Bureau of Investigation for review and possible investigation.

(*b*) Another matter investigated by OIG disclosed that an assistant county supervisor obtained personal loans from FHA borrowers, FHA county committeemen, contractors, FHA employees or their spouses, as well as from various commercial firms. Eight FHA borrowers and one county committeeman claimed they had not been repaid. Also, two contractors and two FHA employees claimed they had not recovered their loans. The investigation disclosed that the subject accepted gifts including turkeys, shrimp, and oysters from contractors and borrowers. He also admitted accepting "kickbacks" from two contractors. The subject claimed that the receipt of gifts, according to local FHA policy, was an acceptable practice. The county supervisor advised that employees in his office did accept gifts and it was left to the individual employee to decide what they may or may not accept. He stated that he was not aware of any FHA policy to the contrary.

After considering the instances cited hereinabove and reviewing current agency guidelines (FHA instructions 207.1 through 207.5), we concluded the guidelines were inadequate to provide management needed controls for monitoring employee conduct, activities, and financial interests.

We further concluded that existing guidelines should be clarified to provide for reviews designed to assure that actual or potential conflict situations are precluded. As a minimum, the guidelines should: (1) require all State and county office personnel and county committeemen to annually file forms AD-392, Statement of Financial Interests and Outside Employment, or forms AD-392-A, Statement of Employment and Financial Interests, with the national office; (2) establish internal review functions for AD-392's and AD-392-A's at the national office level to insure the timely detection and resolution of potential conflict situations; (3) provide for counseling sessions concerning prohibited activities and outside employment with all newly hired county office employees or newly appointed county committeemen, which should include written certification both by the employee and the supervisor that the session has been held and that the employee understands the conflict-of-interest prohibitions; and, (4) provide for individual annual reviews between supervisors and all subordinates and FHA county committeemen of the conflict-of-interest provisions, and secure written certification that reviews were held and the employees understand their responsibilities in conflict-of-interest areas.

Interagency coordination

9. A lack of effective coordination between FHA, the Department of Labor (DL), and the Office of Economic Opportunity (OEO) resulted in the misuse of FHA loan funds and/or OEO/DL moneys at the expense of low income FHA borrowers. An investigation conducted in 1969 disclosed serious irregularities in the administration of a self-help housing program in Fort Myers, Fla. Current guidelines do not adequately cover situations in which members of OEO-financed nonprofit corporations obtain FHA rural housing loans. Thus, appropriate controls and interagency agreements are needed to check unscrupulous profiteering in a program which involves funding from two or more Federal agencies.

Current FHA instructions provide in part for a written agreement between the "participating agencies," in which respective responsibilities are clearly defined. However, these instructions and the attendant suggested form of agreement, do not adequately cover situations involving groups funded by OEO and/or other agency grants.

Examples that point up the need for additional controls are as follows:

(*a*) Southwest Florida Self-Help Housing, Inc. (SW), a nonprofit organization, was established to assist low income families in the construction of new homes. SW obtained an OEO grant to fund payrolls and other expenses. SW representatives agreed to organize and technically assist small groups of FHA borrowers who, in turn, would furnish basic labor to construct their own housing. The executive director of SW, with the agreement of FHA State office officials, collected $85 from each of 136 borrowers to pay for the purported rental of construction tools furnished the borrowers by SW construction supervisors. However, it was determined that the OEO grant to SW included funds for the purchase of all tools and equipment. FHA State and county officials said they would not have authorized use of FHA loan funds for tool rental fees if they had known about the OEO funds. This situation could have been prevented through appropriate interagency coordination at national, State, and county levels.

There were additional indications that windfall profits accrued to SW employees and others as a result of poor supervision and control by FHA. More than $35,000 was disbursed from 104 borrower accounts and deposited in a special SW bank account to cover plumbing costs. The actual cost of plumbing in individual homes was less than the amount paid by the borrowers from FHA loan funds, and some profit had apparently accrued to the account. Moreover, funds were disbursed from the account to the SW executive director and the chief construction supervisor for labor which was purportedly performed in connection with the assembly of plastic plumbing kits, although both were full-time salaried employees of SW.

The OEO grant to SW included moneys for a revolving fund to purchase land for resale to participants. SW purchased land which was subsequently resold at higher prices to Self-Help participants. However, all funds from the sale of lots to the FHA borrowers were not used for improvements. In addition, SW paid for road construction that directly benefited property owned by the SW chief construction supervisor's father who, in turn, sold four lots to Self-Help participants at approximately 100 percent profit.

(*b*) FHA made loans to borrowers in Virginia to purchase homes constructed by Tri-County Housing, Inc. (TCH), an OEO-funded nonprofit corporation. Local builders recently complained through congressional representatives that TCH was building homes and selling them to FHA borrowers at full market value, despite the fact that TCH received U.S. Department of Labor (DL) grants to train construction employees, as well as OEO funds for administrative expenses. While the contractors were concerned primarily with unfair competition, there were no adequate safeguards to assure that the low to moderate income FHA borrowers benefited from the Federal subsidies.

By memorandum dated November 25, 1970, the Virginia FHA State office advised all county supervisors that rural housing loans should be limited to the "cost of materials and hired skilled labor," and should not include funds "to pay an organization for labor contributed under a work training program or any other operational costs paid for by a Federal program." The Administrator of FHA reiterated this policy in a letter to Congressman William C. Wampler of Virginia, dated October 20, 1970, adding in part: "For this reason, we have not financed housing constructed by the Tri-County organization. . . . Further, we have always limited loans of this type to families who could not afford to obtain adequate housing any other way."

Our inquiries disclosed that several FHA loans had, in fact, been made to borrowers who purchased TCH homes. In addition, the county supervisor said TCH would not provide a breakdown of construction costs, and he was unable to determine whether any Federal funds were used to pay labor or other costs included in the sale price of a TCH house. He also remarked that there was a desperate need for additional guidance from the FHA national office in this area.

Additional problems can be anticipated unless positive action is taken by FHA. Therefore, we recommend prompt negotiation of formal agreements with OEO and Labor, at the national level, to assure at a minimum that: (1) FHA at the local level is fully apprised of the nature and extent of Federal subsidies to all nonprofit construction firms or Self-Help organizations where FHA rural

housing loans are involved; (2) pertinent records are maintained by subsidized firms and made available to authorized USDA representatives, where FHA loans are also involved; (3) FHA loans for houses constructed by such firms or groups do not overlap any other Federal subsidies; and (4) any savings realized as a result of Federal subsidies are in fact passed on to the FHA borrowers.

In addition, FHA should expand existing guidelines to cover rural housing loans for houses constructed by both federally subsidized construction firms and Self-Help organizations. These guidelines should also include a revised, enforceable form of agreement, to be approved by Office of General Counsel, which will require full disclosure of all Federal subsidies, their intended use, and a statement of respective responsibilities of the local participating parties. Use of this form of agreement should be a mandatory prerequisite for loan approvals by FHA.

NATHANIEL E. KOSSACK,
Inspector General.

NARRATIVE SUMMARY

FHA PHASE II AUDIT AND INVESTIGATIVE FINDINGS, ALL REGIONS

This narrative summarizes both audit results of 252 county FHA offices in 35 States and Puerto Rico, and the results of certain investigations related to the objectives of phase II. The audits were performed between September 1970 and May 1971. The audit reports contained a total of 1,319 formal findings, 309 memo matters, eight recommendations to the FHA Administrator, 105 recommendations to FHA State directors, and 1,543 recommendations to the District or county office level. During the audits, 10,271 borrower casefiles were reviewed, and 2,704 borrowers were interviewed by audit and/or special agent personnel. The audit emphasis was directed at detecting program irregularities and management weaknesses in the rural housing and related loan programs. Our reviews disclosed:

I. INELIGIBLE RURAL HOUSING LOANS

A. *Ineligible Applicants.*—In 155 counties in 32 States and Pureto Rico, we reported 729 ineligible loans totaling $10,800,000. These loans were determined to be ineligible due to excessive incomes, urban residency without rural employment or rural land ownership, and adequate housing owned by applicants prior to FHA loan approval.

B. *Rural Housing Loans in Urban Areas.*—Our audits disclosed that FHA had financed a minimum of 695 homes in 37 different counties in 16 States (California, Colorado, Kansas, Kentucky, Missouri, New Jersey, New Mexico, Oklahoma, Pennsylvania, South Dakota, Texas, Utah, Virginia, West Virginia, Washington, and Wisconsin) that were located in or near urban centers and exceeded the population limitations for eligible FHA loans. These 695 loans totaled $10,200,000. Our findings in this area ranged from two such loans at Moundsville, W.Va., totaling $27,500, to 165 loans at Cumberland County (Bridgeton), N.J., totaling $2.5 million.

Summary: In total, we disclosed 1,424 ineligible rural housing lonas totaling $21,000,000, and accounting for 13.8 percent of all borrowers sampled during our audits.

II. SUBDIVISION PLANNING AND DEVELOPMENT

In 62 different subdivisions in 14 different States (Alabama, Arkansas, Florida, Georgia, Indiana, Kentucky, Maryland, Missouri, North Carolina, South Carolina, Tennessee, Texas, Washington, and Wisconsin), we found inadequacies in subdivision planning and development involving rural housing loans. These included inadequacies in water systems, sewage/septic systems, and/or road development.

III. LOAN PACKAGING

Our reviews in nine States (California, Kansas, Missouri, Oklahoma, Pennsylvania, South Carolina, Texas, Virginia, and Washington) indicated that irregularities in the handling of the "packaging concept" range from total nonuse to gross abuse. Where the concept has been implemented, there are indications that some "packagers" may be usurping the authority of the county supervisor in the administration of the rural housing program. These irregularities include indications that packagers are not always providing applications reflecting the applicant's true financial position and, in some cases, there are indications

that this condition occurred knowingly on the part of both the applicant and the packager. Also, some county supervisors were not verifying the information furnished by the packagers, and in many offices the packaging concept had not been used at all.

IV. INADEQUATE INVESTIGATION OF APPLICANTS

We found that, in 123 different counties in 23 States, FHA was not adequately investigating the income, employment, repayment ability, residency, need for housing, and character of the rural housing applicants who were receiving loans. We concluded that the eligibility of all such applicants was questionable due to the lack of verification of incomes, etc.

V. INTEREST CREDIT

In 25 States, at 98 county offices, the intent of the interest credit provisions of the rural housing program was misunderstood, abused in some cases, and/or was not properly administered. We found that inconsistent interpretation of instructions resulted in some families receiving interest credits while other families, under like conditions, did not.

We found that, in some cases, applicants with incomes in excess of the permitted maximum of $7,000 were granted interest credit, that applicants were granted interest credit without verification of income, and that computations were often erroneous.

VI. RURAL RENTAL HOUSING AND OTHER ASSOCIATION LOAN PROBLEMS AND/OR DEFICIENCIES

In 18 States (Alabama, Arkansas, California, Colorado, Florida, Kansas, Kentucky, Massachusetts, Minnesota, Missouri, New Jersey, North Carolina, Oklahoma, Pennsylvania, Tennessee, Texas, Virginia, and West Virginia), at 42 different county offices, a variety of deficiencies or problems in rural rental housing and association loans were disclosed. Some of these included:

A. Rural rental housing.—Rental rates were found to be in excess of the amount specified in the loan agreement, ineligible tenants were occupying some of the units, in one case loan funds were not properly accounted for, borrowers were ineligible for the loans they received due to ability to obtain satisfactory credit elsewhere and, in one case, a borrower withdrew the proceeds from the reserve account for investment in his construction company.

B. Association loans.—An EO cooperative loan was not meeting the intended purposes of the loan and, due to inadequate supervision by FHA, irregularities have developed that include possible theft of funds, nepotism, forgery, and nonadherence to bylaws.

In other association loans, we found possible misuse of loan proceeds, absence of required annual audits of association books, inadequate inurance coverage, loan closing conditions not being met, and loans closed before the required membership had been obtained.

VII. CONSTRUCTION OR INSPECTION DEFECTS/IRREGULARITIES

In 26 States and Puerto Rico, at 108 county offices, we found that a significant number of construction defects and/or inspection irregularities existed. These included:

A. Puerto Rico.—Construction of a house was not performed in accordance with plans. As a result, after 90 percent completion, the house collapsed and was destroyed.

B. South Carolina.—In one county, numerous construction defects were noted in FHA-financed "stick" built houses. These involved sagging, buckling roofs, and walls pulling apart. These defects were found in homes built by two contractors who have built 70 FHA-financed homes with an FHA loan investment of about $980,000 in the houses alone.

In another county, six prefabricated houses built by one builder in two subdivisions, and representing an FHA investment of about $70,800, were found by our observations to be "deplorable" in terms of quality of construction. Some of these defects were bricks not plumbed, walls wandering in and out, roofs sagging, ceilings separated from walls, cabinet doors warped, rooms not square, foundation not even, foundation too small for the house, and many others. We questioned the adequacy of the wiring, plumbing, and equipment without the inspection by qualified and impartial engineers and subcontractors.

In addition, we found that, in numerous States and counties, inspections had not been performed, had been done too late, inspections were not done prior to releasing partial payments to contractors, no followup had been taken on construction defects noted in previous inspections, known defects were not reported on inspection records, and needed repairs were not made within a reasonable period.

VIII. DISBURSEMENTS TO CONTRACTORS

In 22 States, at 61 county offices, we disclosed problems concerning the disbursement of loan funds to contractors engaged in rural housing construction. Some of these included payments to contractors that were in excess of the work in place as indicated by development inspections on file, or final payments made prior to the date of final inspection by county office personnel. We also noted that errors had been made in the computation of payments due, payments were made for modular homes when units were delivered to the site, one contractor received partial payment at loan closing before any work had been started, and release of claimant forms had not been obtained by contractors from parties furnishing labor and materials. In two States, we noted instances where mechanic's liens were filed against borrowers for materials and labor furnished contractors who had not paid for the goods or services. We also noted instances where contractors did not complete planned development work for which loan funds had already been disbursed.

IX. SEWAGE DISPOSAL SYSTEMS

A. Community systems

Pennsylvania

1. Lack of initial planning and involvement of FHA caused the need for a subsequent loan of $250,000 for rock excavation. Lack of adequate inspections resulted in construction on the wrong property and permitted leaks and breaks in the system. Storm runoffs necessitated the recent removal of 3,000 gallons of mud from the treatment plant. It appears that user rental fees are not sufficient to meet loan repayment requirements. This matter has been referred for investigation to determine the propriety of the engineer's work.

2. A $268,300 loan was made in November 1970, to construct an 18-unit rural rental housing project in an area without an acceptable sewage system, as approved by the State department of heatlh. FHA personel and the project architect advised that raw sewage from the rural rental housing unit would dump into a river. The FHA planned to coordinate a sewage loan and grant to the local municipality to alleviate the discharge of raw sewage into the river. However, the sewage loan has not materialized due to bids exceeding the estimated cost, but it is estimated that the rural rental housing unit will be ready for occupancy by July 1971.

3. Raw sewage from 13 rural housing units and an 8-unit rural rental housing project was being pumped into an open, unprotected lagoon within 75 yards of the housing involved. State health officials issued warnings to the contractor about this violation in 1969, but no corrective action was taken to date. FHA officials were unaware of this situation, even though their representatives had made about 100 visits to the site since 1969. FHA loans have been made in this area totaling $297,000 to date. In the same period of time, the Federal Housing Administration declined to finance homes in this area due to inadequate sewage treatment facilities.

North Carolina

FHA has financed rural housing dwellings in a subdivision where a contractor-owned sewage system did not comply with State and local laws. As a result, FHA borrower homes were connected to sewer lines that emptied into an open catch basin.

Florida

Raw sewage running in the streets and backing up in commodes was the result of FHA financing homes in a subdivision whose contractor-owned sewage system was not functioning. Local health authorities had not approved and/or issued permits for this system.

B. Individual systems

In 17 States (Arkansas, California, Illinois, Indiana, Kansas, Kentucky, Louisiana, Michigan, Missouri, New Mexico, South Carolina, Tennessee, Texas, Vir-

ginia, West Virginia, Washington, and Wisconsin), at 55 different county office locations, numerous problems were noted in individual septic tank/sewage disposal systems. These included such things as overflowing, backing up of sewage into commodes and bathtubs, unpleasant odors caused by raw sewage standing on the surface of the ground or in open "seeps" in the soil, contamination of water supplies, and real or potential health problems. In one subdivision in Kentucky, rural housing loans totaling $455,000 had been disbursed, although sewage lines were not connected to a treatment plant and the sewage from these houses had been deposited on the ground or had drained into the Ohio River.

In Kansas and Missouri, 55 of 280 borrowers interviewed by OIG had problems of various kinds in their septic systems.

In New Mexico, six-FHA-financed homes were contributing to the pollution of a public waterway through their sewage discharges.

In Arkansas, Virginia, and Texas, OIG obtained water tests to determine whether or not sewage from inadequate systems at rural housing homes was contaminating water supplies. All tests indicated positive contamination of the water by coliform bacteria.

X. WATER SYSTEMS

A. Community systems

Oklahoma

An FHA-financed water system with an original 141 metered users has dropped to 70 metered users due to a high content of iron in the water. The loan is delinquent.

Pennsylvania

1. A municipal water authority is no longer using the water source developed by an FHA loan of $215,000 due to pollution, apparently caused by a nearby mining operation. There are also indications that this water supply was polluted before FHA loan approval. This matter is under investigation.

2. Municipal water authority officials at another county in Pennsylvania fear contamination of their FHA-financed water supply due to a strip mining operation in the area. This water authority loan is also delinquent, due to lack of sufficient users to meet expenses.

B. Individual systems

At 19 counties, in 11 States (Alabama, Arkansas, Florida, Kansas, Maryland, Missouri, Mississippi, North Carolina, Oklahoma, Tennessee, and Texas), our reviews disclosed a variety of deficiencies in individual water systems serving FHA-financed rural housing homes. These deficiencies included water that was either contaminated with coliform bacteria, discolored and with a high mineral content making it unfit for either human consumption or irrigation, or that originated from a source providing insufficient quantities. We also found in some counties that water systems were not properly located in relation to septic tanks, in accordance with State laws, and which have or may become contaminated as a result. In one county in Maryland, we found that, although State law required testing of the water supply, only 23 of 128 rural housing loans had met that requirement.

XI. APPRAISAL PROBLEMS

In 20 States, at 38 county offices, appraisal deficiencies were noted, including improper use of comparable sales data, inflated appraisals, and required appraisals not performed on some FHA rural housing loans.

XII. LOAN CHECKS

In 16 States, at 42 county office locations, we found that loan checks were being ordered prior to the receipt of a preliminary title opinion, indicating that loan closing could actually take place, or that county offices were holding checks in excess of the 21-day limitation.

XIII. SUPERVISION AND LOAN SERVICING

Our audits disclosed 329 instances of supervisory deficiencies involving more than 20 areas of program responsibility at 186 locations in 34 States and Puerto Rico. These included such things as inadequate supervision and servicing of delinquent and problem case borrowers, insurance coverage deficiencies, and inadequate attention to borrower graduation.

XIV. SUPERVISED BANK ACCOUNTS (SBA'S)

In 28 States, at 80 county offices, insufficient controls were exercised over SBA's. Numerous dormant accounts were noted which had been open for periods extending as high as 84 months, while at the same time, in one county office we noted 14 cases where loan funds had been deposited and disbursed within the same day. In some offices, we noted that borrowers were not given a choice of the bank to be used for their SBA's. In at least one office, complaints had originated from other banks concerning this practice.

XV. EMPLOYEE MISCONDUCT AND/OR APPARENT CONFLICTS OF INTEREST

At 50 different locations in 25 States, we disclosed allegations of employee misconduct, including apparent conflicts of interest. These included improper business relationships between employees/committeemen and borrowers, nepotism. kickbacks, and bribery.

Appendix 3.—Farmers Home Administration Action on Recommendations of the Inspector General and the General Accounting Office

We consider the recommendations of the GAO report and the IG report to be significant. We have no substantive disagreement with the suggestions and have taken action to place them into effect. The four recommendations of the GAO report B-171630, December 29, 1972, and FmHA actions resulting therefrom are provided in exhibit A.

With respect to the 16 recommendations of the IG, they are listed below and are followed by the actions FmHA has taken or is in the process of placing into effect:

RECOMMENDATION 1

Make organizational changes which, as a minimum, provide for: (a) a Deputy Administrator for State and county office operations with responsibility for and authority to control State and county office operations, and (b) designating a person on the staff of each FHA State director with responsibility for and authority to control county office operations. (See details—1.)

FmHA response

An organization proposal has been prepared. However, because of additional organization realinements a new organizational proposal is being prepared for submission in the near future to the Office of the Secretary. It is expected that the submitted proposal will be approved. With regard to part (b) of this recommendation, we believe a separate position on the State staff will not be necessary because of actions taken under No. 2 below.

RECOMMENDATION 2

Effect controls designed to more effectively exercise line authority over State and county office operations to assure that policy, procedures, and program objectives are clearly understood and uniformly accomplished.

FmHA response

We have established an internal review staff, headquartered in Washington, to provide coordinated FHA National Office review and supervision of operations at the State and local levels. This review is in addition to regular technical and administrative reviews of State and county operations. One of the functions of this staff is the collection and analysis of information developed in OIG, GAO and internal agency reviews of its operation. In addition, the agency recently has developed a field operations review guide, which is a comprehensive questionnaire which will be completed for each county office by the district supervisor at least once each year and will insure a documented, comprehensive review. Findings resulting from these county office reviews will be reported to the State office level and will be available for consideration by the national office in planning national office reviews of problem areas.

RECOMMENDATION 3

Adopt and implement a career development plan, and expand staffing, both in numbers and technical capabilities, to strengthen program administration and implementation.

FmHA response

A career development system which allows for the progressive movement of employees through the ranks concurrent with the acquisition of knowledge in the various aspects of the respective loan programs is essential in the FmHA. Career ladders are defined within the county and State offices as well as in the national and finance office. To increase our efforts in the development of em-

ployees, FmHA established during fiscal year 1973, six career development positions in the national office, two positions are allotted to each of the major loan programs namely: Rural housing; farmer programs and community services. These positions provide for a 1-year rotational assignment of employees from the field to the national office. The program is designed to provide the participating employee with additional knowledge and skills while also providing the opportunity to gain broad, high-level working experience in the major loan program areas of the national office. During this tenure the employee may rotate for periods of time within and between the respective loan program divisions of the national office. Upon completion of their tours of duty the employee may be returned to the home State, assigned to another State, or retained in the national office.

RECOMMENDATION 4

Strengthen training efforts by developing and implementing an intensified training curriculum with staff specialists to provide training on a continuing basis and include courses for county supervisory personnel on appraisals, inspections, community and subdivision planning, standards for water and waste disposal systems, and asociation loan planning and processing.

FmHA response

The FmHA established in October 1972 a training center at the Unversity of Oklahoma, Norman, Okla. The training center offers a wide variety of technical, supervisory and administrative training courses and programs such as rural housing; rural housing training for architects and engineers; community program specialist (field); farm appraisal; real estate loan making and servicing; compliance review; supervisory development; and management development. Since its opening, October 1, 1972, and through fiscal year 1973, 40 separate, formal training courses or programs have been conducted. Approximately 1,150 FmHA employees have participated in the training courses offered. The schedule of the training courses and programs for fiscal year 1973 being offered at the Center will again be heavily oriented to the respective loan programs and related technical aspects of such programs as well as other related administrative and management areas. Some of the training courses and programs offered through the training center during fiscal year 1973 will be continued. New and special training courses and programs will be added as a result of new authorities being assigned to FmHA.

RECOMMENDATION 5

Develop and implement a system of review of program operations from which qualitative data will be obtained and used to evaluate the accomplishment of program objectives.

FmHA response

In addition to the actions described in recommendation 2 above, which cover systematic and regular review of county office operations by district supervisors, we are establishing regular procedures for reviewing fund analyses and for determining fund analysis data through field operations review (including reviews by the internal review staff out of the national office). The system contemplated in this recommendation will require onsite review by district and State personnel and by the new internal review staff. We expect, also, to utilize the resources of the finance office to summarize the results of these program reviews and to develop a system to provide the needed information. Information obtained through GAO, OIG and the internal review staff field reviews will be analyzed and reported to appropriate program officials in the national and State offices by the internal review staff, information analysis group.

We find the rural housing fund analysis another effective way of monitoring at the State level the loans approved by county supervisors, as well as of accumulating indepth data on the housing program. We are emphasizing the importance of recording reliable data on the fund analysis and expect that most of the shortcomings with respect to income and debts will be overcome by use of the verification of employment form and credit reports, which were introduced last year. We recognize that this statistical report must be supplemented with field visits, but we do believe the report has considerable potential for evaluation of the program. We are proposing to add an economist and an analyst to the National Office staff to work with our Finance Office to make more effective use of the information assembled on fund analysis and from other sources to help analyze and evaluate our operations at the national, State and county levels.

RECOMMENDATION 6

Establish priority criteria for processing rural housing loan applications to assist lower income families in obtaining adequate housing.

FmHA response

We are giving special attention to the needs of low-income families. On June 30, 1971, we issued Administration letter 68(444) requiring that at least 50 percent of section 502 RH loans will be made to low-income families. The families who are considered as low-income are those who (1) receive interest credit and (2) who do not receive interest credit but have adjusted family incomes of not more than the maximum specific amounts listed in the administration letter.

As of October 31, 1971, 48.8 percent of the families received interest credit and another 23.4 percent were low-income families who did not qualify for interest credit. In summary, 72.2 percent of the families who received initial 502 loans during the first quarter of 1972 fiscal year were low-income families.

The National Finance Office has worked with the Rural Housing Loan Division staff in developing a reporting system which will disclose monthly by county, district, and State what percentage of housing loans are going to low-income as compared with moderate-income families. In addition, the system will provide additional information semiannually, by State, for overall program management purposes.

RECOMMENDATION 7

Strengthen and expand existing training efforts to assure that State and county office personnel understand and adhere to program authorizations and objectives.

FmHA response

In addition to the training offered at the FmHA training center, State offices are carrying out and extending the training received to county supervisors and assistant county supervisors. Through a special instructor training course offered at the training center employees are taught how to identify training needs, develop training objectives, prepare and present teaching materials. Employees who have participated in the instructor training course also serve as potential instructors for the respective loan program course being conducted. This "multiplier" effort of training as well as the formal training offered through the training center has assisted in strengthening the understanding and adherence of State and county personnel in loan program authorizations, objectives and procedures. We will continually seek additional means not only to increase the quality and effectiveness of the training being carried out in the agency but assure a more uniform understanding, interpretation and application of policies, procedures, and practices.

RECOMMENDATION 8

Revise existing policy regarding FmHA county office grading structure to give additional weighted workload factors for loanmaking activities, such as interest credit, rural rental housing, self-help housing, and section 504 housing loans, all of which are designed to assist low-income families.

FmHA response

The current policy of FmHA regarding the grading of county office positions is to utilize the grade level criteria contained in the U.S. Civil Service Commission Position Classification Standards for the GS–475 and GS–1165 series to ascertain grade levels of these positions. The FmHA no longer uses weighted workload factors for grade level determination, because this method measured amount of work being performed rather than the difficulty and complexity of the work.

RECOMMENDATION 9

Issue FmHA bulletin No. 3790(444) as an FmHA instruction and strengthen its requirements covering water supply, sewage disposal systems, and road development.

FmHA response

FmHA bulletin No. 3790(444) was issued on November 23, 1970. Subsequently, on February 7, 1973, FmHA issued FHA instruction 424.5. This instruction canceled FHA bulletin No. 3790(444) and prescribes the policies, methods, and

responsibilities with respect to planning and performing site development work in connection with all types of loans and grants authorized by title V of the Housing Act of 1949. This instruction emphasizes procedure relative to subdivision approval and processing and provides for closer cooperation between the community services engineer, the soil conservation service, and our housing personnel in the processing of subdivisions.

RECOMMENDATION 10

Require certifications that subdivisions under construction and/or planned for development with rural housing loans are in eligible areas and that proposed rural housing loans will meet program objectives.

FmHA response

FHA instruction 424.5 outlines policy and procedure that will assure that subdivisions under construction or planned for development with rural housing loans are in eligible areas and will meet program objectives. County supervisors may approve subdivisions of 9 lots or less. Subdivisions with 10 or more lots must be approved by the State director and those with more than 25 sites utilizing individual utilities must have National Office review and acceptance.

RECOMMENDATION 11

Strengthen controls over the packaging of applications by requiring certifications, under oath, both by packagers and applicants that to the best of their knowledge and belief the information supplied on the application is true and correct, and that they have neither altered the applications nor caused to be entered any false or fraudulent information on the application in order to qualify the applicant for a loan.

FmHA response

We issued a new check sheet on July 11, 1971, for rural housing loan packages. This includes the following warning: "Section 1001 of title XVIII U.S.C. provides 'whoever in any manner within the jurisdiction of any Department agency of the United States makes any false, fictitious or fraudulent statements or representations or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry shall be fined not more than $10,000 or imprisoned for not more than 5 years or both.'" This, we believe, is adequate warning to the packager that the information must be correct and, together with the recently issued suspension and debarment procedures, should help assure accurate information.

RECOMMENDATION 12

Assure compliance with the agency's policy and guidelines on supervised credit vis-a-vis packaged applications so that county supervisory personnel perform the required counseling with packaged applicants concerning the availability of choices concerning size, design, location, developer, and type of construction.

FmHA response

The counseling function of the county supervisor is different, with respect to packaging of rural housing loan applications, from counseling when an applicant comes to the county office with a general request for a housing loan.

Our regulations and the packaging booklet itself provide that when a builder or realtor submits a proposal to build a home for an applicant, the county supervisor need not require competitive bidding when:

(*a*) The house is one we can appropriately finance.
(*b*) The house is cost competitive.
(*c*) The house is suitable for the family's needs.
(*d*) The house is one they can afford.
(*e*) The builder is reliable and competent.

If the proposed house is not suitable in size, design, or cost, additional negotiations or bids may be required, or the applicant needs to select a new house plan. The packaging approach is based on the assumption that a county supervisor will accept proposals submitted to him if they meet the above requirements.

Accordingly, it is not consistent with the packaging concept to suggest that county supervisors should, in all cases, encourage competitive bids or advise and counsel families whose applications are submitted by packagers, on choice of location, house styles, size and design features that are normally available to the independent applicant who walks into the county office.

RECOMMENDATION 13

Develop procedures at the field level to achieve a balanced program of making and servicing loans.

FmHA response by Mr. Frank Elliott, Acting Administrator, on July 17,1973

We are continually seeking new ways and making administrative adjustments to improve the efficiency of our operations utilizing resources of manpower and finances allocated to Farmers Home Administration.

The techniques to be used to increase efficiency through a better utilization of resources include making improvements in:

A. Systems and procedures.
B. Organizational reviews and training.
C. Better qualified personnel.

FmHA response previously submitted to OIG

In response to Audit Report No. 6171–2H, Mr. James V. Smith, Administrator, on January 13, 1972, stated:

We concur in the OIG conclusion that primary emphasis on loanmaking, coupled with a lack of time and insufficient staff to maintain a meaningful balance between supervision and loanmaking, has reached a critical stage. This is especially true in the Farmer Programs, where deficiencies in borrower supervision and loanmaking has a major effect on borrower progress and eventual success or failure of the family.

The need for an enlarged county staff and improved training emphasis is imperative if present programs are to be maintained at present levels or expanded, and the necessary balance is to be achieved. Assuming that the staff will not be substantially increased, we are studying the adoption of a "program specialist" system at the county level. This will permit recruitment and training of personnel to be geared to the working needs of the county staff and permit the establishment of meaningful priorities and goals by county, State and national administrative levels. Program specialists would not be limited to one county office jurisdiction, but rather their assigned area would be tailored to the needs of the program as determined by the State director and his staff, based on well defined guidelines.

We feel specializations and improved training would improve the quality of both loanmaking and servicing and could assure that a more balanced program is achieved.

The audit report makes several statements concerning the lack of effective supervision and loan servicing. We feel that our State and county office personnel have done a commendable job in this area, especially when we take into consideration the program expansion that has taken place during the last few years, and compare this with the limited increase in the number of personnel. We agree, however, that additional emphasis needs to be placed on supervision and servicing. To do an outstanding job, we need additional personnel, as recognized in the audit report. However, without waiting for the additional personnel, we are now in the process of completely revising our supervision and servicing instructions for association loans, so that additional emphasis and detailed instructions will be available to guide State and county office personnel.

RECOMMENDATION 14

Clarify existing guidelines covering employee conduct and activities by providing for controls and reviews to assure that actual or potential conflicts of interest are precluded.

FmHA response

The FmHA orientation training program for new employees specifically refers to the employee conduct instructions, and conflict between personal interests and official duties. Semi-annual reminders concerning standards of conduct and conflicts of interest are sent to employees. In addition, periodic reminders in FmHA bulletins regarding specific conflict of interest situations and employee conduct are sent to all employees. Also, the State director's guide in personnel management requires the annual discussion and certification of personnel management items, including employee conduct and conflict of interest.

At the present time, county personnel are not required to submit conflict of interest statements (AD–392). We do require statements from State directors, all State office employees at GS–13 and above, GS–12 program chiefs, and State committeemen.

RECOMMENDATION 15

Negotiate formal agreements with the Office of Economic Opportunity-funded organizations and the Department of Labor covering jointly funded projects where FmHA rural housing loans are involved.

FmHA response

We have discussed with the officials of the Department of Labor our position with respect to not making loans to reimburse organizations for grants they may have received from another source. Department of Labor officials indicate full agreement with this position. A written statement to this effect has been sent to the Department of Labor with a request that it be executed by an appropriate official and returned to us. We are now working to reach a similar understanding with the Office of Economic Opportunity.

Discussions with both the Department of Labor and Office of Economic Opportunity indicate that any benefits accruing from trainees helping build the homes of families to whom FmHA makes RH loans should accrue to the families. Since this is not an issue, formal agreements between OEO, DOL, and USDA do not seem to be necessary.

By way of background, in July 1971, members of FmHA discussed the possibility of an agreement between FmHA and DOL officials. Shortly after the discussions were opened, the legal staff for DOL questioned the propriety of using manpower trainees on private property. This question was not resolved until June 1972 when a favorable decision was issued by DOL attorneys. Recently, we have been involved in discussions with DOL and OEO on a proposed housing subsidy demonstration program that would enable mainstream trainees to build houses for low-income families. In this project proposal DOL, OEO, and FmHA understand all cost savings from the use of trainees will accrue directly to the families involved.

RECOMMENDATION 16

Revise existing guidelines covering RH loans for homes constructed by federally subsidized construction firms and self-help organizations to require disclosure of the nature and amount of all Federal subsidies, their intended use, responsibilities of all parties to the agreement, and to make such disclosures a prerequisite to loan approval.

FmHA response

We now require individual agreements for each self-help project. In order to avoid any possible misunderstanding on the questions raised by OIG, we intend, when the appropriate rural housing regulations are next revised, to include statements to the effect that benefits of any federally subsidized construction assistance must accrue directly to the families receiving loans from the Farmers Home Administration and require firm understandings as to the responsibilities and financial inputs of any other agencies involved.

Exhibit A

USDA Statement of Actions Taken on Recommendations in GAO Report B-171630, Dated Dec. 29, 1972, Entitled "Opportunities To Improve Effectiveness and Reduce Costs of Homeownership Assistance Programs"

GAO RECOMMENDATIONS

"We recommend that the Secretary of HUD and the Secretary of Agriculture insure that resources under sections 235 and 502 programs are allocated primarily in proportion to needs. We also recommend that the Secretary of Agriculture require separate allocations of the subsidized and unsubsidized housing loans according to needs."

The Farmers Home Administration allocation of rural housing funds made to States takes into consideration the number of occupied rural homes, condition of homes, incomes of rural families, average cost of new homes, and historic lending patterns. Our evaluation is that the FHA has distributed funds to States in accordance with effective demand. An evaluation of the effectiveness of the method used to distribute loan funds should be measured against factors other than the distribution of rural population. We recognize, for example, that the condition of housing varies widely by States. Other important considerations are population growth, employment opportunities, and income levels which differ sig-

nificantly among States. The rural housing program has been greater in those States which have had a significant growth in industries that offer employment opportunities to rural families.

Prior to the temporary discontinuance of subsidized housing on January 8, 1973, FHA had directed its field staff to use at least 50 percent of its housing allocation for low-income families. As a result of this action, substantially more than 50 percent of the families receiving homeownership loans during the past year were in the low-income category.

GAO RECOMMENDATIONS

"We recommend that the Secretaries of HUD and Agriculture require that all houses be reinspected within 1 year after purchases to insure that defects covered by builder service policies and sellers' certifications have been identified and corrected.

"We also recommend that the Secretary of Agriculture establish procedures or seek legislation, if necessary, to insure that USDA and/or the purchasers of existing housing under section 502 have recourse to the sellers to cover the costs of repairing defects that existed at the time of sale."

On September 29, 1972, the FHA notified its field staff to make inspections prior to expiration of the warranty period. This requirement has been included as a part of a comprehensive revision of FHA regulations pertaining to construction standards and inspection.

With respect to the buyer of used housing having recourse to the seller to defray the cost of repairing defects existing at time of sale, we have been advised by the Office of the General Counsel that existing State laws establish certain rights and duties governing the relationship between sellers and purchasers of previously occupied housing and that it would be unwise to establish an additional set of such rights and duties dealing with this relationship merely because the financing of the purchase is made through the Farmers Home Administration. In this connection, we have under consideration a legislative proposal, suggested by Farmers Home Administration, which would authorize it, as a last resort, to advance funds to correct any defects.

GAO RECOMMENDATIONS

"We recommend that the Secretaries of HUD and Agriculture: (1) clearly define the types of housing that will be made available under homeownership assistance programs in the various areas of the Nation; and (2) jointly determine what housing options are appropriate for the houses being provided in communities served by both departments."

In FHA the local community needs and borrower income limitations determine the type of homes and options available in each price range. FHA tries to maintain comparability with modest homes and options offered by private credit.

To insure uniformity, FHA recently issued a bulletin to all State directors advising them to clearly decline, within their States, the types of housing that may be built with subsidized housing loan funds.

The Department of Housing and Urban Development predominantly serves the urban housing market, while Farmers Home Administration services the rural United States. Comparable markets are limited to these areas surrounding large metropolitan centers. The Department intends to consider practical approaches toward developing mutually acceptable guidelines if the subsidized housing programs of HUD and USDA are reinstated.

GAO RECOMMENDATIONS

"We recommend that, to improve program effectiveness and reduce costs, the Secretaries of HUD and Agriculture require indepth studies to determine the major reasons for defaults and what can be done to minimize foreclosures. In addition, we recommend that such studies be used as a basis for developing guidelines for screening and counseling program applicants."

FHA has in effect special servicing requirements for delinquent and other problem cases. These provide for a case-by-case evaluation of delinquencies and other types of problems. The delinquent borrower's financial or other problems are analyzed, the reasons for the delinquency determined, and followup action decided upon. The results of these reviews are used to take corrective action on existing cases, evaluate applications at the local level, and to train others in loanmaking and servicing.

Appendix 4.—Losses to FHA From Abandonment of Property

For calendar year 1972 net loss to FmHA on sale of property taken into inventory by foreclosure or voluntary conveyance, amounted to $40,239.60 (see exhibit B).

A spot check of State housing chiefs indicates that about half of the property sold was abandoned property and that about 40 percent of the adandoned properties required some repair to restore the property for resale, with an average cost of approximately $450. Estimated cost for restoration of abandoned properties in 1972 is $100,000.

Not all of this $100,000 is loss since it is capitalized into the value of the property that is considered for resale to other eligible borrowers.

EXHIBIT B

U.S. DEPARTMENT OF AGRICULTURE, FARMERS HOME ADMINISTRATION, FINANCE OFFICE—REPORT ON PROFIT AND LOSS FROM SALE OF ACQUIRED PROPERTY, DIRECT AND INSURED RURAL HOUSING LOANS, JAN. 1, 1973

State and type of liquidation	Inventory beginning of year		Activity for the year					Inventory end of year	
			Property acquired		Property sold				
	Number on hand	Acres [1]	Number acquired	Acres acquired [1]	Number sold	Acres sold [1]	Profit or loss (—)	Number on hand [2]	Acres [1]
Alabama:									
Foreclosure	17		74		36		$8,439.87	55	
Voluntary conveyance	20		136		86		13,083.04	70	
Arizona:									
Foreclosure	1		2		1		−2,000.00	2	
Voluntary conveyance			1					1	
Arkansas:									
Foreclosure	1		4		1		356.14	4	
Voluntary conveyance	3		15		5			13	
California:									
Foreclosure	19		11		18		−1,870.23	12	
Voluntary conveyance	9		13		10		−3,763.80	12	
Colorado:									
Foreclosure	7		6		3		−7,335.85	10	
Voluntary conveyance	16		27		30		−57,236.31	13	
Connecticut:									
Foreclosure			5		1		3.05	4	
Voluntary conveyance			1					1	
Delaware:									
Foreclosure	1				1		−3,000.00		
Voluntary conveyance			2					2	
Florida:									
Foreclosure	9				9		2,741.62		
Voluntary conveyance			10		4		102.46	6	
Georgia:									
Foreclosure	14		39		21		−1,372.55	32	
Voluntary conveyance			39		9		−118.26	30	
Idaho:									
Foreclosure	2				2		−1,500.00		
Voluntary conveyance	4		11		9		−4,620.00	6	
Illinois:									
Foreclosure	2		5					7	
Voluntary conveyance	13		56		39		−3,381.96	30	
Indiana:									
Foreclosure	8		5		8		−12,099.71	5	
Voluntary conveyance	53		216		131		23,437.78	139	

See footnotes at end of table.

EXHIBIT B

U.S. DEPARTMENT OF AGRICULTURE, FARMERS HOME ADMINISTATION, FINANCE OFFICE—REPORT ON PROFIT AND LOSS FROM SALE OF ACQUIRED PROPERTY, DIRECT AND INSURED RURAL HOUSING LOANS, JAN. 1, 1973—Continued

State and type of liquidation	Inventory beginning of year		Activity for the year					Inventory end of year	
			Property acquired		Property sold				
	Number on hand	Acres [1]	Number acquired	Acres acquired [1]	Number sold	Acres sold [1]	Profit or loss (−)	Number on hand [2]	Acres [1]
Iowa:									
Foreclosure	1		5		3		−$489.00	3	
Voluntary conveyance	2		30		20		−15,177.85	12	
Kansas:									
Foreclosure	5				3		732.00	2	
Voluntary conveyance	1		1		2				
Kentucky: Foreclosure			1					1	
Louisiana:									
Foreclosure	12		1		8		−8,163.00	5	
Voluntary conveyance			1		1		226.73		
Maine:									
Foreclosure	6		10		7		−3,078.59	9	
Voluntary conveyance	9		20		18		−9,547.22	11	
Maryland:									
Foreclosure			2		1			1	
Voluntary conveyance			2					2	
Massachusetts: Voluntary conveyance			3		1			2	
Michigan:									
Foreclosure	3		3		2		−2,500.00	4	
Voluntary conveyance	2		17		12		−3,980.40	7	
Minnesota:									
Foreclosure	2		4		1		240.00	5	
Voluntary conveyance	1		6		6		−3,507.60	1	
Mississippi:									
Foreclosure	59		100		84		9,296.56	75	
Voluntary conveyance	13		56		42		242.56	27	
Missouri:									
Foreclosure	31		67		44		−9,998.12	54	
Voluntary conveyance	12		100		52		−4,749.06	60	
Montana: Voluntary conveyance			5		2		265.25	3	
Nebraska:									
Foreclosure	2		8		4		−5,635.00	6	
Voluntary conveyance	2		5		3		5,796.35	4	
New Hampshire:									
Foreclosure	3		3		2		4.00	4	
Voluntary conveyance	5		1		5		−492.00	1	
New Jersey:									
Foreclosure	8		7		10		2,014.45	5	
Voluntary conveyance	9		12		8		−12,811.67	11	
New Mexico:									
Foreclosure	1		1		1			1	
Voluntary conveyance	7		9		4		−2,635.27	12	

New York:					
Foreclosure	8	5	7	−7,450.00	6
Voluntary conveyance	22	52	37	−36,533.42	37
North Carolina:					
Foreclosure	5	48	31	1,201.00	22
Voluntary conveyance	1	16	8	238.74	9
North Dakota:					
Foreclosure	5	7	5	−3,300.00	7
Voluntary conveyance	4	18	11	−5,211.72	11
Ohio:					
Foreclosure		1			1
Voluntary conveyance		6	1	−700.00	5
Oklahoma:					
Foreclosure	2		2		
Voluntary conveyance	2	5	3	705.00	4
Oregon:					
Foreclosure	1	6	2	−4,035.63	5
Voluntary conveyance	13	22	18	−1,215.13	17
Pennsylvania:					
Foreclosure	1	1	1	1,400.00	1
Voluntary conveyance		1	1	2,429.59	
South Carolina:					
Foreclosure	4	24	4		24
Voluntary conveyance	14	160	45	−7,738.14	129
South Dakota:					
Foreclosure	5	4	2	2,937.91	7
Voluntary conveyance	3	6	6	−873.55	3
Tennessee:					
Foreclosure	6	15	15	306.00	6
Voluntary conveyance	3	18	7	−10,227.18	14
Texas:					
Foreclosure	15	63	39	2,554.57	39
Voluntary conveyance	10	104	69	8,612.49	45
Vermont:					
Foreclosure	1		1	150.00	
Voluntary conveyance	2	7	3		6
Virginia:					
Foreclosure	12	5	8	1,219.70	9
Voluntary conveyance	1	1	2	102.97	1
Washington:					
Foreclosure	1	1	2	−126.58	1
Voluntary conveyance	6	63	14	−11,790.41	55
West Virginia: Foreclosure		4	4	119.77	
Wisconsin: Voluntary conveyance	1	2	1	10.00	2
Wyoming:					
Foreclosure	1				1
Voluntary conveyance	2	5	5	385.54	2
Puerto Rico: Foreclosure		2			2
Total:					
Foreclosure	281		1,123	−40,239.62	4,391
Foreclosure and voluntary conveyance	546				

[1] Farm ownership only.
[2] Difference in ending inventory due to partial sales.

Appendix 5.—Instructions Concerning "Packaging" of Loan Applications

Information Required To Package Applications for Section 502 Rural Housing Loans

[FHA Instruction 444.1, Exhibit B]

I. GENERAL INFORMATION

Persons or organizations that want to assist applicants in submitting applications to the Farmers Home Administration (FHA) should first meet with the county supervisor. If these discussions indicate that the person or organization is capable of satisfactorily delivering complete information about applicants and houses that are likely to qualify for Rural Housing (RH) loans, the county supervisor will review in detail the information that is needed and the processing steps required in completing an RH loan. The county supervisor will provide assistance and guidance to all packagers in obtaining the required information. The guide "Packaging applications for rural housing loans" and the following FHA Forms may be provided to prospective packagers as needed:

A. Form FHA 444–12. "Check sheet for rural housing loan package."
B. Form FHA 410–4. "Application for rural housing loans (nonfarm tract)."
C. Form FHA 410–1. "Application for FHA services."
D. Form FHA 410–2. "Supplement to application for FHA services (for applicants who depend on off-farm income)."
E. Form FHA 410–5. "Request for verification of employment."
F. Form FHA 444–10. "Information on property (rural housing nonfarm tract)."
G. Form FHA 424–2. "Dwelling specifications."
H. Form FHA 440–34. "Option to purchase real property."

II. INFORMATION PACKAGER OR APPLICANT MUST PROVIDE

A. Information to be submitted for all applicants.

(1) The applicant family should complete the appropriate application form as prescribed in FHA instruction 410.1:

(*a*) All information on the form must be complete and accurate.

(*b*) If the applicant obtains income from his own business, the current operating statement must be attached.

(*c*) The application form must be dated and signed by the applicant.

(2) Form FHA 410–5 will be used to check employment and income of applicants. The form should be mailed to the employer to be completed and returned directly to the county office. FHA will not provide franked envelopes for the purpose unless the form is sent to the employer directly by the county supervisor.

(3) In cases where it appears that the applicant has sufficient income or assets to qualify for housing credit from another source, he must make a diligent effort to obtain such credit from at least two lenders who customarily make long-term housing loans in the area. If such lenders are unable to provide the credit needed, their written response stating why they cannot assist the applicant should be included in the loan package.

(4) The information specified in paragraph 11B or 11C below, whichever is applicable, will be submitted. In case FHA has issued a conditional commitment on the property, information on the house will be on file in the county office and need not be resubmitted.

(5) If a house to be purchased is under construction, the loan will not be closed until it is completed. In such a case, the information in paragraph II C below will be submitted

B. Information to be submitted for loans to build or rehabilitate homes.

The information requested on the front of form FHA 444–10 will be submitted along with the completed form. This applies regardless of whether a conditional commitment is being requested in connection with the package. When form FHA 424–2 is completed, item 31 of the form should include a complete description of the foundation plantings, trees, seeding, or sodding that are included in the contract.

C. Information to be submitted for loans to buy existing homes.

(1) A signed or certified copy of an option on the property. The option must provide that any payments made by the applicant will be refunded if the loan is not made. Form FHA 440–34 may be used for this purpose.

(2) A termite certification whenever required.

(3) In case major improvements are involved, submit three sets of complete drawings and specifications of the work that must be done, and a contractor's bid or a reliable cost estimate.

(4) If the house is under construction or less than a year old and an individual water or sewage system is involved, include a certification by the builder that the house and any water and waste disposal system have been or will be built or installed in accordance with the local building codes and plans and specifications. Such plans and specifications will also be submitted. Evidence of approval by health authorities having jurisdiction in the area also will be included. If the house is a year or more old, the county supervisor will satisfy himself that the water and/or sewage system is functionally adequate.

(5) Form FHA 444–10 with items 1 through 7 completed. Also the information concerning the applicant's name and address on the bottom of the first page should be completed.

(6) Direction map to the property.

(7) Plot plan drawn to scale showing house location and related facilities.

III. REVIEW AND ACCEPTANCE OF A COMPLETE PACKAGE

During the initial discussions, an agreement should be reached with packagers that loan packages will be delivered to the county office assembled in the order shown on form FHA 444–12. This form should also be attached. The county supervisor should review each loan package when it is submitted and request any additional information needed. If the applicant is not present when the application is presented, the county supervisor ordinarily will not proceed with the processing of the loan until the applicant family has been interviewed.

A. If the applicants appear to be qualified and all the needed material is available, the county supervisor will complete an appraisal of the property and the processing of the application.

B. If a loan can be approved, the county supervisor will notify the applicant. If for any reason a loan cannot be made, the county supervisor will notify the applicant and the packager. Applicants should also be informed in these cases that they should visit the county office if they have any question about the actions taken on their loan application.

IV. LOAN CLOSING

After being approved, the loan can be closed as soon as the necessary title work is completed and any special loan approval conditions met. At the time of loan closing, the following will need to be provided:

A. A fire and extended coverage insurance policy or binder showing that coverage is effective as of that date if construction work is to be paid for with loan funds.

B. Sufficient funds by the applicant to pay attorney fees and closing costs (if not included in the loan) and any downpayment that may be required. Construction work to be paid for with loan funds should not begin, not should the applicant incur any debts, prior to loan closing and authorization by the county supervisor.

V. PACKAGER'S RESPONSIBILITIES

Packagers should fully understand their responsibilities in helping applicants to assemble their RH loan applications. They should also understand that no fees may be charged for providing this service.

Appendix 6.—Definition of "Rural" Areas

Administration Letter 54(444)

U.S. Department of Agriculture,
Farmers Home Administration,
Office of the Administrator,
Washington, D.C., May 3, 1971.

Supersedes Administration Letter 51(444) and modifies FHA Instructions 444.1, 444.3, 444.5, 444.7, 444.8, 444.9, 444.10, and 444.11

Subject: Rural housing loans in places up to 10,000 population.

I. GENERAL

This Administration Letter modifies paragraphs III C and H and IV A 1 of FHA Instruction 444.1 to authorize Rural Housing (RH) loans in rural places of up to 10,000 population.

II. DEFINITIONS

A. A place consists of all the land lying within the official boundaries of any village, town, or city plus all the land lying within any densely settled incorporated or unincorporated areas near or associated with it. "Town" means a municipality similar to a city, not a New England-type town which resembles a township or county in most States.

B. A rural area includes any of the following:

1. Any place which (a) has a population not over 10,000, (b) is not in, near, or associated with a nonrural area, (c) is far enough away from a place of over 10,000 population to have its own separate identity, (d) primarily serves families who work in it and in surrounding rural areas, and (e) is strictly rural in character. Population count will be based on the 1970 census.
2. Open country, including sparsely populated areas, which are not in, near, or associated with a nonrural area and are strictly rural in character.

C. In determining whether a place or open country is near or associated with a nonrural area, the following intervening factors will be disregarded:

1. Minor open spaces due to physical barriers.
2. Commercial or industrial developments.
3. Public parks and similar open spaces.
4. Areas reserved for recreation purposes.
5. Intervening tracts suitable for development.

III. IDENTIFICATION OF RURAL AREAS

The State Director shall publish in State instructions maps identifying the places and open country eligible for RH loans under paragraph II above.

IV. ELIGIBLE APPLICANTS

To be eligible, an applicant must be a person who is one of the following:

A. A person without adequate housing who will become the owner-occupant of a home in a rural area after the loan is closed.

B. A farm owner without decent, safe, and sanitary housing for his own use or for the use of his tenants, sharecroppers, or farm laborers.

C. A farm owner or rural resident who is engaged in farming and is without adequate farm service buildings essential to his farming operations.

V. BUILDING SITES

Building sites and related improvements shall comply fully with the guidelines and requirements in our construction guide and applicable FHA instructions and bulletins.

VI. APPLICABILITY

This Administration letter also applies, where appropriate, to section 504 loans, rural rental and co-op housing loans, site loans, self-help technical assistance, and rural housing disaster loans. The definition of a rural area in paragraph II above does not apply to HUD-FHA section 235 insured mortgages because of the 5,500 population limitation in the HUD-FHA agreement.

VII. PROCESSING APPLICATIONS ON HAND

All applications on hand for financial assistance may be processed in accordance with the terms of this regulation.

VIII. PRIOR COMMITMENTS. (ADDED 8-5-71—SPECIAL PN 8-5-71)

A. Where the State director determines that (1) applicants, potential applicants, or sponsors of applicants or potential applicants have, with the knowledge and formal or informal approval of the FHA, invested or caused to be invested substantial money, time, and effort in connection with a project involving applications, or preparations for applications, for housing assistance under title V of the Housing Act of 1949 in a specific area, (2) the area meets all requirements of paragraph II except that it lies within the legal boundaries of an incorporated village, town, city, or similar municipality whose total population exceeds 10,000, (3) such investment was made in good faith reliance upon then existing regulations or instructions of the FHA, and (4) it would be inequitable and incompatible with the purpose of the title V housing programs not to permit the project to proceed, the State director may recommend to the administrator that the area be specially designated as an eligible rural area to the extent necessary to permit the project to continue to a reasonable degree of completion. (Added 8-5-71—Special PN 8-5-71.)

B. If the administrator approves the recommendation of the State director and finds that such designation is legally permissible, the administrator may authorize the designation subject to such limitations of time and scope as he may prescribe. (Added 8-5-71—Special PN-8-5-71.)

Appendix 7.—Number of FHA Housing and Agricultural Specialists by State

FmHA has a present ceiling of 7,354 employees. Of these, there are 2,960 agricultural specialists at the county level and 265 at the district level totaling 3,225. There are 242 housing specialists and construction inspectors, 208 of which are at the county level and 34 are at the district level. In addition, of the 420 professional personnel manning the State office, 167 of them have been subjected to one or more courses in housing program operations or related courses at the National FmHA training center at Norman, Okla. It should be noted that many of those county professional employees classified as agricultural specialists in fact are familiar with the housing programs, having been engaged part time over the past few years in processing loans.

The details of the above information are provided in the attached tables (exhibits C and D).

EXHIBIT C

FHA AGRICULTURE AND HOUSING SPECIALISTS

Offices	County office		District level		State level		Total
	Housing	Agriculture	Housing	Agriculture	Housing	Other	
Alabama	20	97		7	4	7	135
Arizona	7	28		4	2	5	46
Arkansas	24	121		12	6	11	174
California	2	43	3	5	3	8	64
Colorado	1	40	1	4	2	7	55
Delaware	6	44		4	3	6	63
Florida	6	36		4	3	6	55
Georgia	3	87	3	9	5	8	115
Idaho	4	50	1	4	2	7	68
Illinois	1	71		6	3	7	88
Indiana	5	45		5	3	7	65
Iowa	1	86	7	7	3	6	110
Kansas	1	58	2	6	2	9	78
Kentucky		103		8	3	5	119
Louisiana	1	84		6	4	6	101
Maine	5	60	2	4	3	7	81
Michigan	7	37		5	2	7	58
Minnesota	3	82		8	3	5	101
Mississippi	29	191	3	12	5	14	254
Missouri	16	122		12	3	9	162
Montana		39		4	2	5	50
Nebraska		63		6	3	6	78
New Mexico	3	35	1	3	2	6	50
New York	7	65		5	3	4	84
North Carolina	12	142		11	6	11	182
North Dakota	2	82		5	3	6	98
Ohio		46	5	4	2	5	62
Oklahoma		93	2	10	3	10	118
Oregon		38	2	4	3	5	52
Pennsylvania	3	43		4	2	6	58
Puerto Rico	9	56		3	3	6	77
South Carolina	6	77	1	7	4	8	103
South Dakota		77		6	2	7	92
Tennessee		108		10	3	7	128
Texas	7	202		27	6	13	251
Utah	1	33		3	2	5	44
Vermont	5	37		3	3	5	53
Virginia	8	51		5	3	6	73
Washington	2	40	1	3	2	6	54
West Virginia	1	48		4	3	7	63
Wisconsin		78		7	2	6	93
Wyoming		22		3	2	5	32
National office					12	32	44
Finance office, St. Louis							
Total	208	2,960	34	265	140	324	3,931

EXHIBIT D

FHA Employees, Assigned to State Offices, Who Have Received Classroom Instruction In Housing and Related Fields

States	*Total*	*States*	*Total*
Alabama	4	New Mexico	3
Arizona	4	New York	3
Arkansas	5	North Carolina	5
California	4	North Dakota	3
Colorado	3	Ohio	3
Delaware	4	Oklahoma	5
Florida	3	Oregon	4
Georgia	5	Pennsylvania	5
Idaho	4	Puerto Rico	4
Illinois	4	South Carolina	3
Indiana	3	South Dakota	4
Iowa	4	Tennessee	6
Kansas	4	Texas	6
Kentucky	3	Utah	3
Louisiana	5	Vermont	4
Maine	5	Virginia	4
Michigan	4	Washington	3
Minnesota	3	West Virginia	3
Mississippi	8	Wisconsin	3
Missouri	5	Wyoming	3
Montana	3		
Nebraska	3	Overall total	167

Appendix 8.—Correspondence Between Department of Agriculture and Department of Justice Concerning Great American Homes Corp. Case

U.S. Department of Agriculture,
Office of the Inspector General,
Washington, D.C., June 15, 1973.

Subject: Great American Homes Corp., Frank H. Lee, and Andrew Jackson Lee, Wilcox County, Ala.

Hon. C. S. White-Spunner, Jr.,
U.S. Attorney,
Southern District of Alabama,
U.S. Department of Justice,
Mobile, Ala.

Dear Mr. White-Spunner: On August 24, 1971, Fred W. Harris, Jr., Regional Attorney, Office of the General Counsel, United States Department of Agriculture, referred subject investigation report to you for review of possible violations of Title 18, Section 1001, United States Code, and other possible criminal offenses.

Repeated efforts have been made by the Office of the General Counsel to secure your determination as to the disposition of the case. We have been advised that the subject of the investigation, Frank H. Lee, is deceased and that the Assistant FHA County Supervisor involved in the case has since retired.

The House Committee on Government Operations is conducting hearings on the Farmers Home Administration's administration of the Rural Housing Program and has asked us what action has been taken, or is contemplated, on subject case.

In order that we may reply to this Congressional request, would you please advise us of your determination of this matter?

Sincerely,

David S. Allshouse,
Deputy Assistant Inspector General, Operations.

U.S. Department of Justice,
Southern District of Alabama,
Mobile, Ala., August 7, 1973.

Re Great American Homes Corp., Frank H. Lee, and Andrew Jackson Lee, Wilcox County, Ala.

Mr. David S. Allshouse,
Deputy Assistant Inspector General, Operations,
U.S. Department of Agriculture,
Washington, D.C.

Dear Sir: Reference is made to your letter of June 15, 1973, concerning the above-referenced matter.

In view of the death of Frank H. Lee, the principal subject of the investigation, it is considered that criminal proceedings are inappropriate. Accordingly, criminal prosecution based upon the report of investigation forwarded to me is declined.

Yours very truly,

C. S. White-Spunner, Jr.,
U.S. Attorney.

APPENDIX 9(A).—AUDIT OF ARKANSAS FARMERS HOME ADMINISTRATION PROGRAM

U.S. DEPARTMENT OF AGRICULTURE,
OFFICE OF THE INSPECTOR GENERAL,
SOUTHWEST REGION (V),
Temple, Tex., May 3, 1973.

Attention of: File No. 402-10-T.
Subject: Audit of the Farmers Home Administration Program in the Arkansas State Office and Selected County Offices—Rural Housing Appraisals.
To: Mark H. Nestle, Director, Internal Review Staff, FHA, Washington, D.C.

We have completed the subject audit and transmit herewith two copies of the audit report. We request that a reply indicating corrective action taken or contemplated on the finding and recommendation be provided by July 2, 1973.

The courtesies and cooperation extended to the auditor are appreciated.

R. L. COCKRELL,
Assistant Regional Inspector General.

AUDIT REPORT, FARMERS HOME ADMINISTRATION, ARKANSAS STATE OFFICE AND SELECTED COUNTY OFFICES—RURAL HOUSING APPRAISALS AS OF APRIL 10, 1973, REPORT NO. 402-10-T

U.S. Department of Agriculture, Office of the Inspector General, Southwest Region (V), Temple, Tex.

I—INTRODUCTION AND SUMMARY

A. Introduction

This special audit was conducted primarily in Lee and St. Francis Counties, Ark., and in the Arkansas State office to evaluate the adequacy of rural housing appraisals. We gave special attention during the audit to the appraisals of prefabricated housings. Our review covered the period from March 1, 1970, to April 1, 1973.

As of April 1, 1973, FHA had made approximately 100 rural housing loans on prefabricated dwellings in Lee and St. Francis Counties. Our audit included a review of 20 rural housing borrower files and interviews were conducted with 10 of these borrowers whose files were reviewed.

B. Summary of audit results

The audit disclosed that FHA's appraisals of prefabricated dwellings were not consistent with their appraisals of conventionally constructed dwellings. In some instances, prefabricated dwellings were appraised for approximately $3,000 more than similar conventionally constructed dwellings. A number of these prefabricated dwellings had been taken into Government inventory and had been reappraised at approximately $3,000 less than they were originally appraised. State office personnel advised that the appraisals on the prefabricated dwellings were increased to try to increase the volume of rural dwellings and to meet the demand for rural housing loans in the State; however, FHA instructions, in effect at the time, did not contain any provisions for appraising a dwelling for more than its current market value.

II—RECOMMENDATIONS AND DISCUSSION WITH MANAGEMENT

A. Recommendations for the State office

1. Action should be taken to strengthen rural housing appraisals and establish controls to insure that properties are appraised in line with their current market value. This should include, but not necessarily be limited to, the following: (a) include houses sold outside the FHA program, as well as FHA-financed houses, as comparable sale properties; (b) include conventionally constructed dwellings

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as comparables for the appraisals of prefabricated dwellings; (c) recognize, when appraising prefabricated dwellings, that such dwellings have a limited appeal to the public due to unconventional construction; (d) discontinue using comparable sales which are outside the vicinity of the property being appraised; (e) insure that comparable sales data are current and correctly listed on appraisal reports; and (f) discontinue using comparable sales of dwellings sold under Government interest credit assistance programs, as these do not constitute sales under normal conditions. (See Details—1.)

B. Discussion with management

A discussion concerning the audit results was held on April 10, 1973, with:
Robert L. Hankins—State director.
Lee A. Cook—Assistant State director.
Lyle H. Rogers—Chief, rural housing.
Jim D. Graddy—Rural housing specialist.
Sherman Williams—District supervisor.

A further discussion was held on April 13, 1973, with Mr. Hankins and Mr. Cook concerning our recommendation. Personnel generally agreed with our finding and recommendation and expressed a desire to take corrective action. Their comments, where appropriate, are included in the Details section of this report.

The Office of the Inspector General was represented at the initial audit discussion by supervisory auditor Wayne E. Stuckey and auditor Don R. Martin. Auditor Martin represented OIG at the subsequent discussion.

III—DETAILS

Rural housing appraisals

1. Appraisals of dwellings that utilized prefabricated component sections were not consistent with appraisals of conventionally constructed dwellings. These dwellings, commonly referred to as premanufactured or prefabricated dwellings, hereinafter referred to as prefabs, were appraised for as much as $3,000 more per dwelling than similar conventionally constructed homes.

FHA had financed approximately 100 of these prefab dwellings in Lee and St. Francis Counties plus an undetermined number in other counties throughout the State. These prefab dwellings were prefabricated by Pacific Homes, Inc., of Marks, Miss. The basic model sold in Lee and St. Francis Counties contained 936 square feet of living area, and had three bedrooms, one bathroom, kitchen, and a small laundry room. It was of frame construction, on a concrete slab foundation, with an asphalt shingle roof and a concrete parking pad. The basic model had individual electric room heaters and a vent-hood in the kitchen, but did not contain any appliances or have a carport or storage area. It was paneled throughout on the inside and inside ceilings were sheetrock with a sprayed textured finish.

The first appraisal on these prefab dwellings in Lee and St. Francis Counties was made by John F. Knox, St. Francis County supervisor, on March 25, 1970. Mr. Knox appraised this prefab dwelling at $11,500. This particular prefab dwelling was located on a gravel road about 4 miles from Forrest City, Ark. The house was located on an approximately ½-acre lot and had an individual water well and septic tank disposal system. This appraisal was made for RH loan applicant Carey Bruce Gilmer, who subsequently received an RH loan to purchase the dwelling.

The three comparable properties used on this appraisal were all FHA-financed properties and they were all of conventional type construction. The first comparable used was the property of RH borrower Ben Harbin. The Harbin property was rated better than the prefab because it contained 190 square feet more living area, plus it had 336 square feet of carport and storage area. This dwelling also contained 1½ baths, was of brick veneer construction, and had a built-in cooktop and oven with vent-hood. All other features were approximately the same as the prefab. The appraisal report had erroneously listed the Harbin property as selling for $12,000 in 1968. The property was actually purchased new in 1967 for $11,500 according to the borrower's loan file. Although this property was rated better than the prefab being appraised, the prefab was appraised at the same value.

The second comparable used was the dwelling of RH borrower James Chatters, Jr. This property had 70 square feet more living area than the prefab. It also had 325 square feet of carport and storage area, and was of brick veneer construction. This property was erroneously shown on the appraisal report as being located on a 50 feet by 150 feet lot, as being 5 years old, and having been sold in 1967. The borrower's loan file showed that the dwelling was actually located on a 92 feet by

150 feet lot, was built new in 1970, and was purchased in 1970. The property sold for $10,500. This property was rated better than the prefab being appraised, but the prefab was appraised $1,000 higher. The appraisal report did not explain the reason for the higher value being placed on the prefab.

The third and last comparable used was the dwelling of RH borrower Eugene Turner. This dwelling was rated poorer because of its somewhat obsolescent type of construction, apparently a reference to the wood siding on the exterior of the dwelling. This dwelling was located on a 2-acre lot with public water facilities and had a septic tank disposal system. The dwelling contained 90 square feet more living area than the prefab. This house sold for $7,150 in 1967.

All of the comparables had desirable locations in rural areas.

Similar conventionally constructed dwellings were being appraised as much as $3,100 less per dwelling than prefab dwelling during this time. The following examples are cited:

Ollie R. Harrison.—This borrower's FHA-financed dwelling was of similar frame construction and had 30 square feet more living area than the prefab. The house had public water facilities, and a built-in cook top and oven. All other features were approximately the same as the prefab dwelling. This dwelling was appraised by FHA on November 18, 1970, at $8,400 or $3,100 less than the prefab.

James H. Ware.—This house was also of similar frame construction and had 30 more square feet of living area than the prefab. This house had central heat, public water, and a built-in cook top and oven. This house and lot were very similar to the prefab in construction, size, and location, yet, this house and lot were appraised on June 10, 1970, for $8,800 or $2,700 less than the appraisal on the prefab dwellings.

Doris W. Young.—This house was of similar frame construction and had 130 more square feet of living area than the prefab plus 300 square feet of carport and storage area. This property was very similar to the prefab in other features. This property was appraised on May 15, 1970, by FHA for $10,000, $1,500 less than the prefab.

All of the dwellings cited above were new dwellings and were built under FHA inspection during construction. These dwellings were constructed by conventional construction methods. Other similar differences between appraisals on prefab dwellings and appraisals on conventionally constructed dwellings were noted during our review.

Mr. Knox stated that he was instructed by the State FHA Office to appraise the prefab dwellings higher than conventionally built dwellings. He stated that the higher evaluation was to cover the increased cost that prefab builders had in preparing packaged applications and the cost of interim financing that these builders incurred due to building under the FHA conditional commitment method. He stated that he personally considered the conventionally constructed dwellings to be superior in construction to the prefab dwellings. He stated that State office personnel had assisted him on the Gilmer property appraisal and on other appraisals of prefab dwellings. He requested that we refer all questions about these appraisals to State office personnel.

On June 5, 1970, Sherman Williams, former rural housing specialist, Arkansas State FHA Office, now a district supervisor, made an appraisal on a prefab dwelling located in the FHA-financed Dogwood Acres subdivision at Madison, Ark., in St. Francis County. This prefab was of the same size, design, and construction as the prefab previously mentioned as having been appraised by Mr. Knox. Mr. Williams appraised this prefab at $11,350. The prefab was located on a one-fourth-acre lot, with paved streets, public water facilities, and had a septic tank disposal system. Mr. Williams' appraisal was intended to be used as a guide and, in fact, was copied for all appraisals made in the FHA-financed Dogwood Acres and Magnolia Acres subdivision. FHA subsequently made approximately 53 loans on these prefab dwellings in the two subdivisions, involving approximately $600,000.

The first comparable used on Mr. Williams' appraisal was the FHA-financed dwelling of Johnny Taylor. This dwelling was shown on the appraisal report as being similar in size and construction to the prefab, but it was rated poorer due to a much less desirable location. However, we were unable to discern any difference in location quality during our inspection. The appraised property was located in the same area (Madison, Ark.) and in the same type neighborhood. The Taylor dwelling contained 24 more square feet of living area and had 324 square feet of carport and storage area. This property was erroneously listed on the appraisal report as selling for $8,750 in 1968. It actually sold for $8,000 in 1968, according to a copy of the sales contract in the borrower's loan file.

The second comparable used was the Carey Bruce Gilmer property previously described in this report. The Gilmer property, as noted above, was the first prefab dwelling appraised in St. Francis County. The Gilmer property was rated poorer than the property being appraised due to its site and location.

The third comparable used was the same type prefab dwelling, located near Marianna (Lee County), Ark., in the FHA-financed town and country subdivision No. 2. Mr. Williams had previously appraised this Lee County prefab dwelling, and his appraisal will be discussed later in this report. Mr. Williams showed this comparable as equal to the prefab being appraised, but that it was slightly less desirable due to its site and location. This comparable sold for $11,250 in 1970.

At the time Mr. Williams made his appraisal, there were numerous FHA-financed conventional-type dwellings under construction in St. Francis County by various builders. Although these dwellings were similar in size, location, and design to the prefab dwelling, they were being appraised, contracted, and built from $1,000 to $3,000 less per dwelling than the appraised value put on the prefab dwelling.

On May 27, 1970, Mr. Williams made the first appraisal of an FHA-financed prefab dwelling in Lee County, Ark. This appraisal was on the same type prefab dwelling as previously described. This prefab dwelling was located 3 miles south of Marianna, Ark., in the FHA-financed town and country subdivision No. 2. The prefab was located on approximately a one-half acre lot on a gravel street with individual water well and individual septic tank disposal system. The prefab was appraised by Mr. Williams at $11,250. As noted above, this prefab dwelling was used as a comparable by Mr. Williams in his St. Francis County appraisal.

The comparables used on this appraisal were all FHA-financed dwellings. The first comparable was the James M. Klenk property. This dwelling had over 200 more square feet of living area than the prefab dwelling, plus 312 square feet of carport and storage area. This comparable is of brick veneer construction, located on a paved street, and has public water facilities. The dwelling was shown as being 5 years old. The appraisal report erroneously listed the selling price of this comparable as $12,000. An option to purchase agreement in the FHA loan file of borrower Klenk showed the selling price of the property to be $10,000. The appraisal report listed this comparable as better than the property being appraised but only nominally better.

The second comparable used was the dwelling of RH borrower Harvey L. Passmore. This dwelling was rated poorer than the prefab due to its much less desirable location. We noted that the comparable is located on paved road in Moro, Ark., and has city water facilities. The comparable also contained over 100 square feet more living area than the prefab being appraised and also had 336 square feet of carport and storage area. The comparable was of brick veneer construction, was 6 years old, and was listed as selling for $10,000 in March 1969.

The third comparable used was the same type prefab dwelling as the one being appraised. This comparable was located at Garland City, Ark., which is approximately 250 miles from Marianna, Ark. This comparable was rated poorer than the property being appraised due to its location. The sales price of this comparable was listed as $10,800 and date of sale was listed as May 1970. At the time this appraisal was made, FHA had appraised the same type prefab dwellings in neighboring Phillips County for $9,500. Phillips County is located just south of Lee County. Mr. Williams stated that he did not use these prefabs because they were in a better location than the prefabs being appraised. He could not explain why he then put a $1,750 higher value on the property being appraised.

FHA instruction 422.3, dated June 15, 1965, in effect at the time the Lee County appraisal was made, defines a comparable sales value of similar properties recently sold in the open market *in the same vicinity* (italics supplied).

In our review of FHA appraisals, we noted no instances where properties other than FHA-financed properties were used as comparable properties.

In October 1972, at OIG's request, Thomas L. Dial, real estate appraiser, Helena, Ark., appraised two prefab dwellings located in Lee County in the town and country subdivisions No. 1 and 2. Mr. Dial appraised the prefab in town and country subdivision No. 1 as $7,900, and the one in town and country subdivision No. 2 at $8,150. FHA officials had appraised these same prefab dwellings at $10,500 and $11,250, respectively. Mr. Dial's appraisal report contained the following comparable properties: (1) A purchase of an existing dwelling (H. Passmore), (2) one new FHA-financed dwelling that was conventionally constructed, and (3) one similar dwelling that was sold outside the FHA program. All of these dwellings were in Lee County, Ark.

FHA made 12 RH loans in the town and country subdivision No. 2, the abovementioned appraisal of Mr. Williams serving as the supporting appraisal document and all being valued at $11,250. Seven of these borowers have since moved out of their dwellings, and the dwellings had been taken into Government inventory or foreclosure action was in process. Foreclosure action was first taken on RH borrower Michael Howell. This prefab dwelling was taken into Government inventory and reappraised for $8,000 in March 1972 by Mr. Joe Kennedy, Lee County supervisor. We inspected the Howell dwelling and found that the borrower had only lived in the house about 3 months and the dwelling was in essentially the same condition as when it was new. Mr. Kennedy stated the reason his appraisal was $3,250 less than the original FHA appraisal was that the house, in his opinion, was overappraised originally. He also stated that the unfavorable newspaper publiicty about the poor construction in this subdivision had affected the market for the dwelling. He stated that he did not have buyers for the dwellings even at the $8,000 selling price. He stated that the Government would have a loss of over $20,000 on the seven dwellings that foreclosure action had been taken on.

Borrowers that we interviewed in this subdivision stated that the prefab dwelling's purchase price was too high, but they were attracted to the dwellings by the liberal credit terms extended by FHA. They were not required to make a down payment and monthly payments were reduced by interest credit assistance.

On March 7, 1973, Lee A. Cook, assistant to the State Director, completed an appraisal in the town and country subdivision No. 1, covering the same type prefab dwelling that FHA appraised for $10,500 in 1971. Mr. Cook appraised this dwelling at $8,500.

Mr. Lyle H. Rogers, chief of the rural housing, Arkansas State office, stated that in order to increase the volume of rural housing construction in the State and meet the demand for rural housing loans, they had to appraise the prefab dwellings higher than conventionally constructed dwellings. He said that this increased appraisal was intended to cover increased cost that prefab builders incurred in "packaging applications" and the costs of interim financing incurred by builders building under the conditional commitment procedures.

Mr. Rogers stated that several factors had contributed to the prefab dwellings' decline in market value during a period of time when conventionally constructed dwellings were increasing substantially in value. He attributed the decrease to: (1) an economic boycott in Lee County which resulted from racial problems; (2) unfavorable publicity about the poor construction of these prefab dwellings; and (3) a reluctance of the general public to accept a house that was constructed by prefabricated construction methods.

We made a limited review of appraisals on this type prefab dwelling in Miller and Lafayette Counties, Ark., which are located approximately 250 miles from St. Francis and Lee Counties. There had not been any economic boycott or adverse publicity about the FHA dwellings in this area. These prefab dwellings were originally appraised at from $10,500 to $11,000 and about 60 RH loans were made on them from 1970 through 1972. Foreclosure action had been taken or was in process on about 30 of these loans. The houses were reappraised at from $8,000 to $9,500 when taken into Government inventory.

The FHA county supervisors in these counties estimated that they will have to take foreclosure action on approximately 40 of the 60 RH loans made on these prefab dwellings. They stated that the families that purchased the prefab homes moved out of the dwellings for a variety of reasons including general dissatisfaction with the prefab type housing. The county supervisors stated that they could not sell the prefab houses in Government inventory, even at the reduced appraised value. We estimated that the Government will suffer a loss of over $120,000 on the loans made on the prefab dwellings in Miller and Lafayette Counties.

We concluded that the prefab dwellings were originally appraised and sold for more than their normal market value. Buyers of these prefab homes were attracted to them because of the liberal credit terms and interest credit assistance extended by FHA. FHA Instruction, in effect at the time these appraisals were made, did not contain any provisions for appraising property for more than its normal market value.

Action should be taken by the State Director to strengthen appraisal procedures and establish the necessary controls to insure that properties are appraised in line with their current market value.

R. L. COCKRELL,
Assistant Regional Inspector General.

Appendix 9(B).—Interim Reply From Arkansas State Office

U.S. Department of Agriculture,
Farmers Home Administration,
Little Rock, Ark., May 22, 1973.

Subject: Audit of the Farmers Home Administration program in the Arkansas State office and selected county offices—Rural Housing Appraisals—Audit Report No. 402-10-T (for official use only)

To: Director, Internal Review Staff, Farmers Home Administration, Washington, D.C.

This interim report is provided in accordance with your telephone instructions.

A preliminary review of the circumstances and material provided by the subject audit report reveals, in our opinion, the appraisals were approximately correct.

In earlier years the Farmers Home Administration started a rural housing program with the community "father-son" type builder. This builder operated for wages and had little, if any, investment as compared to a volume contractor. Local material dealers and the local carpenters could deliver a limited number of completed units on scattered sites each year. However, through the years this operation created a false market value for rural housing units. The complaint was expressed many times by the larger contractors that Farmers Home Administration appraisals were too low. However, in the sixties when the program was small, this delivery by the small carpenter was utilizing the rural housing loan funds and the full impact of underappraising was not realized.

With the expanded rural housing program, the local carpenter was unable to meet the demand or the intent of the national housing goals. In early 1970 the development of rural subdivisions and accelerated housing starts was discussed with all county supervisors and public meetings were held with developers and contractors. It was the presumption this mass production of homes would help to meet the pressing need for rural housing and assist in meeting the national housing goals. As a result of this experience, we were made aware of our years of underappraising real properties. To further substantiate this fact, we now find many of the small builders were forced out of business.

To meet this problem, we immediately took action to update our appraisal attitude and to make employees charged with this responsibility knowledgeable of the need to use current sales information from units sold for cash or financed by conventional lenders. However, we must recognize this type information is not always available in rural areas. In many cases this requires the substitution of less desirable comparables or even foreign comparables.

This updating of our appraisal system has produced a good Rural Housing program. We will admit some errors in judgment as to the needs, wants, and desires of people. We have improved the "prefab" dwellings by asking the builder to add carports, concrete driveways, improved bath equipment, outside storage, washer-dryer connections, improved room arrangement, and in most cases brick veneer. After a visit by Mr. Jennings Orr, Director, Single Family Housing Division, in May 1972, we made other changes in our program. A copy of Mr. Orr's field report is attached.

An indepth analysis is being made of our appraisals and a complete report will be submitted in the near future.

Robert L. Hankins,
State Director.

Appendix 9(C).—Final Reply From Arkansas State Office

U.S. Department of Agriculture,
Farmers Home Administration,
Little Rock, Ark., June 29, 1973.

Subject: Audit of the FHA program in the Arkansas State office and selected county offices—rural housing appraisals report No. 402-10-T (for official use only)

To: Mark H. Nestle, Director, Internal Review Staff, FHA, Washington, D.C.

This replies to the subject audit report as requested in a memorandum dated May 3, 1973, to you from Mr. R. L. Cockrill, Assistant Regional Inspector General, a copy of which was received in this office on May 7, 1973. The reply is based on an in-depth analysis of the report, discussions with employees involved, reviews made of case files, and corrective actions taken. The auditor's review covered the period from March 1, 1970, to April 1, 1973.

Prior to 1970, practically all of the RH loans made in Arkansas on new dwellings were made to applicants who, after the loans were closed, entered into a construction contract with a local carpenter or contractor to build their dwellings in accordance with plans and specifications approved by FHA. The plans, specifications and construction work were expected to meet FHA requirements as contained in "A Guide for the Construction of Farm Buildings." The contractor was usually a carpenter or small builder selected by the applicant on the basis of the lowest and best bids he could obtain. Most such builders seldom had more than one or two dwellings under construction at any given time.

Appraisals were made to reflect the appraiser's recommended normal value of the property in accordance with FHA Instruction 422.3, issued June 15, 1965, on Procedure Notice 950. "Normal value," more often than not, was less than present market value since it reflected the sale price of comparable properties in the area during the past several years. Complaints were seldom received from builders about appraisal values placed on properties since they dealt with borrowers under a construction contract arrangement and were not building houses for sale under the RH loan program.

In 1969 and 1970, the RH program was broadened by implementing new authorities and procedures which resulted in rapid changes in the agency's approach to meeting the rural housing needs. The new authorities and procedures included: (1) issuing conditional commitments to builders and sellers of dwellings to be built and offered for sale at a specified maximum amount to eligible RH loan applicants; (2) packaging applications for RH loans by builders, developers, realtors and others interested in working directly with prospective borrowers in packaging their loan applications for submission to county supervisors; (3) approving conditional commitments and RH loans in new subdivisions to be developed; (4) financing manufactured (prefabricated and modular) homes to be erected on building sites; and (5) making appraisals on "present market value" basis. During this period, FHA was also authorized to process HUD section 235 loans in rural areas under HUD regulations.

The new RH loan program authorities and procedures were discussed and implemented by the National Office in regional training meetings with State office staff personnel in September 1969. Following the National Office regional training meeting, a statewide training meeting was conducted with county office personnel by the State director and RH staff members. Emphasis was placed upon the need for county supervisors to acquaint builders, developers, building supply dealers, realtors and other home industry tradesmen in their counties with the broadened RH program to meet the housing needs of eligible applicants. An intensive educational program was conducted throughout the State in late 1969 and in 1970 to acquaint the housing industry with the RH program. A statewide meeting was held in Little Rock at which the RH staff discussed the new RH program authorities and the need for their participation. The meeting was attended by more than 400 builders, developers, tradesmen and realtors inter-

ested in providing housing financed by FHA. These meetings and discussions resulted in a tremendous increase in the number of section 502 RH loans made and the amount of funds loaned.

The table below shows the number of loans made and the amount of funds loaned in the fiscal year ending June 31, 1969, as compared with the succeeding years through March 31, 1973, the end of the period covered by the audit.

Fiscal year ending	Number loans made	Amount funds loaned
June 30, 1969	2,410	$18,835,820
June 30, 1970	3,373	35,744,120
June 30, 1971	5,753	59,470,370
June 30, 1972	5,467	64,971,000
Mar. 31, 1973	3,566	47,204,000

Approximately 50 percent of the loans made in 1971, 1972 and 1973 were for the purchase of new dwellings constructed under FHA conditional commitment procedure, as well as a large percentage of those made in 1970. In addition to the increased loan activity, over 500 subdivision proposals of builders and developers were approved through the State office during the period covered by the audit. Most of the conditional commitments issued were on dwellings to be constructed in these subdivisions.

Implementation of the new authorities and procedures during the transition period from late 1969 through 1970 and 1971 placed county supervisors and State office personnel in direct contact and relationships with individuals and firms engaged in building or producing houses for sale. Many produced houses on a volume basis using the most modern techniques, methods, and materials. They were accustomed to producing houses financed by conventional lenders and other Federal agencies. They were accustomed to building houses under HUD minimum property standards (MPS) as opposed to FHA's antiquated "A Guide for the Construction of Farm Buildings." They were accustomed to building and selling houses under HUD's and other lenders' housing appraisal systems. Some had also constructed houses for HUD section 235 borrowers whose loans were processed by FHA, as well as for section 235 loans processed by HUD.

At the meetings and discussions held with builders, et cetera, mentioned above, the one major complaint, almost without exception, was that FHA county supervisors' appraisals were too low. The State office RH staff, at statewide personnel meetings held soon after the 1969 national office regional meeting, discussed RH appraisal procedure and policies emphasizing the use of the most recent comparable sales and cost data available in order that appraisals may more nearly approach "market value." Following the statewide training meetings and throughout 1970 and 1971, RH specialists gave individual appraisal training assistance to county supervisors in those counties where the need was most apparent. All county supervisors were instructed to request State office assistance in making the first appraisal on properties located in the first approved new subdivision in the county before issuing conditional commitments or approving loans on the properties. Some, if not most, county supervisors were still prone to make appraisals based on the old "normal value" approach as prescribed in FHA instruction 422.3, dated 1965, and to use in their appraisal process cost data taken from houses constructed by borrowers under the contract method wtih small local carpenters or contractors who were building one or two houses at a time.

It was not until 1972, through continuous training of county office appraisers and in district group meetings with county supervisors and assistant county supervisors, that a high degree of uniformity was reached throughout the State in making RH appraisals based on "market value" as prescribed in FHA instruction 422.3, which was revised August 12, 1970, following the National office regional program meetings in 1969.

The above background information is given because it is significant to the disclosures made in the audit report which will now be discussed or commented on by cited cases and situations.

Section I A, introduction, of the audit report states that special attention was given during the audit to the appraisals of prefabricated housing and that the review covered the period from March 1, 1970, to April 1, 1973. The only FHA appraisals identified by the auditor are listed below in the order in which they appear in the audit report.

St. Francis County

Carey Bruce Gilmer—appraisal made March 25, 1970.
Ollie R. Harrison—appraisal made November 18, 1970.
James H. Ware—appraisal made June 10, 1970.
Doris W. Young—appraisal made May 15, 1970.
Dogwood Acres Subdiv.—appraisal made June 5, 1970.

Lee County

Town and Country subdivision No. 2—appraisal made May 27, 1970 (12 RH loans made using an appraisal of Mr. Williams made on May 27, 1970, as the supporting appraisal document.)

Michael Howell (foreclosure case)—appraisal made in March 1972.

Town and Country subdivision No. 1—appraisal made March 7, 1973.

It is noted that although the auditor's review covered the period March 1, 1970 to April 1, 1973, every case cited in the audit report—except two—were appraisals made between the period March 25, 1970, and November 18, 1970. The two exceptions, the foreclosure case and the appraisal made March 7, 1973, will be commented on later.

Section III, details, of the audit report will be discussed by paragraphs and the cases cited.

The second pargaraph on page 3 of the audit report describes the prefabricated dwellings financed in Lee and St. Francis Counties. This general description of the dwellings is correct. The dwelling plans and specifications met requirements for FHA financing.

The third paragraph on page 3 of the audit states, "The first appraisal on these prefab dwellings in Lee and St. Francis Counties was made by John F. Knox, St. Francis County Supervisor, on March 25, 1970." This statement could be interpreted that Mr. Knox made appraisals in Lee County, which he did not. The first case cited in the audit report is an appraisal made by Mr. Knox for $11,500 on the Carey Bruce Gilmer property. The three comparables used in making the appraisal were dwellings sold to RH borrowers Ben Harbin, James Chatters, Jr., and Eugene Turner, respectively.

The county office file for borrower *Carey Bruce Gilmer* contains a typewritten appraisal report (form FHA 422–8) dated March 25, 1970, and signed by Mr. Knox. The "recommended normal value" in part 5 of the appraisal report is $10,500. There are, however, three alterations made with pencil on the appraisal report. The "depreciated replacement value of building as improved plus site improvements" was typed "$12,000." This figure has been lined through with pencil and the amount "$10,500" inserted above it. The "summation value of property as improved" was typed "$9,500." This figure has been lined through with pencil and the amount "$11,500" inserted below it. The "recommended normal value" was typed "$10,500." This figure has been lined through with pencil and the amount "$11,500" shown. The alterations were not initialed by the county supervisor.

The county supervisor was requested to explain to this office why the appraisal report had been altered. He stated that he later used the appraisal report, thoughtlessly, as a worksheet in preparing another appraisal he was making on the same type house but containing four bedrooms instead of three for another loan applicant. He stated that his appraisal on the *Carey Bruce Gilmer* property was $10,500 and not $11,500 as reported by the auditor.

The appraisal report, of course, should not have been left altered by the county supervisor. The borrower's case file, however, contains ample documentation to support the fact that the property was appraised at $10,500 on March 25, 1970. Form FHA 444–2, Housing Fund Analysis, shows "Amount of Loan, $10,500;" "Appraised Value, $10,500;" and "Total Amount Furnished by Applicant, None." Form FHA 440–3, Record of Actions; Form FHA 440–1, Payment Authorization; and Form FHA 427–1 Ark, all show a loan of $10,500. One could have easily noted such documentation in the file and questioned the county supervisor as to why the appraisal had alterations.

The first comparable used in making the appraisal in the above case was the property of RH borrower *Ben Harbin*. This house was on a "scattered" site, as was the appraised property, and was constructed by contract between the borrower and contractor. The comparable was in fact erroneously listed on the appraisal report as selling for $12,000 in 1968, when it actually sold for $11,500 in 1967 and an FHA loan was made for that amount. The county super-

visor could not explain why the error was made. The prefabricated house was appraised at $1,000 less than the Harbin comparable, rather than $1,000 higher as reported by the auditor.

The second comparable used was the property of RH borrower *James Chatters, Jr.* The county supervisor advised the State office June 20, 1973, that according to this borrower's case file, the dwelling was constructed by contract between the borrower and J. B. Cook & Sons for the amount of $10,500. The property was appraised at $10,500 on April 30, 1970, and the loan was made June 26, 1970. He explained that he apparently used the property as a cost comparable and did not know why it was shown as a sale in 1967. The county supervisor, in comparing the comparable properties listed with the property being appraised, stated on the appraisal report, "When adjusted to present prices, we judge the house being appraised should be valued close to No. 2." No. 2 comparable listed is the Chatters property. The county supervisor could not explain why the comparable was erroneously listed as being on a 50 by 150 foot lot. The prefabricated house in this case was appraised at $10,500, the same as the comparable, and not $1,000 higher as reported by the auditor.

The third and last comparable used was the property of RH borrower *Eugene Turner*. The auditor stated, "This dwelling was rated poorer because of its somewhat obsolescent type of construction, *apparently a reference to the wood siding* on the exterior of the dwelling." (Italic supplied.) The full statement of the county supervisor on the appraisal report is "House 3 is rated poorer due to a somewhat obsolescent type of construction. However, it has city water and a larger lot." The property did not sell for $7,150 in 1967 as reported by the auditor. The borrower's case file shows that the loan was made to purchase and repair the dwelling. The file contains a development plan showing repairs to be made as follows: Underpinning dwelling; finish sheetrock; panel living room, dining room and kitchen; and paint dwelling exterior. The estimated cost of the planned repairs was $900, the cost of the dwelling was $6,200, legal fees were $50, making a total cost of $7,150. The appraisal was made on this property April 13, 1967, with a "recommended normal value" of $6,500. A loan was made for $6,500, leaving a balance of $650 which apparently was paid by the borrower who was living in the house and paying rent for it at the time the loan was made. This property was listed on the appraisal report as having been sold in 1967 at a price of $6,500. It is understandable why the county supervisor considered the "obsolescent type of construction" which could, and apparently did, refer to other construction features in addition to the *wood siding*. This was, to say the least, a very poor comparable to use in making an appraisal in 1970 on a new dwelling to be constructed. The prefabricated house was appraised $4,000 higher than the *Eugene Turner* property and, apparently, should have been.

The auditor stated in the last paragraph on page 4 of the report that similar conventionally constructed dwellings were being appraised as much as $3,100 less per dwelling than prefabricated dwellings during the time of the review. The cases cited are *Ollie R. Harrison, James H. Ware*, and *Doris W. Young*, all appraised in 1970.

All three of the cited cases are located on scattered lots in the rural town of Hughes. The population of Hughes declined from 1,960 in 1960 to 1,872 in 1970. The town is approximately 22 miles from Forrest City which has good employment opportunities and is the nearest trade center of any size. The population of Forrest City increased 10,544 in 1960 to 12,521 in 1970. The prefabricated houses cited were all located in close proximity to Forrest City. An appraiser would give more value to a house located near Forrest City than to the same or similar house located in Hughes, assuming that all other factors in the appraisal process were the same. The dwellings in all three of the cited cases were constructed under a contract between the borrower and the builder. The county supervisor may have underappraised these properties as the appraisals were made for loan applicants in 1970, the first year of transition to "market value" appraisal under new program authorities and procedures. This premise is supported by the fact that the builder later discontinued building FHA-financed houses.

The audit report discloses that Mr. Knox stated that he was instructed by the State FHA Office to appraise prefabricated dwellings higher than conventionally built dwellings. No State office employee was authorized to give such instructions, and each employee has said they gave no such instruction. Mr. Knox was given an opportunity to read the audit report June 22, 1973. He then made the statement, "On page 5, the auditor quoted me as stating that I was instructed to appraise prefab houses higher than conventional buildings. My statement to

him referred to commitment houses and not prefabs." The State office did assist Mr. Knox on making the first appraisal of prefabricated houses in his county because he had no experience with that type construction. They were to be built under commitments, and some were to be built in proposed new subdivisions.

The audit report, beginning with the last paragraph on page 6, refers to appraisals of cited cases and other appraisal work performed by Mr. Sherman Williams. Mr. Williams was, at that time, a rural housing specialist in the State office, with authority to make appraisals and train county office employees in appraisal work. He was present at the discussion concerning the audit results, held April 10, 1973, and referred to on page 2 of the report. Mr. Williams was requested to review the audit disclosures in which he had any responsibility and give a written reply or explanation on each disclosure. His report was made by memorandum to the State director, dated June 15, 1973, and is quoted below:

"I have recently completed a review of the above-named audit report which was prepared by Mr. Don R. Martin, auditor for the OIG, and have investigated some of the cases referred to therein. It appears that certain deficiencies listed, statements made, and conclusions reached in the report are in error. My reply will deal principally with rural housing appraisals prepared by me and cited in the report.

"Section II–B of the report indicates there was general agreement with findings and recommendations of the OIG representative. Based on my recollection of the rather strong discussion relative to the rough draft of the report presented on April 10, 1973, it was my impression that personnel generally disagreed with the auditor's findings. Section I–B contains the statement that, 'State office personnel advised that the appraisals on the prefabricated dwellings were increased * * *' and infers that State appraisers arbitrarily added $3,000 to the value of prefabricated dwellings as opposed to dwellings constructed by conventional methods. At the meeting on April 10, 1973, it was explained at length that, due to FHA moving into large volume housing loans the policies, procedures and methods relative to appraisals were revised in 1969 and 1970 to meet changing conditions. Prior to that time, FHA had provided financing for a small number of houses each year located on scattered lots and, based on policies in effect at that time, kept rural housing loans as low as possible by appraising security property well under the market value. During the 1969 and 1970 period additional costs relative to developing a house and site were included as part of the replacement cost of rural housing and appraisals were upgraded on 'all types of housing' to show the market value.

"In section III, page 7 of the report, reference is made to an appraisal I made in Lee County, Ark., on May 27, 1970. The information given in the first paragraph is essentially correct, however, Mr. Martin failed to mention that at the time of my appraisal this was a new subdivision proposal to be located in an open field and that the appraisal was based on an approved house plan and specifications, as well as plans for developing the subdivision. No site improvements had yet been started and no houses had been built. Consideration was given to the cost of land for a house site, the cost of developing a well for a sanitary water supply, the cost of installing a driveway, a concrete parking slab and the individual sewage disposal system. The base cost of a frame dwelling of similar size as the manufactured house being considered was used. In line with existing policies and procedures at that time other cost items considered were loan closing, surveys, preparation of plans and specifications, subdivision layout, marketing costs, and the overall packaging of the application and proposal. This is known as the summation or cost data approach and includes the average cost of all items required to completely replace the property.

"Comparable properties were used in the sales or market data approach as a check against the summation or cost data approach. Property A consisted of a house and site purchased by James M. Klenk in March 1969. In the second paragraph on page 7, Mr. Martin states the appraisal report erroneously listed the selling price of this property as $12,000 and that the option to purchase agreement in the FHA loan file showed the selling price of the property to be $10,000. Mr. Martin's research and analysis appears to leave something desired as evidenced by the following facts established during a visit to the Lee County FHA office on June 13, 1973:

"1. My appraisal report, dated May 27, 1970, contained in the Bobby L. Ashburn case file lists the price or cost of the Klenk property as $12,000.

"2. The James M. Klenk case file contains an option dated March 26, 1969, listing the total purchase price of the Klenk property as $12,000. The option is

signed by Billy J. Spears and Beulah F. Spears, sellers, and James M. and Betty C. Klenk, buyers.

"3. The Klenk case file contained the original warranty deed signed by the Spears as seller, conveying title to the Klenks, as purchaser and was dated September 26, 1969. The deed was prepared by Carroll E. Ray, attorney, Marianna, Ark., and the instrument was recorded September 26, 1969, at 3 p.m., book 238 at page 202, W. F. Curtis, circuit clerk. The transfer price was listed as $10 and other considerations. Revenue stamps affixed to the deed included one green stamp, $31.50, and one blue stamp, $4.50, for a total of $36. I telephoned the office of Daggett, Daggett & Van Dover, attorneys, 8 South Poplar, Marianna, Ark., and talked to Kathy Flowers. She looked up the statutes in effect on September 26, 1969, and advised me that the requirement for revenue stamps at that time was $1.50 for each $500 or fraction thereof for the total sale price of the property. By the use of this information, the sale price of the Klenk property was determined to be $12,000.

"4. The appraisal report contained in the Klenk case file established the 'normal value' as being $10,900.

"5. The running case record in the Klenk case file dated March 21, 1969, states the applicant was advised that FHA could loan $10,000 on the property.

"6. The running case record of the Klenk file dated March 26, 1969, stated the applicant came to the office and advised FHA to process his loan and he would furnish the balance between the amount of the option and the loan.

"7. The record of actions contained in the Klenk file indicates that the FHA loan was approved on July 7, 1969 ,in the amount of $10,000.

"The Klenk property was rated only nominally better than the property being appraised, even though it was a larger dwelling and of brick veneer construction. The fact that it was 5 years old when the transfer occurred and it is located in a town which is somewhat static, with no employment in the immediate area and 14 miles distant from a high school accounts for the sale price of $12,000. This dwelling was built by conventional methods and under the appraisal policies existing early in 1969 only a $10,000 loan was made, yet in my appraisal of May 1970, under the new policy relative to appraisals, I gave full weight to the $12,000 sale price in comparing it with the property being appraised.

"The auditor apparently questioned my rating the Harvey L. Passmore comparable less desirable, due to location. The property is located 1 mile south of the town of Moro, on highway 78, with 0.6 acre comprising the site. As indicated previously the town of Moro was in a rather static condition at the time of my appraisal. The property is located some 14 miles from a high school.

These facts give some indication as to why the transfer price was only $10,000 and therefore rated poorer than the property being appraised.

"Comparable C listed Pacific Homes house near Garland City, Ark., because it was the same house, with the same floor plan, as that being appraised in Lee County. The site of comparable C was approximately the same size, the soil type and percolation rate were quite similar, drainage was equal, and the location of the site was similar, being on a gravel road just off a paved highway. Site improvements were the same, with a gravel driveway, concrete parking pad, individual well and a sewage disposal system. Although the properties were almost identical, comparable C was located near a smaller and less desirable town than the property being appraised. The transfer price of comparable C was $10,800, therefore was checked poorer compared to the property being appraised.

"Mr. Martin criticized the use of comparable properties located some distance from the property being appraised. It was the policy of State appraisers who were familiar with properties all over the State to use comparables that were very similar to properties being appraised in other areas. The important point is to be thoroughly familiar with such comparable properties, which was the case in this instance.

"The auditor indicated FHA had appraised the same type manufactured dwelling in neighboring Phillips County at the same time for $9,500. The Phillips County property was developed approximately one year prior to the Lee County property in question, with an entirely different floor plan being used as the first manufactured house supplied by Pacific Homes. This was explained to Mr. Martin on a visit he made to my office in Paragould but he did not mention this in the audit report.

"The Phillips County property is located near a larger town with more facilities and with a larger potential market. The site itself, however, was considerably less desirable than the Lee County site, due to a high embankment being cut

down and leveled with loose fill to form the individual house sites and to construct the street. This was explained to Mr. Martin as the reason for not using the Phillips County property as a comparable and why the resultant value established on the Lee County property was somewhat higher than the transfer price on the Phillips County property.

"On page 8 of the audit report, Mr. Martin indicates that in October 1972, he obtained the services of an outside appraiser to appraise two properties with manufactured houses in Lee County. He indicated the value established by this appraiser was $7,900 in Town and Country Subdivision No. 1 and $8,150 in Town and Country Subdivision No. 2. This apparently was an effort on Mr. Martin's part, some 2½ years later, to point out that my earlier appraisal was in error. In the following paragraph, Mr. Martin refers to a reappraisal made in March 1972 by Mr. Joe Kennedy, County Supervisor, at which time he established a current value of $8,000. In view of the fact that Mr. Kennedy had analyzed the market on the basis of changed social and economic conditions that had occurred since my original appraisal, one might conclude that Mr. Martin obligated the Government for unnecessary expense in paying for the services of an outside appraiser who, interestingly enough, arrived at approximately the same value as determined by FHA's reappraisal some seven months earlier. Mr. Martin, also stated that the Howell dwelling, which was reappraised by Mr. Kennedy, was in essentially the same condition as when it was new, although Mr. Martin's inspection was some 2½ to 3 years later.

"The property on which I made the first appraisal was purchased by Bobby L. Ashburn and is two or three doors from the Howell property reappraised by Mr. Kennedy. The Ashburn case file contains numerous field visits in the running case record, one of which was made on June 1971, for maintenance inspection and a notation in the file stated the borrower had moved out of the house. The running record also stated that the house was badly abused, with two door locks missing, two door units wrecked and the floors in bad condition. On another field visit, dated August 12, 1971, Mr. Joe Kennedy stated the house was in very bad shape and he prepared an inspection report listing some 10 major deficiencies due to misuse of the dwelling. This property was also reappraised and a value of $8,000 established, which is the same value established on the Howell property. This would indicate that the Howell property was not in 'essentially' the same condition as it was when it was 'new' at the time reappraisal was made on that property. The report indicates that borrowers were attracted to the manufactured dwellings by the liberal credit terms extended by FHA. For the record, it should be noted that FHA offers the same credit terms on all types of housing and that applicants have the prerogative of selecting the house they desire to purchase.

"On my visit in May 1970 to Lee County, I inspected the proposed 20-acre site for another subdivision on which conventional housing was to be constructed. I made suggestions to the supervisor and advised on requirements that the developer should meet to qualify for conditional commitments. I inspected this subdivision on June 13, 1973, and observed that several houses had been constructed by conventional methods and that these properties had been appraised by FHA in excess of $14,000. With a minimum amount of research and analysis beyond the apparent preoccupation with manufactured housing, Mr. Martin should have ascertained that appraisals on conventional housing are made on the same basis as appraisals on manufactured housing.

"On June 14, 1973, I visited the St. Francis County FHA Office to review material relative to certain items cited in the audit report. Specific reference was made to the original appraisal prepared by me on property located in Dogwood Acres subdivision in the town of Madison, Ark., which was completed on June 5, 1970. Mr. Martin stated in his report that he is unable to discern any difference in the location quality of the Johnny Taylor property as compared to the property being appraised in the Dogwood Acres subdivision. My original appraisal was based on approved plans and specifications, as well as an approved subdivision located on a paved street in the southwest part of the town of Madison. The subdivision was planned with central water service and paved streets and is located close to churches, stores, and other facilities in Madison. The subdivision was to be composed of some 30 new dwellings, making it a fairly desirable area. In contrast, the Johnny Taylor property is located on a county gravel road across Highway 70 at the north edge of the town of Madison. It is further from the churches, stores, and other facilities and the immediate neighborhood is rather poor, with an old dwelling located beside the comparable property. The

property is located on a 50 foot lot and other houses in the area are crowded. For these reasons, the Johnny Taylor comparable is less desirable, as indicated in my appraisal.

"In the last paragraph on page 6 of the audit report, the auditor indicates that dwellings constructed by the conventional method were being appraised at that time from $1,000 to $3,000 less than the appraised value placed on the manufactured dwelling. Since Mr. Martin did not cite specific cases, no details can be given. Any such houses would have been constructed prior to the appraisal of the Dogwood Acres property in order to be given any consideration. As mentioned previously in this reply, it had been explained to Mr. Martin the reasons for adjusting appraisals more nearly in line with market values and that conventional housing was being appraised on the same basis as the manufactured housing. I inspected the Dogwood Acres subdivision and the security property appears to be fairly well maintained, making the subdivision a fairly desirable area.

"This reply is rather lengthy and detailed in order to set out pertinent facts as regards my appraisals and other items mentioned in the audit report. My appraisals were prepared in accordance with policies and procedures in effect at that time. The values established were based on research and analysis of the market under conditions then existing. The audit report states that approximately 100 families purchased these houses in St. Francis and Lee Counties, giving substantial support to my analysis of the market and appraisal of the property."

Mr. Williams failed to explain the apparent erroneous listing of the dwelling of Johnny Taylor as the second comparable cited on page 6 of the audit report. The borrower's file shows that the original agreement between the seller and the buyer, Johnny Taylor, was $8,000. Johnny Taylor applied to FHA for assistance in purchasing the property. FHA agreed to make a loan of $8,000 provided the following repairs were made to the property: (1) 4-inch concrete slab in carport; (2) replace tile in hallway and kitchen; (3) install driveway across ditch; (4) repair septic tank and drain field; and (5) stucco blocks on front. The cost of the repairs was determined to be $750. The cost of the property plus the cost of required repairs was $8,750, which is the amount shown under "Cost or price" in the appraisal report.

The third paragraph on page 8 of the audit report states, "In our review of FHA appraisals, we noted no instance where properties other than FHA-financed properties were used as comparable properties." The use of such comparables is not a good appraisal practice and should be avoided where there are data available on sales of comparable properties on the open market. This practice has been noted more recently by RH specialists in other counties during routine appraisal reviews. Arkansas Bulletin No. 1882, which will be referred to later, was issued June 14, 1973, to assure discontinuance of this practice.

Cited in paragraphs 2 and 3 on page 8 and paragraph 2 on page 9 of the audit report are appraisals made by Mr. Thomas L. Dial, real estate appraiser, at OIG's request; Mr. Joe Kennedy, Lee County FHA supervisor; and Mr. Lee Cook, assistant to the State director—all on property located in Town and Country subdivision No. 1 and Town and Country subdivision No. 2. It is gratifying to note that, since all four properties have the same location, are of the same type construction, have the same physical conditions and same market conditions, the FHA employees' appraised values did not significantly vary from the appraised value found by the private real estate appraiser.

Town and Country subdivision No. 1 is located at Haynes, which is approximately 9 miles north of Marianna and 7 miles south of Forrest City on State Highway No. 1. These two subdivisions were developed by New-Lee Builders, Inc., after having submitted to FHA for approval the proposed subdivision plans along with plans and specifications of the dwellings to be constructed on the individual lots. The dwellings were prefabricated houses manufactured by Pacific Homes, Inc., Marks, Miss.

The dwelling plans and specifications were approved. The developer was advised that if the subdivisions were properly developed and the houses were constructed to meet FHA inspections, RH loans could be made to eligible applicants to purchase them. State office personnel made the first appraisals in order to give assistance to the county supervisor who would then make other appraisals in the subdivision as individual RH loans were processed for applicants desiring to purchase the completed houses. The first appraisals were made on the basis of approved plans and specifications and prior to any construction work. Mr.

Sherman Williams made the initial appraisal, as noted by the auditor on page 7 of the audit report, in Town and Country subdivision No. 2.

The developer constructed on a speculative basis 13 houses in Town and Country subdivision No. 2, and 17 houses in Town and Country subdivision No. 1 during the period from about July 1, 1970, to about November 1, 1971. FHA made five loans to purchase the completed houses in Town and Country subdivision No. 1 and 11 loans to purchase houses in the other. All of the houses on which FHA loans were made were inspected by an FHA construction inspector before loans were closed. The inspection report on each showed 100 percent complete with no exception. The FHA construction inspector was a temporary employee who is no longer employed by this agency. FHA began receiving numerous complaints from borrowers in the two subdivisions during the first year of the loans which was from about December 1970 to about November 1, 1971.

The county supervisor investigated the complaints and found numerous deficiencies because of poor workmanship during construction. They were brought to the attention of the builder who failed to make satisfactory corrections. The first time the prevalence of serious deficiencies in construction came to the attention of the State office was when adverse publicity was given in statewide news media—both television and newspapers—in November or December 1971. The county supervisor was immediately notified by telephone to make no more loans on the houses without authorization from the State director.

RH specialists and the FHA architect worked 2 weeks in the county during January 1972 inspecting each house on which a loan had been made and all completed houses that had not been sold. A list of all defects was made of each borrower's house and presented to the builder. The builder was requested to correct all listed deficiencies in each borrower's house and notify the county supervisor when all deficiencies were corrected in order that an inspection could be made. The corrected deficiencies were inspected by the county supervisor, FHA architect, and an FHA construction inspector detailed from the State office in April 1972. The builder was advised that no FHA loans would be made on the remaining unsold houses until construction defects were corrected. As of this date, no additional loans have been made in the two subdivisions. There are 14 speculative built houses which have not sold and have been vacant since they were constructed in 1971.

Some of the borrowers became dissatisfied with their homes the first and second year of occupancy because of the construction deficiencies, the publicity given in news media, and the racial turmoil and economic boycott in Marianna that occurred during 1971 and 1972. Some abandoned their houses and foreclosure was necessary; some conveyed title to the Government; and others liquidated their accounts by transfer. The five houses on which RH loans were made in Town and Country subdivision No. 1 are still owned and occupied by the borrowers.

The market for the houses in the two subdivisions, appraised by Mr. Dial, Mr. Kennedy, and Mr. Cook, is not the same as when the original appraisals were made because of the economic-socio-political problems that occurred in Marianna and the houses appraised were older with some deterioration, abuse, and vandalism. Attached hereto is a copy of an article which appeared in the Arkansas Gazette, Little Rock, on Wednesday, April 4, 1973. The article is headlined "Marianna Boycott Cost $5 Million, Researchers Say," and reports the results of a study made by the University of Arkansas. The article reports that as a result of the boycott, the number of homes listed for sale jumped in the middle of the months of the boycott and, at the same time, property values dropped as much as 25 percent on domestic property. The same article appeared in the Arkansas Democrat, April 3, 1973.

The appraisal made by Mr. Cook on March 7, 1973, was made on one of the houses that had not sold in Town and Country Subdivision No. 1. The appraisal was made at the request of the county supervisor because he had an applicant interested in purchasing the property with a rural housing loan. The appraisal value was based on the house being rehabilitated. His estimate of value had no relationship to the original appraised value on properties in the subdivision in 1970.

The audit report, in the *last paragraph on page 8*, refers to a foreclosure case and the appraisal made by Mr. Joe Kennedy, Lee County FHA supervisor. The appraisal of $8,000 by Mr. Kennedy in March 1972 on the *Michael Howell* property was made for use in determining the maximum authorized bid on behalf of the Government at the foreclosure sale, in accordance with paragraph XVIII–B–4–g of FHA Instruction 465.1. Mr. Kennedy was given an

opportunity to read the audit report and he stated, "I did not make the statement that in my opinion the prefabricated dwellings were overappraised by $3,250, as shown in the audit report. I did make the statement that adverse publicity from newspapers, radio, and TV had affected our market for houses adversely, and also the racial situation had affected adversely our housing conditions. I did make the statement that we did not have any buyers for these homes at that time. I did not mention or state that the Government would lose $20,000 on foreclosures." It is obvious that such losses will occur unless the local housing market improves considerably.

The audit report, *page 9, paragraphs 3 and 4*, refers to statements made by Mr. Lyle H. Rogers, chief of rural housing. Mr. Rogers made his statements during the interview with the auditors on April 10, 1973, when FHA appraisal methods and procedures were discussed at length.

The statement attributed to Mr. Rogers in paragraph 3, "They had to appraise the prefab dwellings higher than conventionally constructed dwellings," is not correct. What Mr. Rogers did say in effect was that under the new authorities, in order to increase the volume of rural housing construction in the State and meet the demand for rural housing loans, houses constructed under the commitment procedures had to be appraised higher than appraisals previously made on the houses constructed by the small builder under the contract method with a borrower. The higher appraisals took into consideration typical development cost items incurred by developers and builders constructing and marketing houses on a volume basis.

Mr. Rogers was asked why the prefabricated house values had declined while conventionally constructed houses had increased at the same time. The houses under question were those in town and country subdivision Nos. 1 and 2 in Lee County, those in Garland City, in Miller County, and those at Stamps in Lafayette County. He attributed the decrease to: (1) the economic boycott and racial troubles in Marianna (referring to the two subdivisions there), (2) unfavorable publicity about the poor construction of the prefabricated houses (referring to the two subdivisions in Lee County), and (3) the reluctance of the general public to accept the prefabricated house. Mr. Rogers pointed out during the discussion that since those houses were constructed, he and the FHA architect had meetings with the builders of the Pacific Homes type dwellings and brought about changes which upgraded the dwellings to include such items as paved drives, carports with outside storage, vanities under bathroom lavatories, partial and complete brick veneer, and good workmanship.

The report of the audit findings in the last paragraph on page 9 refers to prefabricated dwellings (Pacific Homes) in Miller and Lafayette Counties. These houses were constructed in new subdivisions at Stamps (Lafayette County) and Garland City (Miller County). There are, however, other prefabricated houses of the same type in both counties financed by FHA. Losses will be incurred at Stamps and Garland City where there was no boycott.

State office personnel have reviewed the delinquent borrower and loan failure situation at Garland City and Stamps on several occasions, and did not find the types of houses nor the original appraised value of the properties to be a factor in the borrowers' failures to meet their loan obligations. The original appraisals were creditable and consistent with the policies and procedures in effect at the time they were made. The loans that have failed would have failed regardless of whether the houses had been of the prefabricated type or of conventional construction and regardless of whether values recommended in the original appraisals had been $11,000 or $8,000. The loan failures are attributed to the type of applicants to whom the loans were made and to the social and economic conditions existing in the area where the loans were made. At the time the audit was made, there were three houses in Miller County that had been acquired by the Government through either voluntary conveyance or foreclosure, and four houses in Lafayette County. The three houses in Miller County were inventoried at a value of $9,500 each. Two of the houses in Lafayette County were inventoried at $9,000 each, one at $8,700, and one at $8,600. The fact that these houses were taken into inventory at values somewhat less than the original appraised values is pointed out in the audit as the primary basis for concluding that they were originally overappraised. The inventory values were determined in accordance with paragraph XVII–B–5 of FHA instruction 465.1 in the voluntary conveyance cases and paragraph XVIII–B–4–g of FHA instruction 465.1 in the foreclosure cases. The fact that these houses had sustained a considerable amount of abuse in the period between the original appraisals and the inventory value

determination was not disclosed in the audit report as having any bearing on the differences in values.

The basic objective of FHA in making housing loans is to assist low-income people in rural areas to obtain decent, safe, and sanitary housing. The town of Garland City is located in a small rural community 20 miles from Texarkana with a population of 320, the majority of whom are of the minority race with very low incomes derived mostly from farm day labor, social security, welfare assistance, and part-time work at various low paying, nonskilled jobs in the local area. At the time the subdivision was being considered, there was practically no decent housing in the community. The people lived in small, dilapidated shacks which they either owned, lived in rent free, or paid rent ranging from $5 to $25 per month. It was also at this time that a considerable amount of emphasis and urgency was being given to the need to accelerate various housing programs to provide housing for the poor and disadvantaged. Wide publicity was being given to the larger appropriations designated for housing, to the subsidized housing authorizations, and to meeting national housing goals. Builders and developers were being encouraged to become involved in the push for more housing produced on a larger scale at a more rapid pace. Organizations and agencies connected with OEO, civil rights, rural housing alliance, and others were exerting pressure on Farmers Home Administration to revise its appraisal concepts and speed up its loan processing methods in line with the new authorizations. In working under these circumstances and going through a period of transition to an accelerated type program, some mistakes, errors in judgment, and failures to give due consideration were understandably made by FHA State and field office personnel. Had a more thorough investigation into the social and economic conditions at Garland City been made, we may not have approved of a housing project in that community. However, from physical observation of the conditions, the need for adequate and sanitary housing in that area was obvious, and it was felt that, even though the incomes of the people were very low, they would be able and willing to pay $40 to $50 per month for modern and adequate housing. When loans were made to these families and they moved into the new houses, they had no furniture or household equipment to speak of, and most of them, in addition to the housing loan obligation, obligated themselves for new furniture, stoves, refrigerators, washing machines, and other items. It was only a matter of time until most of these families were in financial trouble on payments which they could not meet with their limited incomes. Many of them have chosen, and are still choosing, to move back into the shacks they lived in before. This we do not understand. We did not receive any complaints from the borrowers on the type of construction or the size of loan on these houses and cannot attribute their moving out to an overappraisal of these properties.

The audit cites an estimate by the country supervisors that foreclosure action would have to be taken on 40 of the 60 loans made on these prefab dwellings in two subdivisions in Miller and Lafayette Counties (Garland City and Stamps) and that the Government would suffer a loss of $120,000 on these loans. At the time the audit was made, only 7 of the 60 units had been taken into inventory and foreclosure action had been initiated on only 6 other of these loans. Even though it is evident that losses will be suffered, any forecast or estimate as to the amount of such losses prior to actual acquisition and disposition of the security is based on the assumption that the present economic trends will continue in this area.

We recognize that a significant variance in appraisal values of properties exists within counties and from county to county on appraisals made during the period of transition from program operations in 1969 to the expanded program authorities in 1970 and 1971. The appraised values should not vary significantly, however, in those years on properties developed under commitment procedures and new subdivisions.

Mr. William Adams, the rural housing specialist delegated primary responsibility to review appraisals and give appraisal training, was detailed to St. Francis and Lee Counties the week of June 18, 1973, for the purpose of reviewing appraisals made on prefabricated and conventionally constructed houses since 1971. He was also requested to give special training to the county office employees authorized to make appraisals to assure an understanding of current appraisal procedures.

Listed below are appraisals, made in each county which Mr. Adams reviewed, showing comparisons of appraised value per square foot of effective area on each type house appraised. The effective area is the sum of the living area in the dwelling plus one-half of the other area, such as carports and storage. The cases reviewed were taken at random from the files:

Borrower	FHA appraiser	Date appraised	Type construction	Effective area (square feet)	Appraised value per square feet
Lee County:					
L. Walker	T. McCall	June 15, 1972	Prefabricated/brick veneer	1,212	$10.96
L. Brown	J. Kennedy	Oct. 19, 1972	do	1,117	10.74
A. Walton	do	Feb. 18, 1972	do	1,396	10.74
R. Warren	do	Aug. 10, 1972	Conv./brick veneer	1,104	10.87
B. Brister	M. McNeal	June 19, 1972	do	1,296	10.86
H. Jackson	do	July 17, 1972	do	1,104	10.96
O. Morgan	do	Mar. 22, 1973	do	1,404	12.00
J. Smith	do	May 30, 1973	Prefabricated/brick veneer	1,204	11.21
St. Francis County: ,					
P. Fryer	J. Knox	Aug. 17, 1972	Conv./ brick veneeer	1,200	11.00
A. Blake	J. Lang	Oct. 3, 1972	do	1,170	11.66
J. Threat	M. Norman	Mar. 9, 1973	do	1,104	11.68
J. Tinner	J. Lang	Aug. 18, 1972	Prefabricated/brick veneer	988	11.13
S. Ivy	do	Aug. 22, 1972	do	988	11.13
I. Jones	do	Aug. 18, 1972	do	988	11.13
L. Wynne	J. Knox	Jan. 22, 1973	Prefabricated/frame	932	10.40
A. Warren	do	Aug. 24, 1972	Prefabricated/frame	932	10.19

Paragraph II–A recommendation on page 2 of the audit report contains recommendations for State office actions. Arkansas Bulletin No. 1882, dated June 14, 1973, was issued to all county supervisors and all assistant county supervisors who have been delegated authority to make rural housing loan appraisals. The bulletin directed these employees to immediately review and study FHA Instruction 422.3, appraisal of nonfarm tracts and small farm tracts for rural housing loans. They were instructed to give special attention to: (1) paragraph II concerning comparable sales prices, replacement costs, and market value; (2) paragraph II, considerations influencing value; (3) paragraph IV–A, obtaining background information; (4) paragraph IV–C, study of comparable homes recently sold in the area; and (5) paragraph VII, preparation of form FHA 422–3, appraisal report. Arkansas Bulletin 1882 also requested the employees to update comparable sales data in the county office by obtaining current information on sales of dwellings recently sold in the open market and to record and maintain such sales information on form FHA 422–12, nonfarm tract sales data. The bulletin requires the use of the recorded sales for comparable properties when appraisal reports are made. The employees were further instructed in the bulletin that appraisal reports should reflect the use of comparable properties sold outside the FHA program as well as FHA-financed dwellings and that appraisal reports on prefabricated dwellings will reflect at least one conventionally constructed comparable property.

A copy of Arkansas Bulletin No. 1882, dated June 14, 1973, is attached. Rural housing specialists have been instructed to routinely review a sample of appraisals made by county office employees and the sales data recorded on form FHA 422–12 each time they visit a county office and to give training to employees where there is an apparent need.

Compliance with Arkansas Bulletin No. 1882 will embody the specific recommendation contained in the audit report except "(c) recognize, when appraising prefabricated dwellings, that such dwellings have a limited appeal to the public due to unconventional construction" and "(f) discontinue using comparable sales of dwellings sold under Government interest credit assistance programs, as these do not constitute sales under normal conditions." The national office should consider recommendations (c) and (f) and advise the State office as to whether they should be adopted and implemented in the county offices.

The audit report has not been an easy one to analyze, understand, act on, and reply to the disclosures therein. We believe, however, the audit will result in FHA making better appraisals on all types of dwellings financed with rural housing loans in the State.

ROBERT L. HANKINS,
State Director.

[From the Arkansas Gazette, Little Rock, Ark., Apr. 4, 1973]

MARIANNA BOYCOTT COST $5 MILLION, RESEARCHERS SAY

MARIANNA.—The 13-month long black boycott of white-owned businesses here in 1971 and 1972 was 95 per cent effective, costing as much as $5 million in lost wages alone and causing an economic nosedive that may linger months or even years, a study conducted by the University of Arkansas has revealed.

The study was published in the spring 1973 Arkansas Business and Economic Review. Robert D. Hay, professor of management at the U. of A., and his colleague, Donald D. White, assistant professor of management, wrote the report.

The boycott began June 11, 1971, and ended in July 1972.

Twelve downtown retail merchants were either forced out of business or chose to close their doors rather than endure hard times brought on by the boycott, the report said. Eight of the stores sold convenience goods, two sold shopping goods and two sold specialty goods. Two other owners sought to overcome their losses in sales by relocating their stores on the outskirts of town.

"However, boycott leaders were quick to notify black citizens that mere changes of location did not remove these stores from the list of firms to be boycotted," Hay and White said.

Five other businesses, both black and white, were lost in fires. "Not all fires were attributed by local authorities to arson," the professors said. "However, all did occur during the period of the boycott."

Appendix 9(D).—Comments of Auditor Concerning Arkansas State Office Final Reply

COMMENTS OF FHA OFFICIALS	COMMENTS OF AUDITOR
1. State FHA officials stated that Gilmer prefab was appraised at $10,500 rather than $11,500 as stated in our audit report.	1. During the audit we questioned Knox about the pencil changes made on the Gilmer appraisal. Knox stated that he first appraised the Gilmer prefab for $10,500, but later changed the appraisal to $11,500 after he consulted with State Office personnel. Knox stated that he could not recall with whom in the State Office that he had conferred about the appraisal. We questioned Knox again later in our audit about the Gilmer appraisal and he again stated that he intended for the appraisal of the Gilmer property to be $11,500. The FHA District Supervisor, Harold Foster, was present at the later discussion. The Gilmer property actually sold for $10,500, which was the amount of the FHA loan. The audit report stated that the Gilmer prefab was appraised at the same value as the Harbin property and not $1,000 higher as stated by FHA officials. Based upon our understanding of the Knox appraisal of the Gilmer prefab, the prefab was appraised $1,000 higher than the Chatters property.
2. FHA officials stated that the Turner property did not sell for $7,150 as reported in the audit report.	2. The Turner property did not technically sell for $7,150. The borrower (Turner) did pay $7,150 for the property with a portion of the $7,150 being used to improve the property. The improvements were made under FHA supervision and inspection as a condition of the FHA loan. Based upon our inspection of the Turner dwelling, we considered that the construction compared favorably with the prefab construction. The two-acre lot of the Turner property should contribute to the value of the property considerably. The Turner property was not a good comparable property for the Gilmer appraisal. FHA officials acknowledged that this was not a good comparable, and the sales price was listed in error on the appraisal report.
3. State FHA officials stated that houses in Hughes, Ark., were not as valuable, regarding appraisals as a similar house near Forrest City.	3. The FHA officials failed to mention that Hughes is within easy commuting distance of both Forrest City and West Memphis, Ark., and therefore had many more jobs available than the Forrest City area alone. The three similar conventionally constructed dwellings cited in our report were all appraised after the Gilmer property was appraised. If FHA was upgrading their appraisals at this time, why were these appraisals not upgraded also?

4. Knox denied making the statement that he was instructed by the State FHA Office to appraise the prefabs higher to cover increased cost.

4. After our audit was completed, an OIG investigation was made of Mr. Knox. Several times during the investigation, Mr. Knox made false statements to the reporting agent. Some of these statements were in writing.

We know of no FHA instruction which would allow FHA officials to appraise a conditional commitment house for more than its current market or normal market value. If Knox was instructed by State Office personnel to increase the value of dwellings built under conditional commitments, we consider this to be in violation of FHA appraisal instructions.

5. Official stated that there was generally disagreement with the audit at the exit conference at the Arkansas State FHA Office.

5. According to R. L. Hankins' sworn statements at the congressional hearing, he stated that FHA personnel agreed with our findings and recommendations at the exit conference.

6. FHA officials disputed the selling price of the Klenk property as reported in audit report.

6. The selling price of the Klenk property as reported in our audit report was taken from a copy of the acceptance of option, dated September 25, 1969. This acceptance of option is dated some six months after the option itself was dated. The acceptance of option (copy in audit working papers D–1/8) was originally for $12,000, but was later changed to $10,000. This change was initialed on the acceptance by both buyer and seller of the Klenk property. It should be noted that the acceptance of option is the only document in the loan file that should state the correct selling price for the property. The information cited by FHA officials, such as the appraisal report of another unrelated FHA borrower, does not discredit the selling price of the Klenk property as stated in the audit report. During our audit, we attempted to locate the buyer and seller of the Klenk property to confirm the sales price but we were unable to locate them.

7. FHA officials stated that Passmore property was poorer due to its location.

7. It should be noted that the town of Marianna, Ark., which was the location of the property being appraised, was also in a "static" condition or a period of declining population. Therefore, the location should not have made any difference in the values of the two properties.

Appendix 9(D).—Comments of Auditor Concerning Arkansas State Office Final Reply—Continued

COMMENTS OF FHA OFFICIALS	COMMENTS OF AUDITORS
8. [See Appendix 9(C), page 211.]	8. We pointed out in our audit report that the practice of using comparables outside the vicinity of the property being appraised was in violation of FHA instructions. In our opinion, we did not consider the market value of a similar house located in Garland City, Ark., to be a suitable comparison for a property located 250 miles away in another market area. It should be noted that FHA officials had appraised the comparable used in Garland City and probably had an influence on the selling price of the property due to their appraisal.
9. FHA officials stated that prefab in Phillips County was entirely different.	9. The prefab houses in Phillips County were of the same type construction, material, size and were also prefabricated by Pacific Homes, Inc. Value wise, the houses were identical in our opinion.
10. FHA officials disputed the condition of the Howell dwelling as being in essential new condition.	10. We selected the Howell dwelling for appraisal because this dwelling had not been abused. We inspected the dwelling and found that the dwelling had been lived in only a few months and was in good condition. The appraisal report prepared by the outside appraiser, Mr. Dial, states that the property needs only minor painting and screen replacement. Had Mr. Dial appraised the Ashburn dwelling, no doubt, the appraisal would have been even lower due to its deficiencies caused by misuse. The Kennedy reappraisal of the Ashburn dwelling was probably based upon the Ashburn dwelling being repaired. The appraised value of the Ashburn dwelling would have been its value after all the deficiencies had been corrected. Mr. Dial stated on the appraisal report that "I think the biggest hinderance to resale is the overall price of the property, which is too high." The price of this property was also the FHA appraised value.

11. FHA officials disputed our contention that Taylor dwelling had equal value relative to location.

11. The Taylor dwelling is located less than one mile from the Dogwood Acres Subdivision within the City of Madison, Ark. On the FHA appraisal, the Taylor dwelling was described as "is similar in size and construction, has carport, but the site location is much less desirable." We did not consider the location to account for the $3,350 difference in the two properties as indicated by the FHA appraiser.

12. FHA officials contended that prefabs and conventionally constructed were appraised the same.

12. We cited specific cases in our audit report (pages 4 and 5) in which similar conventionally constructed dwellings were valued from $1,500 to $3,100 less than prefab houses. Two of these houses were appraised after Williams' appraisal of the prefab in the Dogwood Acres Subdivision. The other house was appraised less than one month before Williams' appraisal. If all appraisals were being "upgraded" why were these appraisals not also being "upgraded"?

13. FHA officials apparently were trying to dispute the sales price of the Taylor property.

13. FHA officials stated that the cost or price of the Taylor property listed on the appraisal report was $8,750. It should be pointed out that this does not mean selling price of the property. The selling price of the property was the price that should have been used on the appraisal report and not the cost. The $8,000 selling price of the property was conditioned upon the property being repaired. The sales contract in the borrower's file is the only document that should correctly indicate the correct selling price. The appraisal report in the borrower's file has nothing to do with the selling price of the property.

14. FHA officials denied making statements attributed to them in the audit report.

14. The statements attributed to Kennedy, Knox, and Rogers were our understanding of their comments during the audit. We are unable to explain why they all have apparently changed their minds about the comments made.

Appendix 10.—Audit of Farmers Home Administration Program in St. Francis County, Ark.

Audit Report, Farmers Home Administration Program, Saint Francis County FHA Office, Forrest City, Ark., as of March 20, 1973 (Report No. 412-233-T)

I—INTRODUCTION AND SUMMARY

A. Introduction

This audit was made on a test-check basis and included tests of all active FHA loan programs, with emphasis on the Rural Housing (RH) Program. Primary emphasis was given to sampling recent and current operations, but older transactions were reviewed to the extent deemed necessary. We gave special attention during the audit to the review of FHA-financed subdivisions.

As of January 29, 1973, there was an unduplicated case load of 661 active borrowers in the unit. The audit included a review of 27 borrower files and interviews were conducted with 12 borrowers whose files were reviewed.

B. Summary of audit results

Four FHA-financed subdivisions, involving 63 dwellings with loans totaling about $750,000, are experiencing serious problems with household sewage disposal systems, surface drainage, and street construction. Septic sewage is surfacing in the Dogwood Acres, Magnolia Acres, and Dawson subdivisions, creating a health hazard as well as offensive odors in the area. Residents stated that they were unable to use their sewage systems during wet weather as raw sewage would back up into bathtubs and commodes. Streets in the Dogwood Acres, Magnolia Acres, and Redbud Acres subdivisions, constructed within the past 2 years, did not have adequate grading and bases and have disintegrated in some areas.

These deficiencies have been the subject of various borrower complaints. Some borrowers have threatened to stop payment on their loans unless sewage problems are corrected. One of these subdivisions is occupied by white families and the others are inhabited exclusively by minority families.

Three FHA-financed houses had one-fourth-inch paneling suitable only for interior use, installed on exterior carport areas. This paneling, which was unapproved for exterior use, already showed signs of deterioration. In addition, enclosures for water pumps for these dwellings were not provided to prevent the pumps from freezing. Borrowers stated that their pumps had frozen on several occasions. Also, necessary concrete walkways were not provided from the driveways to the front entrances.

Rural Housing loans were being made to applicants with poor credit ratings and unstable incomes. RH loans were made to some applicants who had as many as 10 delinquent accounts shown on their credit reports. These borrowers subsequently became delinquent on their RH accounts.

Timely servicing action was not being taken on chronically delinquent cases to effect foreclosure or other appropriate corrective measures. This has contributed to the county's high rate of delinquency.

Although there was a wide range of deficiencies in FHA-financed subdivisions, these deficiencies were found in both white and minority race projects. We found no difference in the quality of construction of housing for white and minority races.

II—RECOMMENDATIONS AND DISCUSSION WITH MANAGEMENT

A. Recommendations

For the State office

1. Base subdivision planning and development on sound engineering data with detailed specifications for street construction, surface drainage, and lot development. Discontinue making RH loans in congested areas that do not have adequate central sewage disposal facilities. Take appropriate corrective action on the deficiencies cited. (See details—1.)

For the county office

2. Strengthen RH construction inspections to ensure that building contractors use suitable building materials and maintain good construction practices. Also, take action on the cases cited and other similar cases in the case load. (See details—2.)

3. Take measures to strengthen the processing of loan applications to ensure that loans are made only to applicants with adequate repayment ability and satisfactory credit records. Submit the cited borrower case to the State Office for appropriate administrative determinations concerning borrower eligibility. (See details—3.)

4. Initiate appropriate servicing action on the cited cases and on other similar cases in the case load. Improve the overall servicing of delinquent borrower cases to assure that such cases receive timely attention and that needed corrective measures are decided on and carried through to a conclusion. (See details—4.)

B. Discussion with management

A discussion concerning audit results was held on March 20, 1973, with:

John F. Knox—County Supervisor.
Margaret P. Norman—Assistant County Supervisor.
Marcus N. May—Assistant County Supervisor.
Joseph L. Lang—Assistant County Supervisor.
Harold E. Foster—District Supervisor.

A further discussion was held on March 26, 1973, with Mr. Lyle Rogers, Chief, Rural Housing, Arkansas State FHA Office.

Comments of State and county personnel, where appropriate, are included in the details part of this report. Personnel were in general agreement with our findings and recommendations.

The Office of the Inspector General (OIG) was represented at the county audit discussion by Auditor Don R. Martin and Supervisory Auditor Wayne E. Stuckey. Auditor Martin represented OIG at the State office discussion.

III—DETAILS

Rural housing program

Subdivision development

1. Four FHA-financed subdivisions, with loans totaling $742,950, are experiencing serious sewage disposal problems, inadequate streets and surface drainage problems. Details follow:

Dogwood Acres subdivision.—This subdivision, located in the city of Madison, Ark., consists of 31 FHA-financed dwellings with loans totaling $367,600. Loans were closed in this subdivision from September 1970 to September 1972. The subdivision has public water facilities, paved streets, and individual dwelling sewage disposal systems (septic tanks and field line filter fields). These subdivision improvements were installed by the subdivision developer, New Mer Building Co., under FHA inspection and supervision.

We observed septic tank effluent surfacing and draining across a majority of the yards in this subdivision. A majority of the borrowers that we interviewed complained that they could not use their individual sewage disposal systems during periods of wet weather because the raw sewage would back up into their bathtubs and commodes. They stated that the surfacing sewage created a terrible odor problem in the area.

Mr. Walter H. Abring, St. Francis County Sanitarian, inspected the subdivision at our request and reported that the sewage on the surface of the yards was a serious health hazard and constituted a violation of Arkansas State Department of Health (ASDH) regulations.

Mr. Henry N. Means, district engineer of the ASDH, explained that surfacing septic tank effluent was a danger to public health since harmful bacteria and virus growth were rampant in this sewage. He also stated that this surfacing sewage provided an excellent breeding ground for flies and mosquitos which in turn can transmit diseases to humans.

Borrowers in the subdivision have made various complaints about the sewage problems and have threatened to stop payments on their loan accounts and move out unless something is done about the condition.

The houses in this subdivision are located on approximately one-fourth acre lots and were inspected during construction by Richard Rice, city building inspector for Forrest City, Ark. Mr. Rice stated that the individual sewer systems were

installed in accordance with the engineering specifications. He stated that he did not personally agree with the engineer's specifications because he considered the field line filter fields to be too small. FHA officials also inspected the systems during construction according to inspection reports.

The dwelling septic systems met ASDH requirements concerning construction, distance from property lines, distance from water wells, etc. However, as will be noted below, ASDH does not recommend use of individual dwelling septic systems for housing developments or congested areas.

The streets and driveways in this subdivision were paved with a layered oil compound which had dissolved in many places, and were in need of repairs. Streets constructed without adequate grading and bases and structures (culverts and drainage ditches) for surface drainage were not provided. Surface water had washed out the streets in some places.

Mr. Willard Whitaker, mayor of Madison, Ark., stated that the streets in this subdivision had not been accepted by the city of Madison for maintenance purposes. He stated that the paved streets in this subdivision were of very poor quality and would not compare favorably with city asphalt streets adjacent to the subdivision.

Mr. Virgil Merrill, president, New Mer Building Co., stated that the subdivision was developed and approved by FHA and that he complied with all FHA requests in developing the subdivision.

Magnolia Acres Subdivision.—This subdivision located at Widener, Ark., consists of 20 FHA-financed dwellings with loans totaling $226,150. FHA loans have been made in this subdivision since January 1971, with two loans remaining to be closed. The subdivision was developed by New Mer Building Co. and included paved streets, public water lines, and individual dwelling sewage disposal systems.

Borrowers in this subdivision were experiencing the same type sewage problems as were reported above in the Dogwood Acres Subdivision. Borrowers had made various complaints about the inoperative systems and surfacing septic tank effluent. These sewage systems were also installed in accordance with the engineer's specifications and conformed to ASDH guidelines. These sewer systems were also installed under FHA inspection and supervision according to inspection reports.

The paved streets and driveways in this subdivision were constructed of a layered oil compound which had completely dissolved in many places, leaving the streets in very poor condition and in need of extensive repairs. The streets were constructed without a suitable base and were not constructed to allow surface water to readily drain off. Structures for surface drainage were not provided. Surface water had washed the streets out in several places. Driveways and parking pads constructed with this layered oil compound had also completely dissolved.

The mayor of Widener, Ark., Andy Jones, stated that the subdivision is located just outside the city boundary and the city does not want to annex the subdivision. He stated that the city was unable to maintain the streets in the subdivision.

St. Francis County Judge, W. C. Hamilton, who is responsible for maintenance of county roads and streets, stated that the county had not and would not agree to maintain the streets in the subdivision. He stated the streets were improperly constructed without an adequate base and did not have proper drainage. He stated that he would not accept them because of this poor original construction.

Redbud Acres subdivision.—This FHA-financed subdivision, located south of Palestine, Ark., consists of six dwellings with loans totaling $75,000. FHA has financed four of these dwellings and loans have been approved for the remaining two dwellings. The first loans were closed in this subdivision in April 1972. The subdivision contains paved streets, individual water wells, and individual sewage disposal systems. This subdivision was developed by New Mer Building Co., and all subdivision improvements were constructed under FHA supervision and inspection. Three borrowers in the subdivision advised us that they could not use their sewage disposal system during periods of wet weather. They stated that raw sewage backs up into their commodes and bathtubs. However, we noted no surfacing sewage in this subdivision. Inadequate surface drainage in this subdivision permitted surface water to accumulate on the sewage disposal fields contributing to the malfunctioning sewage systems.

The plans and specifications for individual water wells and individual sewage disposal systems were approved by the ASDH as being in compliance with their guidelines for individual dwellings. ASDH, in a letter to Mr. Virgil Merrell, sub-

division developer, dated September 20, 1971, stated that they could not, in good conscience, recommend the use of individual sewage disposal systems for housing developments or congested areas. This letter stated that individual sewage disposal systems that utilize septic tanks and field line filter fields were recommended only for isolated rural installation where community sewage disposal systems were completely impractical. The State Director in a letter to the county supervisor, dated October 19, 1971, approved the subdivision with individual sewage disposal systems but required the lot sizes to be doubled, citing the ASDH's letter as his reason for this requirement.

The paved streets, constructed only 6 months ago, already show signs of deterioration. The streets were constructed of the same material as the streets in the other previously discussed subdivisions. St. Francis County Judge W. C. Hamilton stated that the county had not agreed to maintain the streets in this subdivision.

Dawson subdivision.—This subdivision located south of Palestine, Ark., consists of six FHA-financed dwellings with loans totaling $76,600. This area was not developed originally as a subdivision, but was developed on a lot by lot basis. Loans were closed from November 1969 to November 1972. The subdivision has individual water wells and sewage disposal systems and a gravel street. The borrowers in this subdivision were experiencing the same sewage problems as were reported in the other subdivisions.

The gravel street in this subdivision was impassable during our visit due to poor street construction and wet weather. Mr. Hamilton stated that the county had not agreed to maintain the streets in this subdivision. The houses in this subdivision were constructed by Carl Reeves.

Mr. James L. Gray, soil scientist, Soil Conservation Service, Forrest City, Ark., stated that the winter water table in the Magnolia Acres, Redbud Acres, and Dawson subdivisions ranged from 20 to 30 inches below the surface from 1 to 4 months per year. He stated that this high water table alone would cause the individual sewage disposal systems to malfunction.

All FHA-financed subdivisions in the county that were using individual sewage disposal systems were having problems with inoperative systems and/or septic sewage surfacing on the lots. These problems were caused by: (1) above normal rainfall in the county; (2) high water table underneath the ground; (3) concentration of houses with individual sewage disposal systems.

Detailed construction specifications for the streets in the Dogwood Acres, Magnolia Acres, and Redbud Acres subdivisions were not included in the engineer's plans and specifications for these subdivisions. Streets adjacent to these subdivisions have high grade asphalt streets.

FHA bulletin 3790, guidelines for rural housing sites, dated November 23, 1970, requires subdivision streets to be dedicated to the public body having jurisdiction. This bulletin also requires streets to be based upon sound engineering practices and prohibits use of a layered oil surface for paving of streets unless this type street has already been constructed in adjacent areas. This bulletin requires that necessary structures for proper drainage be provided.

Mr. Knox agreed with the conditions as reported. He stated that he had recently discontinued approval of subdivisions that relied on individual sewage disposal systems. He stated that he had relied on the engineer's recommendations in construction of the individual sewer disposal systems. He attributed the poor street construction and inadequate drainage to his lack of experience in supervising subdivision development. He stated that he had overlooked the need to get street maintenance agreements from local governmental officials as required by FHA instructions.

Appropriate corrective measures should be taken with respect to the conditions discussed above. Subdivision planning and development should be based upon sound engineering data with detailed specifications for street construction, surface drainage, and lot development. RH loans should not be made in congested areas that do not have an adequate central sewage disposal system.

Mr. Lyle Rogers, chief, rural housing, Arkansas State FHA office, agreed with our recommendation. He confirmed that subdivisions would no longer be approved in St. Francis County, if they utilized individual sewage disposal systems.

The Redbud subdivision is occupied by white families. The others are inhabited exclusively by minority race families.

RH construction

2. Construction deficiencies were noted on RH construction in the Dawson subdivision. The dwellings of borrowers John A. Akins, Charles L. Stidum, and Jesse

Hawkins contained an interior grade one-fourth inch paneling on the exterior of the house. The paneling was installed as siding for the carports and was exposed to the elements. This paneling was less than 1 year old and already showed signs of deterioration.

Enclosures were not constructed for these borrowers' water pumps to protect them from freezing. Borrowers stated that their pumps had frozen on several occasions. The water wells and water pumps were included in the plans and specifications for these dwellings. Also, needed hard surfaced walkways were not provided from the driveways to the front entrances of these homes. FHA's minimum property standards, in effect at the time these houses were constructed, required that water systems be frost proof and that necessary hard surfaced walkways be provided to front entrances.

These dwellings were inspected three times during the construction and no exceptions were taken to these defects according to the inspection reports.

Mr. Knox agreed with the condition as reported. He stated that he would take corrective action.

Appropriate action should be taken to strengthen RH construction inspection to insure that building contractors use suitable building material and maintain good construction practices. Corrective action should be taken on the deficiencies cited.

Applicant eligibility

3. Rural housing loans were being made to applicants with poor debt repayment records and unstable incomes. This has contributed to the county's high rate of delinquency.

The following cases were noted in our review:

Borrower "A".—This borrower made application for a rural housing loan on August 11, 1970. His annual income was shown as $4,200 from his and his wife's employment. Request for Verification of Employment, FHA Form 410-5, showed an annual income of only $2,128, the borrower and his wife having terminated some of their employment after filing their application. According to the loan file, no further action was taken to determine the borrower's actual income.

The loan was approved on April 20, 1971, by Mr. Knox. Interest Credit assistance was granted based upon an annual income of $4,200. Our interview with the borrower revealed that his family income at the time of loan approval was only approximately $2,000 per year. The borrower confirmed that he had only part-time employment at the time of loan approval and closure. He further stated that he had no commitment for additional employment.

A credit report was obtained on this borrower which listed three credit accounts. Two of these accounts were shown as past due and had been turned over to a collection agency. We checked this borrower's credit record with a local car dealer that the borrower had shown on his application as a credit reference. The dealer's records revealed that the borrower had had a credit account with them since 1968, but that the account was finally written off in 1971 as a bad debt. This account was not included on the borrower's credit report.

At the time of our review, this borrower was over $1,500 delinquent on his RH account and had made only one monthly payment since the loan was closed on May 21, 1971. The servicing action taken on this case is discussed in Details—4 of this report.

Borrower "B".—This borrower made application for a RH loan on March 8, 1972. A credit report for this borrower was submitted with the application and covered twelve credit accounts. Six of these accounts were shown as from one to five years past due and had been turned over to a collection agency for collection. Five other accounts were from two to eight months past due. Only one account was listed as being current. Another credit report was obtained on March 17, 1972. This credit report covered ten credit accounts, all of which were shown as past due. The loan file did not contain any record that the financial problems evident from the credit report were discussed with the borrower prior to the date of loan closure.

An RH loan of $11,300 was approved on June 6, 1972, by Mr. Knox and the loan was closed on July 12, 1972. As of February 12, 1973, the borrower was four months delinquent on his 1972 scheduled payments. The servicing action on this account is further discussed in Details—4 of this report.

Borrower "C".—This borrower made application for an RH loan on May 27, 1971, and a credit report, dated May 28, 1971, was obtained. The report showed

nine credit accounts, six of which had been turned over to a collection agency for collection. Four of the six were shown as eventually collected. The three other accounts were listed as from four months to two years past due. A notation in the file showed that the slowness in paying these credit accounts was caused by medical bills associated with child birth. There was no record of any further check of this borrower's debt payment record.

On August 26, 1971, an RH loan of $11,300 was approved by Mr. Knox and was closed on October 6, 1971. The borrower has made only two monthly payments on his accounts since the loan was closed and he was over $1,200 delinquent on his RH account at the time of our review. The servicing action on this case is discussed in Details—4 of this report.

Borrower "D".—This borrower's RH loan of $12,000 was approved by Mr. Knox and was closed on June 8, 1971. The credit report on this borrower covered nine credit accounts, eight of which were past due or were not paid on time. This borrower was over $600 delinquent on his RH account at the time of our review.

Borrower "E".—This borrower received an RH loan of $11,300 on April 16, 1971. The borrower listed two credit accounts on his loan application. A contact was made with one of these creditors and it was determined that the borrower was slow in paying his account. The borrower listed his employment with a local electronics firm but this employment was not verified. The loan file contained no additional information regarding the borrower's resources or debt repayment record.

At the time of our review, this borrower was over nine months behind on scheduled monthly RH payments.

This county has one of the higher delinquency rates in the State. At the time of our review, the county had 116 delinquent RH accounts out of a total RH case load of 514 active borrowers. Making loans to applicants with unstable incomes and poor debt repayment records has contributed to this high delinquency rate.

Mr. Knox agreed that loans had been made in the past to applicants with poor debt repayment records. He attributed this condition to the large volume of RH loans that have been processed in the county during the past two years. He stated that in the rush to process loans, some applicants were made loans who should have been turned down.

The overall processing of RH loan applications should be strengthened so as to avoid making loans to applicants who are not deserving of credit assistance. The borrower cases discussed above should be submitted to the State Office for review and appropriate administrative determinations regarding borrower eligibility.

Servicing delinquent loans

4. Prompt servicing action was not taken on delinquent rural housing accounts to determine the cause of the delinquencies and to effect necessary follow-up action. This condition has contributed to the county's high delinquency rate.

Our audit sample of delinquent RH borrower accounts revealed three cases where borrowers were as much as seven months behind on scheduled monthly payments before collection visits were made. Prompt follow-up action was not taken on chronically delinquent accounts to accomplish the needed servicing action.

The following cases are cited:

Borrower "A".—This borrower received an RH loan of $11,300 on May 21, 1971, to purchase a new dwelling. The borrower's account was set upon a monthly payment basis, however, he has made only two monthly payments on his account since the loan was closed. The first collection visit was made on December 10, 1971, when the borrower was five months behind on his monthly payments. It was discovered during this visit that the borrower had never moved into the dwelling. During this visit FHA officials suggested to the borrower that he transfer the house and loan to a qualified applicant. No follow-up action was taken on this until five months later, May 10, 1972, when another collection visit was made. During this visit the borrower promised to start making monthly payments and also promised to move into the dwelling. The borrower failed to follow through on these promises. FHA officials made another visit in June 1972, and discovered that the borrower still had not moved into his house. Two attempted visits were made during September 1972 but officials were unable to find the borrower at home. No follow-up action was taken on these visits.

On November 30, 1972, the borrower's case was reported to the State Office as a problem case. This report recommended that the property be transferred to an eligible applicant and that the borrower be released from financial liability. No further action had been taken as of March 20, 1973. During our visit to the dwell-

ing we noted that the dwelling was vacant and the windows and doors on the dwelling showed signs of vandalism. Borrower "A" told us that he did not move into the dwellings because he did not have enough money to pay moving costs, purchase a few needed household items, and pay utility deposits.

Borrower "C".—This borrower received an RH loan of $11,300 on October 6, 1971, to purchase a new dwelling. The borrower's account was set up on a monthly payment basis, but he made only one monthly payment after the loan was closed. FHA officials attempted two collection visits in May 1972, and one visit in June 1972, and another in July 1972. No contact was made with the borrower on these attempted visits. It was discovered during these visits that the borrower had not moved into his FHA-financed dwelling.

On August 1, 1972, the borrower was finally contacted at a residence that he was renting in Forrest City, Arkansas. He promised to move into his dwelling and start making monthly payments as soon as two minor leaks were fixed in the roof of the new dwelling. No further visits were made. On November 30, 1972, a report on a real estate problem case was submitted to the State Office on this borrower. The report recommended that the house be transferred to an eligible applicant and that the borrower be released from financial liability. As of March 20, 1973, no further servicing action had been taken.

During our visit to the dwelling we noted that it was vacant and the windows and doors showed signs of vandalism. A neighbor next door to the dwelling stated that vandals had stolen some heating and plumbing fixtures from the dwelling.

Borrower "C" stated that he did not move into his FHA-financed dwelling because he did not have enough money to purchase an electric cook stove that he needed for the new house and to pay a connection deposit to have electricity and water connected to the house.

Borrower "B".—This borrower received an RH loan of $11,300 on July 12, 1972. As of January 1, 1973, the borrower was four months behind schedule on monthly payments. As of March 20, 1973, no collection visits had been made to this borrower.

Mr. Knox agreed with the conditions as reported. He attributed these conditions to county personnel not having time to adequately service these delinquent loans.

Immediate servicing action should be taken on the cases cited and on other similar cases in the case load. Controls should be established to ensure that borrowers who are behind schedule on monthly payments are timely contacted to determine the reason for their being behind schedule and to plan the proper future servicing action. Also, as pointed out in Details–3, increased attention to eligibility requirements, particularly debt payment ability, should reduce delinquency problems.

April 18, 1973.

S. D. JONES, Jr.,
Regional Inspector General.

[Note.—Names of borrowers were deleted by the subcommittee]

Appendix 11.—Statistical Data Concerning FHA Loans on Prefabricated Dwellings in Arkansas

[Information obtained from a survey of the 34 counties in Arkansas that have prefabricated houses financed by FHA:]

COUNTIES IN ARKANSAS THAT HAVE PREFABRICATED HOMES FINANCED BY FHA

County	Pacific Homes, Inc.	Other prefabricated homes	County	Pacific Homes, Inc.	Other prefabricated homes
Arkansas	56		Miller	43	
Benton		2	Mississippi	4	10
Chicot	45		Monroe	11	3
Columbia	9		Montgomery		2
Conway	26		Nevada	6	
Craighead	1		Perry		2
Crittenden	50	2	Phillips	50	55
Cross		6	Poinsett	62	7
Desha		14	Polk		14
Garland		2	Pope	15	
Grant		5	Pulaski		1
Hempstead	3		St. Francis	74	5
Jackson		9	Sharp		1
Johnson	14		Union		16
Lafayette	29		Woodruff	6	
Lawrence	8	5	Yell		6
Lee	27				
Lonoke	33		State total	572	167

Note.—Total prefabricated homes financed by Farmers Home Administration in Arkansas from June 1, 1969, to June 7, 1973, is 739.

Firms that sell prefabricated housing components financed by Farmers Home Administration in Arkansas

Kingsberry Homes	55
Kingsberry Briarwood	1
American Eagle Homes	3
Hyman Homes, Inc	23
Modular Housing, Inc	19
National Homes	8
Greenbriar Homes	1
O. L. Puryear & Sons, Inc	14
Capp Homes, Inc	1
Heatherwood Corp	1
Holiday Manufacturing Co	16
Fulline Building	2
Lou-Add Corp	21
Van Meter Lumber Co	2
Pacific Homes, Inc	572
Total	739

Information Concerning Foreclosures

The following information pertains to all manufactured (prefab) houses financed by Farmers Home Administration in Arkansas during the directorship of Robert L. Hankins:

1. Number of foreclosures in process as of June 7, 1973	51
2. Number of borrowers who are 3 or more months behind schedule on their payments as of May 31, 1973	224
3. Estimate of the number of foreclosures to be initiated in fiscal year 1974 on loans approved since June 20, 1969	85

Total number of prefabricated dwellings financed by Farmers Home Administration in Arkansas from June 1, 1969, to June 7, 1973	739
Percentage furnished by Pacific Homes	79
Percentage furnished by other suppliers	21
Total number of prefabricated dwellings financed through Farmers Home Administration in Arkansas, which have resulted in the loans being liquidated by voluntary conveyance, foreclosure, or transfer	52
Percentage of prefabricated dwellings financed through Farmers Home Administration in Arkansas, which have resulted in voluntary conveyance, foreclosure, or transfer	7.03
Percentage of Pacific Homes dwellings	8.23
Percentage of dwellings furnished by other suppliers	3.59

LOANS LIQUIDATED—PREFABRICATED AND CONVENTIONAL HOUSING

County	Prefabricated housing			Conventional housing		
	Number loans	liquidations [1] completed	Amount of loss	Number loans	liquidations [1] completed	Amount of loss
Arkansas	56	0	0	26	0	0
Benton	2	0	0	273	0	0
Chicot	45	1	$592.99	126	2	0
Columbia	9	1	0	86	0	0
Conway	26	4	1,397.67	256	19	$1,137.76
Craighead	1	0	0	413	0	0
Crittenden	52	0	0	174	7	0
Cross	6	0	0	375	50	0
Desha	14	0	0	242	13	620.00
Garland	2	1	0	122	1	0
Grant	5	0	0	76	0	0
Hempstead	3	0	0	228	0	0
Jackson	9	0	0	460	58	913.87
Johnson	14	0	0	89	0	0
Lafayette	29	9	21,670.00	65	0	0
Lawrence	13	1	0	437	47	0
Lee	27	3	9,750.00	184	1	0
Lonoke	33	5	800.00	235	14	0
Miller	43	8	17,400.00	76	1	0
Mississippi	14	2	2,500.00	567	119	36,600.00
Monroe	14	2	0	99	1	0
Montgomery	2	0	0	89	4	0
Nevada	6	1	1,000.00	82	0	0
Perry	2	0	0	66	0	0
Phillips	105	5	0	303	13	1,296.42
Poinsett	69	5	0	208	15	0
Polk	14	1	0	228	17	1,500.00
Pope	15	2	0	130	5	0
Pulaski	1	0	0	154	1	0
St. Francis	79	2	0	199	0	0
Sharp	1	0	0	285	1	0
Union	16	0	0	70	0	0
Woodruff	6	0	0	170	6	0
Yell	6	0	0	111	2	0
Total	739	52	55,110.66	6,693	397	42,068.05
Average			1,040.00			106.00

[1] Liquidations completed include foreclosures, transfers, and voluntary conveyances.

Note: Prefabricated housing: There were 728 loans made from June 1, 1969, to June 7, 1973, of which 52 were liquidated at a total loss of $55,110.66. Conventional housing: There were 6,693 loans made from June 1, 1969, to June 7, 1973, of which 397 were liquidated at a total loss of $42,068,05.

Appendix 12.—Material Supplied by Arkansas State Office Relating to Appraisal Procedures

[The following exhibits were supplied to the subcommittee and are in its files:]

Attached are national procedures, Arkansas bulletins, training agendas, and other training aids used in training personnel in Arkansas since late 1969 in our ongoing training program relative to FHA's expanded rural housing program.

The following is a summary of pertinent exhibits that will be supplied to appropriate officials upon request of FmHA:

Exhibit

Remarks by Joseph Haspray, Deputy Administrator, FHA 1
Program Meetings with State Director. September 15, 1969—Minneapolis, Minn.; September 18, 1969—Oklahoma City, Okla.

Note: See "Exhibit 1" for excerpts of remarks for insight of future national policy on meeting housing goals.

Arkansas Rural Housing Training Material—October 1969 2
Used in Rural Housing Training Sessions.

USDA Announcement—Washington, December 30, 1969 3
Introduces Housing Act of 1969 with increase goals and new legislation authorizing "Conditional Commitments" to builder and realtors as a tool to increase interest in housing program.

FmHA Instruction 444.9—Washington, February 5, 1970 4
"Issuance of Conditional Commitments for Rural Housing."

Arkansas FmHA Bulletin No. 1535—March 4, 1970 5
Announcement of three district training meetings to be held on March 16, 17, and 18. Subject: Training Meetings on Issuance of Conditional Commitments for Rural Housing Loans.

FmHA Bulletin No. 3611(004)—Washington, May 14, 1970 6
Announcement of rural housing training meetings to all State Directors for June 1970. Training Meeting topics include:

A. Informing the public and working with other agencies.
B. Industrialized housing.
C. Working with builders, developers, and realtors.
D. Multiple housing and use of architects.

Discussions to include: Conditional commitments, packaging of applications, and impact of volume builders prices on local appraisals.

FmHA Bulletin 3629(444)—Washington, May 27, 1970 7
To all State Directors. Discussion Paper: Ideas for upgrading the rural housing delivery capacity of FmHA.

FmHA Instruction 444.1—Exhibit B—Washington, June 19, 1970 8
Subject: Information Required to Package Applications for Section 502 Rural Housing Loans.

Arkansas FmHA Bulletin No. 1577—June 30, 1970 9
Announcement of four District Training Meetings to be held July 14, 15, 16, and 17, 1970. Subject: Rural Housing Training Meetings. Topics to Include: A Rural Housing Program for the seventies conditional commitments, subdivision development, packaging, appraisals, industrialized housing, and plans for meeting with builders and suppliers.

FmHA Instruction 422.3—Washington, August 3, 1970 10
Subject: Appraisal of Nonfarm Tracts and Small Farms for Rural Housing Loans.

Arkansas FmHA Bulletin 1589—August 4, 1970 11
To: County and District Supervisors. Subject: Distribution of additional insurance authority for low- and moderate-RH loans—remainder of first quarter 1971 fiscal year.

Note: Advises meetings with builders if progressing to help assure increased volume of housing.

20-482—73——16

Exhibit

Arkansas FmHA Bulletin 1594—August 28, 1970 12
To: County and District Supervisors. Subject: Appraisal Service. Designates the Chief of Rural Housing to coordinate and assist in housing appraisals.

Arkansas FmHA Bulletin 1600—September 11, 1970 13
To: County and District Supervisors. Subject: Rural Housing Loans, Low and Moderate Income. Discusses expanded rural housing programs and some techniques to administer.

Arkansas FmHA Bulletin 1614—October 16, 1970 14
To: County and District Supervisors. Subject: Statewide Housing Meeting. Purpose: To inform all interested parties, particularly builders and suppliers, of the programs available to them through the rural housing program of FmHA. Meeting to be held October 28, 1970.

Arkansas FmHA Bulletin No. 1621—November 5, 1970 15
To: County Supervisors. Subject: Press-Radio Coverage on Packaging of Rural Housing Loans. Used to announce public county meetings.

Arkansas FmHA Agenda—June 21, 1971 16
Subject: State Staff Conference. Discussions included subject of "Appraisals."

Arkansas FmHA Agenda—August 6, 1971 17
Subject: State Staff Conference. Discussions included "upgrading appraisals."

Arkansas Bulletin 1722—September 17, 1971 18
To: District and County Supervisors. Subject: Rural Housing Training Meetings to be Held in 4 Districts October 5, 7, 8, and 12. Discussions include "appraisals" and other aspects of rural housing loan making.

Arkansas FmHA Agenda—April 12, 1972 19
Subject: State Staff Meeting. Discussions included "upgrading appraisals."

Arkansas Bulletin 1803—July 24, 1972 20
Subject: Rural Housing Training Meeting. To be held in 5 districts August 15, 16, 17, 22, and 23, 1972. Discussions include "appraisals" and other aspects of rural housing loan making.

Appendix 13.—Documents Relating to Moratorium for Rural Housing Loans

On January 7, Mr. Harman, who was acting as Administrator, received word from the Office of Management and Budget that the suspension of subsidized housing loans being announced at Houston by Mr. Romney would apply to rural areas. Mr. Harman asked the rural housing staff to develop a telegram which advised the field of the suspension. A copy of this telegram is attached. The FmHA was not contacted previously nor asked for advice in this action. The telegram of January 8 has subsequently been modified. Copies of this modification are also attached (exhibits I through O).

EXHIBIT I

Farmers Home Administration,
January 8, 1973.

All State offices:

County and State offices will discontinue approving the following types of housing loans and grants after January 8, 1973:

Farm labor housing loans and grants;

Rental and cooperative housing loans; and

Section 502 loans that involve interest credits except such loans to self-help participants.

Dockets for the above types of loans and grants approved before January 9 and postmarked before January 11, will be honored by the finance office.

No conditional commitments will be approved until further notice.

State offices will immediately, by telephone, notify county offices of these changes.

Details follow. Field support is expected.

James V. Smith,
Administrator.

EXHIBIT J

U.S. Department of Agriculture,
Farmers Home Administration,
Office of the Administrator,
Washington, D.C.

PROCEDURE NOTICE

Attention State and County Offices

Notice (WSC)

This supplements the telegram of January 8, 1973, concerning adjustments in rural housing programs.

I. BUDGET ADJUSTMENTS FOR FISCAL 1973

Budget allowances for the balance of the 1973 fiscal year have been reduced for several types of rural housing assistance; consequently, after January 8, 1973, loans or grants of the following types may not be approved except as authorized in this procedure notice:

A. Farm labor housing loans and grants.

B. Rental and cooperative housing loans, and

C. Section 502 loans that involve interest credits.

II. GUIDELINES FOR MAKING ADJUSTMENTS

In order to make the required adjustments in the operation of your housing programs, you should proceed as follows:

A. *Interest Credit 502 Loans.*—Interest credit loans may continue to be approved for families participating in mutual self-help groups or low-income families whose homes will be built or repaired with the special assistance of manpower trainees. Loans in these excepted categories must be approved by June 30, 1973. The county supervisor should review all RH applications on hand and determine which applicants may qualify for loans without interest credits and those that require interest credits and are involved in either a mutual self-help or manpower-training program. Such applications may be processed in the usual manner. Other applicants should be notified by letter that their applications cannot be approved.

B. *RRH–RCH–LH.*—Applications on hand that were not approved before January 9, 1973, for RRH–RCH and LH loans and grants may be processed and completed only if the National Office had reviewed the docket and authorized approval and the loan or grant can be approved by June 30, 1973. Each State office will report to the National Office the name of any applicant and the amount of loan requested for those applications that are within the State director's approval authority where he has reviewed the application, found the project to be feasible, and has authorized the county supervisor in writing before January 9, 1973, to complete the docket. The information will be reported, by telephone, to the Multiple Family Loan Division on the first working day following receipt of this procedure notice. No new applications should be accepted until further notice.

III. OTHER ACTIONS TO BE TAKEN

A. Each county supervisor will evaluate the situation in his county with respect to outstanding conditional commitments. Additional commitments will not be issued until he determines that houses for which commitments have already been issued will be purchased by applicant eligible for loans under the requirements of this procedure notice. Furthermore, any additional commitments issued will be based on a market analysis for RH loans without interest credits.

B. Until further notice, interest credits will not be granted existing RH borrowers unless they were receiving such assistance on January 8, 1973.

C. State allotments of section 502 authorizations will be adjusted to the revised program level. You will be notified of these changes and should adjust your program accordingly.

D. State directors should take immediate action to assure full compliance with this procedure notice and also establish adequate controls to stay within the amount of RH authorizations allotted to their States for fiscal 1973.

E. Responses to requests for information concerning these program changes will be consistent with the statements in the attached press release. County supervisors will continue to be responsive to questions asked about our authorizations and program activity; however, requests for special types of information will be referred to the State director for a reply.

NEWS, U.S. DEPARTMENT OF AGRICULTURE

Rural housing program proceeds on unsubsidized basis:

WASHINGTON, January 10.—The Department of Agriculture announced today that its rural housing credit program, administered through the Farmers Home Administration, will continue on an unsubsidized basis.

The Department said several federally subsidized loan and grant programs for rural housing will be subjected to an 18-month evaluation study, during which the processing of new applications will be temporarily discontinued. This is a part of a Government-wide program, previously announced by Secretary George Romney, Department of Housing and Urban Development.

Farmers Home Administration (FHA) will confine its subsidized housing loan program this fiscal year to applications that have been certified for approval between July 1, 1972 and Jan. 8, 1973. Most construction under those approvals will occur during the coming spring building season.

Unsubsidized homeownership loans will continue to be made. It is estimated that there will be more than 100,000 housing loans for the fiscal year. The current interest rate on unsubsidized loans is 7¼ percent.

The Department said the suspension in subsidized housing will be in effect for 18 months to allow time for a comprehensive evaluation of the programs. The

study will seek to determine whether the programs in question are the most effective means available for providing benefits to low-income families, whether the programs provide benefits to persons other than low-income borrowers, and whether the Government's role in the programs is an appropriate Federal role.

Housing programs affected by the temporary discontinuance of new approvals are—

Housing loans to low-income families that involve an interest subsidy. Subsidized interest rates to borrowers have ranged as low as 1 percent under the present program.

Rental and cooperative housing loans.

The farm labor housing program of grants plus loans at 1 percent interest.

The announcement specified that all applications in these categories that have been certified for approval prior to the suspension will be processed through to loan or grant disbursement.

Housing programs of the Farmers Home Administration not affected by the discontinuance announcement are—

Housing loans to families of low and moderate income that do not involve interest subsidies.

Housing repair loans to low-income families (loan maximum $3,500).

Mutual self-help housing loans under the program whereby low-income families perform much of the labor in building their own homes.

Grants to provide technical aid organizations that assist in organizing and carrying out self-help housing projects.

Loans to nonprofit organizations for development of rural homesite areas.

Farmers Home Administration housing programs are administered in rural areas, including the countryside and towns of up to 10,000 population, and serve people of low and moderate income who find no other housing credit available.

EXHIBIT K

U.S. Department of Agriculture,
Farmers Home Administration,
Office of the Administrator,
Washington, D.C.

PROCEDURE NOTICE

Attention State and County Offices

Notice (WSC)

This supersedes the special procedure notice of January 11, 1973, concerning adjustments in rural housing programs.

I. BUDGET ADJUSTMENTS FOR FISCAL 1973

After January 8, 1973, loans or grants of the following types may not be aproved except as authorized in this procedure notice:

A. Farm labor housing loans and grants;

B. Rental and cooperative housing loans that involve interest credits; and

C. Section 502 loans that involve interest credits.

II. GUIDELINES FOR MAKING ADJUSTMENTS

In order to make the required adjustments in the operation of your housing programs, you should proceed as follows:

A. *Interest Credit 502 Loans.*—Section 502 loans with interest credits may continue to be approved, if any of the following conditions exist:

1. The applicant is a member of a mutual self-help group.

2. The applicant is a low-income family whose home will be built or repaired with the special assistance of manpower trainees.

3. The loan is made to a low-income family to buy a home built or being built as a result of a written commitment made to a builder or developer by the Farmers Home Administration with the expectation that the home would be financed with an interest credit loan, provided the written commitment was executed by the county supervisor prior to January 9, 1973.

4. In addition, certain verbal commitments may have been made to builders prior to January 9, 1973. These commitments will be considered in those

cases where construction was actually started and footings poured prior to January 9. Applications resulting from such commitments should be submitted to the national office for review and approval with the full discussion of the particular circumstances of each case.

B. *RRH–RCH and LH Loans*

1. *Applications on Hand.*—Applications for RRH–RCH and LH loans and grants that were not approved before January 9, 1973, may be processed and approved provided:

(*a*) The national office reviewed the docket and authorized approval of the loan after completion of step c, or

(*b*) The national office reviewed the application and authorized the development of the complete docket after completion of step c, or

(*c*) The State office reviewed the docket and made a written commitment to the applicant before January 9, 1973.

2. *Special Conditions Applicable to RRH–RCH*:

(*a*) Only applications that do not require interest credits may be received, processed and approved.

(*b*) The State director will not exceed the RRH allocation for his State.

3. *Special Condition Applicable to LH.*—No additional applications for LH loans and grants will be processed.

III. OTHER ACTIONS TO BE TAKEN

A. Priority will be given to processing all applications which result from the above commitments.

B. The county supervisor will notify, in writing, each builder to whom a written conditional commitment was issued before January 9, 1973, that an RH loan with interest credits will be made available to eligible purchasers of the houses covered under such commitments.

C. Each county supervisor will evaluate the situation in his county with respect to outstanding conditional commitments. Any additional commitments issued will be based on a favorable market analysis for RH loans without interest credits.

D. No additional verbal commitments will be made to builders or developers. In the future all commitments to builders or developers will be made in accordance with FHA instruction 444.9.

E. Until further notice, change in status from noninterest credit to interest credit will not be approved for existing rural housing borrowers after January 8, 1973.

F. State directors should take immediate action to assure full compliance with this procedure notice and also establish adequate controls to stay within the amount of RH authorizations allotted to their States for fiscal 1973. This will include actions such as obtaining a report from each county supervisor on the number of written conditional commitments outstanding that were executed before January 9, the number of homes started before that date on the basis of verbal commitments and how many of the families who likely will buy these homes will require interest credits. The State director will set aside sufficient funds from his State allocation to honor such commitments.

G. If adjustments in RH or RRH State allocations are necessary, States will be advised accordingly.

EXHIBIT L

U.S. DEPARTMENT OF AGRICULTURE,
FARMERS HOME ADMINISTRATION,
OFFICE OF THE ADMINISTRATOR,
Washington, D.C.

PROCEDURE NOTICE

ATTENTION STATE AND COUNTY OFFICES

Notice (WSC)

This supplements the special procedure notice of January 29, 1973, and authorizes the granting of interest credits to qualified applicants and borrowers in the following types of situations:

I. SUBSEQUENT LOANS

Interest credits may be authorized in connection with subsequent RH and RRH loans if such loans are made for the sole purpose of paying for cost overruns involved in completing construction started with an initial loan which qualified for interest credits.

II. APPLICATIONS FOR SECTION 502 LOANS FILED BEFORE JANUARY 9, 1973

A loan with interest credits may be made to an applicant who filed an application before January 9, 1973, and prior to that date written evidence was in the county office records that he had been determined to be eligible or that he owned or had selected a house or a site. Such written evidence may consist of one or more of the following:

A. An option to buy a building site or a home.

B. Evidence of ownership of a building site on which the applicant plans to build a home.

C. A packaged application, including the required information on the applicant and the house.

D. Evidence that the applicant owns the home he wants to repair or improve with an RH loan.

E. A letter or other written evidence indicating the applicant had been informed that he was eligible for an RH loan.

III. RURAL HOUSING SITE LOANS

Interest credits may be authorized when funds are included in a housing loan to a family to buy a building site developed with an FHA rural housing site loan provided the State director determines that:

A. The site loan was approved before January 9, 1973.

B. An interest credit loan is necessary for the family to be able to repay a loan to buy the site and build a home; and

C. Failure to authorize exceptions in connection with loans to buy building sites in the development would result in the organization being unable to sell the sites and repay its FHA loan.

IV. TRANSFERS AND CREDIT SALES

Interest credits may be authorized to qualified applicants who acquire single family or rental property by transfer or through a credit sale when:

A. Processing of the transaction had been started before January 9, 1973, and in the case of a transfer, the loan is one that qualifies for interest credits; or

B. The county supervisor determines that the only qualified applicant to whom the property can be transferred or sold out of Government inventory is one that requires interest credits.

V. RENEWAL OF EXISTING INTEREST CREDIT AGREEMENTS

Renewals of interest credit agreements on rural housing loans may be authorized by the State director when for some reason beyond the control of the applicant or county supervisor the processing of the agreement was not completed during the 1972 review period.

VI. USE OF INTEREST CREDITS IN SERVICING LOANS

Interest credits may be authorized by the State director when necessary to avoid acquisition of property by the Government provided he determines that:

A. The borrower is likely to repay the loan and correct any other defaults that may exist if interest credits are granted; and

B. The loan and borrower qualify for interest credits.

VII. SPECIAL CASES

Exceptions other than those authorized by this procedure notice may be made only with the prior consent of the national office. Any such requests submitted to the national office should be supported by a complete explanation and justification.

VIII. NOTICE TO FINANCE OFFICE

Whenever the county supervisor submits a loan or an interest credit agreement under the situations authorized by this procedure notice, he will include on the record of action or in a separate memorandum a statement that "This loan (or interest credit) is approved in accordance with special procedure notice dated February 5, 1973." A similar notice will be included for loans approved under special procedure notice dated January 29, 1973.

EXHIBIT M

UNITED STATES DEPARTMENT OF AGRICULTURE,
FARMERS HOME ADMINISTRATION,
OFFICE OF THE ADMINISTRATOR,
Washington, D.C.

PROCEDURE NOTICE

ATTENTION STATE AND COUNTY OFFICES

Notice (WSC)

This supplements the special procedure notices of January 29, 1973, and February 5, 1973, and describes the steps to be taken to comply with the requirement that the national office must grant authority for approval of loans with interest credits to families who will buy homes built under verbal commitments made to builders or developers before January 9, 1973.

I. HANDLING APPLICATIONS INVOLVING HOMES BUILT UNDER VERBAL COMMITMENTS

To comply with the requirement of paragraph III F of the special procedure notice dated January 29, 1973, the State and county offices will take the following action:

A. County supervisors will notify, in writing, each builder or developer who received a verbal commitment for homes expected to be financed with loans to families needing interest credit assistance, that RH loans with interest credits can be made provided all of the following are met:

1. The builder submits to the county supervisor a plat map or sketch of the building site(s) or a subdivision plat which clearly identifies the site(s) on which construction was started before January 9, 1973.

2. The developer or builder certifies that the foundation footing was in place before January 9, 1973. The plat map or sketch, together with the builder's or developer's written certification, will be submitted to the county supervisor by March 16, 1973. The certification will read as follows:

"I certify that the foundation footings were in place before January 9, 1973, for the homes identified on the attached plat or sketch."

3. The loan is approved and funds obligated before July 1, 1973.

B. If a family that needs interest credits wants to buy a home that was started under a qualifying verbal commitment and their application does not meet the requirements of the special procedure notice dated February 5, 1973, prior consent must be obtained from the national office before the loan can be approved. In such a case, the county supervisor will submit to the State office a list of name(s) of the applicants together with the plat map(s) or sketches of the building site(s) and certification(s) he received from the builder or developer. The State director will, if he determines that the information and the statement from the county supervisor complies with this special procedure notice, forward the list of applicants, together with supporting information received from the county office, to the national office for prior authorizations to approve loans for the homes.

EXHIBIT N

U.S. DEPARTMENT OF AGRICULTURE,
FARMERS HOME ADMINISTRATION,
OFFICE OF THE ADMINISTRATOR,
Washington, D.C.

PROCEDURE NOTICE

ATTENTION STATE AND COUNTY OFFICES

Notice (WSC)

This amends FHA bulletin 4533(444) dated February 2, 1973, supplements the special procedure notices of January 29 and February 5, 1973, and authorizes development of all RRH–RCH loans with written or verbal commitments.

I. RRH–RCH APPLICATIONS ON HAND

Applications on hand for RRH–RCH loans that were not approved before January 9, 1973, may be processed, provided a written or verbal commitment was given prior to that date. This authorization is limited to those specific projects reported to the national office in response to special procedure notices dated January 11, 1973, and FHA bulletin 4532(444). If a State determines that any reported project will not be approved this fiscal year, the national office should be notified immediately.

A. Dockets for applications that qualify under this procedure notice should be developed promptly. Priority in processing should be given to applications that require interest credits, since these loans must be approved by June 30, 1973.

B. Adjustments will be made in RRH allocations consistent with the authorization in this procedure notice. Until the allocations are revised, States may process dockets, even though they will result in obligations in excess of the current allocation. Loan dockets in these categories which are within the State director's approval authority may be approved and forwarded to Finance. Loans in these categories in excess of the State director's approval authority require prior review by the national office.

C. Applications not in any of the above categories may be processed during the remainder of fiscal year 1973 only with the clear understanding that the project will be funded at a later date when funds become available. No requests of this type should be submitted to the national office for an exception unless it involves an application for which a commitment had been made before January 9 but had not been reported previously because of oversight.

EXHIBIT O

U.S. DEPARTMENT OF AGRICULTURE,
FARMERS HOME ADMINISTRATION,
OFFICE OF THE ADMINISTRATOR,
Washington, D.C.

PROCEDURE NOTICE

ATTENTION STATE AND COUNTY OFFICES

Notice (WSC)

This procedure notice supplements and modifies special procedure notices dated January 29, 1973, February 5, 1973, and March 15, 1973, by authorizing approval of certain types of housing loans with interest credits after June 30, 1973.

I. EXTENSION OF JUNE 30 CUTOFF DATE FOR NEW LOANS

Priority will continue to be given to completing the processing of loans with interest credit in order to obligate funds before June 30, 1973. However, if they

cannot be obligated by that date, loans with interest credits may be approved after June 30 for the following types of applicants.

A. Applicants for rental and cooperative housing who received written or verbal commitments that meet the requirements of special procedure notice dated March 15, 1973.

B. Applicants for rural housing loans to buy a home on which a written or verbal commitment was made that meets the requirements of paragraph II A 3 and 4 of special procedure notice dated January 29, 1973. In case a written commitment given prior to January 9 expires before an RH loan to buy the house is approved and funds obligated, the commitment may be extended for a 6-month period and still qualify for an interest credit loan.

C. Families who had filed applications in the county office before January 9, 1973, and meet the requirements of paragraph II of special procedure notice dated February 5, 1973; and

D. Families who participate in a mutual self-help project or whose homes are built or repaired under approved manpower training programs.

E. Families who apply for a RH loan to buy a building site developed with an FHA rural housing site loan, and meet the requirements of paragraph III of special procedure notice dated February 5, 1973.

II. EXTENSION OF JUNE 30 CUTOFF DATE FOR SERVICING EXISTING LOANS

The authorizations to use interest credits as outlined in paragraphs IV through VII in special procedure notice dated February 5, 1973, will remain in effect after June 30, 1973.

III. FARM LABOR HOUSING

Farm labor housing loans and grants for which written commitments were issued and which meet the conditions outlined in paragraph II B of special procedure notice dated January 29, 1973, must be approved and funds obligated before June 30, 1973.

IV. NOTICE TO FINANCE OFFICE

Paragraph VIII of special procedure notice dated February 5, 1973, will continue to apply to all cases where interest credits are approved under special authorizations.

Appendix 14(A).—Audit of South Carolina Farmers Home Administration Program

Audit Report, Farmers Home Administration, South Carolina State Office, Columbia, S.C., as of April 30, 1971, Report No. 401-17-A

U.S. DEPARTMENT OF AGRICULTURE, OFFICE OF THE INSPECTOR GENERAL, SOUTHEAST REGION, ATLANTA, GA.

I.—Introduction and Summary

A. INTRODUCTION

Scope

This report presents the results of a coordinated audit of a coordinated audit of the activities of the South Carolina Farmers Home Administration (FHA) State Office at Columbia and 12 county offices. The county offices are:

Report No.	*County and location of office*
1. 411-223-A	Anderson County, Anderson
2. 411-224-A	Lee County, Bishopville
3. 411-225-A	Orangeburg County, Orangeburg
4. 411-226-A	Sumter County, Sumter
5. 411-227-A	Williamsburg County, Kingstree
6. 411-228-A	Spartanburg County, Spartanburg
7. 411-229-A	Clarendon County, Manning
8. 411-230-A	Greenville County, Greenville
9. 411-231-A	Horry County, Conway
10. 411-232-A	Berkeley County, Moncks Corner
11. 411-233-A	Cahoun County, St. Matthews
12. 411-234-A	Jasper County, Ridgeland

Individual county office audit reports, disclosing conditions applicable to the particular county offices involved, were issued as the county audits were completed. This audit was conducted as part of a National audit of FHA and the report treats conditions applicable to the South Carolina State Office, and as appropriate, the FHA National office.

The audit was made to appraise the efficiency and effectiveness of State office and county office operations and to determine whether activities were in accordance with laws, regulations and procedures. Emphasis was given to rural housing loans made since January 1, 1969; however, other types of loans and older transactions were reviewed as considered appropriate.

During our county office audits we examined the files of 515 active rural housing borrowers of whom 143 were interviewed. We also interviewed FHA personnel in the State and county offices and hundreds of informed persons such as developers, builders, insurance agents, building suppliers, representatives of Savings and Loan Associations and other lending institutions, representatives of Soil Conservation Service, U.S. Geological Survey, Public Health, and other Public officials including law enforcement officers. We interviewed representatives of the Federal Housing Administration of the Department of Housing and Urban Development (HUD), in Columbia, South Carolina, and Atlanta, Georgia. We visited the factories of several manufacturers of modular and pre-fabricated houses in South Carolina and Georgia.

The following housing loans were processed during the first nine months of 1971:

Type	Number of loans	Amount
Low/moderate	1,822	$24,158,980
Interest credit	3,243	44,019,100
Special/502	14	42,170
Self-help	1	10,760
Section 504	51	68,220
Rural rental housing	8	776,780
Total	5,139	69,076,010

As of March 31, 1971, county offices had on hand, 4,037 rural housing applications in various stages of processing.

There were 216 FHA employees in the State. According to the staffing criteria set forth in FHA Bulletin 2267 (040) the State was understaffed 76 positions as of April 30, 1971.

Background

South Carolina was operating the largest rural housing (RH) loan program in the United States. During all of FY 1971, $94,745,000 will have been channeled through the State's 44 county offices, for a county average of $2,153,396. The RH lending volume compares with other States of the Southeast as follows:

State	Rural housing fiscal year 1971 allocation	Number of county offices	Average rural housing loan volume per county
Alabama	$16,800,000	57	$1,084,211
Florida	20,905,000	26	804,038
Georgia	63,005,000	61	1,032,869
Mississippi	67,240,000	79	851,139
North Carolina	90,900,000	71	1,280,282
Tennessee	46,470,000	64	726,094

B. SUMMARY

South Carolina operates the largest RH program in the Nation. An aggressive and dedicated State and county office staff work many hours of uncompensated overtime to keep up with the program. More than 900 builders and/or developers are oriented to the program, many of them being new and inexperienced in housing. Heavy workloads have brought about serious problems in the management of the program, such as:

Packagers excessively influence where and what the loan applicants buy and/or build, and competitive bidding has been eliminated. Inexperienced developers have built subdivisions on sites which are subject to flooding, creating septic tank overflows which pollute the area. FHA has not used all available technical assistance in site selection and development, and county personnel need training to adequately handle the problems.

Inexperienced builders and unskilled laborers are building houses with many construction defects, resulting in borrower complaints and jeopardizing the Government's security position.

State guidelines, conflicting with National instructions, authorized arbitrary reductions in the regular incomes of wives and other adult family members, and resulted in many improper RH loans and erroneous interest credit computations. Some county office staffs omitted verification of applicants' incomes, resulting in loans to ineligible applicants and erroneous interest credit computations; and at least two county offices were treating bonus food coupons as income, resulting in some borrowers receiving less interest credit than allowed by procedure.

Some FHA employees and/or their close relatives had private business interests which were, or could come to be, involved with the FHA program and could result in charges of conflicts of interest. There was a need for monitoring of these conditions by the State office.

Several minor items needing corrective action are included in Part IV, Memo Matters.

The conditions reported in our previous State office audit report dated February 16, 1968, had been corrected.

II.—Recommendations and Discussion with Management

A. RECOMMENDATIONS

For the FHA Administrator

1. Clarify FHA Instruction 444.1 with respect to the propriety of treating bonus food coupons as income in determining eligibility for loans and/or interest credits. (See Details–4).

2. Establish a policy for State office monitoring of the quality of the manufacturing of houses to assure compliance with HUD Bulletins relating to minimum standards; have the State offices submit any adverse reports to the National office so that other States can be alerted to the conditions found. (See Details–6)

3. Revise FHA instructions to require at least three on-site inspections of constructon for all housing. (See Details—6).

For the South Carolina State director

4. Amend the State policy which precludes counseling of applicants whose loans are packaged. Require county supervisors to advise and counsel applicants in those instances where the proposed house is illogically located or size and design features and/or cost is not in the best interest of the family. Further encourage competitive bidding in appropriate instances. (See Details—1).

5. Have all county offices analyze all interest credits granted, as well as all RH loans made, *since April 1970 when National instructions were issued superseding State guidelines on the subject of determining adjusted family incomes. In addition to having all ineligible borrowers refinance their loans, all erroneous interest credits should be appropriately adjusted.* (See Details—2)

6. Remind all loan approval officers of the importance of verifying applicants' income, and require district supervisors to follow up and determine that procedure on the subject is followed throughout the State. (See Details—3)

7. Closely monitor all business relationships of FHA employees, using FHA Instruction 207.1 as a guide, to determine that the Agency is protected from the possibility of charges of conflicts of interest. Determine the circumstances of all conditions, including those cited in this report, involving business relationships of employees and/or their close relatives with FHA oriented businesses. (See Details—7)

8. Start a training program for all FHA personnel responsible for building site preparation using FHA Bulletin 3790 (444) as a guide. In addition, require coordination with SCS at the State and county levels on the selection and development of building sites. Further, see that construction is discontinued on all improperly developed subdivisions throughout the State until all drainage, road, and sewerage problems are corrected. (See Details—5)

9. Require all county supervisors and construction inspectors to make timely and strict construction inspections, including periodic inspections of speculative building. (See Details—6)

B. DISCUSSION WITH MANAGEMENT

On May 7, 1971, we discussed the findings and recommendations at the FHA State office in Columbia, with the following: E. Whitson Brooks, State Director; Eugene R. Stewart, Chief, Rural Housing.

They agreed with the results except for Details—1 dealing with loan packaging. Their comments are included in the appropriate sections of the report.

Representing OIG were: D. L. Wininger, Regional Inspector General; K. K. King, Assistant Regional Inspector General; P. T. Arnwine, Supervisory Auditor; J. A. Jones, Auditor-in-Charge; J. R. Griffith, Special Agent.

On June 22, 1971, the report was discussed in the FHA National office with the following: James F. Neville, Assistant Administrator for Rural Housing; Lewis D. Malotky, Deputy Assistant Administrator for Rural Housing; George C. Knapp, Assistant Administrator for Management; George J. Schladt, Rural Housing Technical Services Officer; Mark Nestle, Operations Review Officer.

Representing OIG at these discussions were the following: Thomas T. Osasa, Deputy Assistant Inspector General, Operations; James J. Scott, Supervisor-in-Charge, OIG, Headquarters; K. K. King, Assistant Regional Inspector General, Region III, Atlanta; Philip T. Arnwine, Supervisory Auditor, Region III, Atlanta.

Additional discussions were held in Atlanta on July 1, 1971. Representing the FHA National office were the following: George J. Schladt, Rural Housing Technical Services Officer; Richard H. Slater, Architect; Earl Bell, Engineer; John Pomeroy, Sanitary Engineer.

Representing OIG in these discussions were: Thomas T. Osasa, Deputy Assistant Inspector General, Operations; James J. Scott, Supervisor-in-Charge, OIG Headquarters; D. L. Wininger, Regional Inspector General; K. K. King, Assistant Regional Inspector General; James R. Griffith, Special Agent, Region III.

On August 31, 1971, we gave officials of the FHA National Office the final draft of the report and on September 7, 1971, they advised that they concurred with the findings and recommendations.

On September 17, 1971, we informed the State Director of the substantive changes made in the report since the discussions with him on May 7, 1971. He said that these changes would not affect the comments he made on May 7.

III.—Details

LOAN PROCESSING

Packaging

1. *Packaging practices in South Carolina tend to restrict the applicants' access to the expert counseling services of FHA on cost, location, size, design, and other features of housing. FHA has largely relinquished its counseling role to the packagers in order to achieve and maintain high loan activity.* The packagers are primarily interested in making sales and therefore cannot be expected to look out for the applicants' interests as FHA itself would do. Consequently, packaging has the effect of trading off the applicants' interests, to some degree, in exchange for a high volume of loan activity.

An applicant who walks into the county office uncommitted to a packager can receive counseling and advice from the county supervisor on the proper style, size and design of the house and its location. Further, the amount of the loan can be expertly tailored to the family's needs and in some cases the applicant with no children can be placed in a smaller house with lower monthly installments than might be available through a packager.

One purpose of the packaging concept was to transfer some of the paperwork burden from the county office to the financially interested packager and thereby allow the county office to handle a greater lending volume. In this respect, the system has been a success in South Carolina, permitting the State to become the National leader in RH lending volume.

FHA regulations on the subject of packaging do not require competitive bidding when the proposed house is one that the agency can appropriately finance, is cost competitive, is suitable to the family's needs, the price is within the family's debt repaying capability, and the builder is reliable and competent. When the package documents show, to the satisfaction of FHA, that all these criteria have been met, face-to-face counseling of the family is normally not considered necessary.

As the system actually works in South Carolina, counseling by the county supervisor on these points is not permitted if it could result in the applicant's switching to a seller other than the one who packaged the loan. The lack of counseling could result in some borrowers being placed in housing located at points distant from their work and/or schools and shopping centers. For low income families lacking transportation, the location can be a critical factor.

There are more than 900 builders and developers participating in the RH program in South Carolina. Most of them package loans and are heavily dependent on FHA for financing. Most packagers offer one basic house style, especially those who handle only manufactured homes. It follows that some packagers may not handle a style nor offer a price suitable to every applicant for whom they package a loan. Nevertheless, as the system works in South Carolina, the packager is almost certain of the sale once the county supervisor determines that the applicant is eligible and the loan sound from a repayment standpoint.

Generally, county supervisors in the State told us that while they are appreciative of the services offered by packagers in getting much of the paperwork burden off their shoulders, they have some regrets over the way the system works in the State. *They said too much of the counseling service they formerly offered applicants has shifted to the sales oriented packager.*

The county supervisors said they have been instructed by the State office that the position and interests of the packager are to prevail so long as the applicant is eligible, the loan sound, and the proposed house and lot fits the RH program and can be appraised at the asking price of the packager. They said that for all practicable purposes this policy eliminates competitive bidding and otherwise precludes them from counseling or advising applicants in any manner that might result in the applicant's switching to another developer. If the packaged applicant

decides for any reason that he wants a different location or a different house that cannot be provided by the packager, FHA must have a written release from the packager before proceeding with the applicant.

County supervisors who have provided information about FHA services available to applicants resulting in the applicants' selecting houses or locations that could not be provided by the original packager have been the target of criticism by packagers and in turn the State office. In a sense, the applicant becomes the captive of the packager even though a different location, style and size of house, and cost, might be available elsewhere.

County supervisors said that, as a matter of policy, they do not encourage or even mention to applicants that competitive bids might result in a lower cost. They said this was true even though it stands to reason that in at least some situations competitive bids could prove beneficial both to the borrower and the Government.

FHA personnel told us that the vast majority of RH applications come through packagers. *Some large scale franchisers of factory-built houses operate almost exclusively through packaging.* Many hire salesmen who in turn hire contact men. Some salesmen and their staffs concentrate on the Negro community, and many of the packaged loans are made to families who fall into the interest credit category. Reaching these applicants in unprecedented numbers represents a salutary effect of packaging.

A promotional method used by at least one packager is to furnish free barbecue and beer at the site of a complete model house. Applicants are signed up (packaged), on the scene in some instances, after seeing the model of a home they can move into in as little as two weeks, with no down payment and low monthly payments. Some applicants see only a picture of the house prior to signing the application.

The low income family is likely to be poorly educated and cannot reasonably be expected to be well informed of the full services offered by FHA. For example, the applicant is not likely to realize that if he rejected the packager's offer and walked into the FHA county office free and uncommitted the county supervisor could make known to him the full range of services available. The applicant would learn, among other things, that any number of house styles, size, design features, and locations might be available to him. He not only would be allowed to shop around, but would be encouraged by the county supervisor to do so and to seek competitive bids if the county supervisor felt a significant savings could be realized through such bidding.

We found that most borrowers who acquired housing through packagers had seen the deal as a once-in-a-lifetime opportunity and had not asked many pertinent questions concerning the alternatives available. As the system actually works, it is the packager, not FHA, who counsels, guides, and influences the applicant as to where and what to buy and build. Further, with the knowledge that there is to be no competitive bidding the price is consistently fixed at the highest point, the appraised value.

One county supervisor told us of a couple who came to the county office seeking a loan to build on their own lot. They had their own house plans, and the identical house had been financed by FHA for the wife's father for $12,800 a year before. He said the next time he heard from the couple was through a packager who submitted a bid of $14,850. He said he recognized inflation had driven prices up, but, breaking with policy, he suggested to the applicant that he seek bids from other builders they might choose. They subsequently returned with two other bids of $14,500 and $14,200, and they decided to accept the low bid. When the packager learned of the other bids, he complained to the county supervisor that had he known there would be other bids he would have bid lower.

The county supervisor asked the packager if he had two bids—one for the packaged loan he knew he would handle without any risk of a competitive bid and one he used where there was likely to be competitive bids. The packager told him he had to pay a salesman's commisison on packaged loans and therefore had to bid higher in those instances. Further, he had money tied up in getting the lot approved, pollution control, and telephone calls. The packager subsequently harrassed the applicants whereupon they offered to reimburse him for his expenses, but he insisted on handling the package. He resubmitted a bid of $14,475 and the applicants told him (the county supervisor) they agreed to the deal to keep from making the packager mad at them.

In another county office a packager, irritated because the county supervisor had not processed his loans fast enough, retrieved 12 loan packages he had pre-

pared and took them to the State office and complained of the service. The State office called the county supervisor and instructed him to give priority to these applications.

County supervisors also told us they had found that packagers were insensitive to the Agency's responsibilities, and had on occasions omitted from loan forms critical information such as additional income, ownership of other housing, etc. We encountered some of these problems during our audit but concluded that the condition may not be widespread. There were relatively few such omissions compared to the number of files examined.

In our conversations with borrowers who had acquired their houses through packagers we heard many complaints about construction deficiencies (see Details—6), *but we heard almost no complaints of the packaging system.* We did learn that these borrowers had very little knowledge of FHA and were prone to look upon the packager, rather than FHA, as their benefactor. To them it was the packager who had gotten them out of the shack and into a new home, and it was the packager who had gotten them a quick low interest loan as promised in the sales pitch.

Generally, county supervisors expressed regret that packaging has shifted so much of the counseling process to the packagers. They found it undesirable that so much of the applicant-county office rapport, prevalent in pre-packaging days, had been lost through packaging, pointing out that under the system they usually saw the applicant only once—at loan closing. *Some county supervisors suggested that delinquencies are becoming aggravated because they were unable to outline sufficiently to applicants at the outset what the borrower-agency relationship would be, and what would be expected of the borrower under the conditions of the loan.*

We believe that the packaging concept as developed by the National office is sound and that it envisaged a developer who would offer a choice of at least several different house plans and locations, and a reasonably knowledgeable applicant who would accept or reject the offer with realization that he could receive FHA services for which he was eligible, using a qualified builder of his choice. We do not believe the system intended for so much influence of the decision making process to rest with the packager while the county supervisor holds back information about FHA lending policies which, if known to the applicant, could result in a different choice of location or style and design.

In time, many of these borrowers whose loans were packaged under the restrictive methods herein described may learn that their previous ignorance of the FHA program (and the varieties of housing and locations it can offer the independent applicant) led them to act hastily and not in their own best interests. Further, some of these borrowers, particularly those with poorly constructed houses (see Details—5 and 6) will likely become disillusioned and blame FHA rather than the packager.

Officials of the FHA National office told us the National office guidance on the subject of loan packaging does not intend to preclude counseling of applicants on matters of location, size and design features or cost.

These officials also said that if the proposed house is not suitable in terms of location, size, design, and cost, additional negotiations or bids may be required or the applicant may need to select a different house plan. They indicated that experience has shown that in most instances the packaged loan has met all these conditions, but that in some situations FHA counseling is necessary to fulfill all the aforementioned criteria.

The State Director said that the State has pioneered the packaging system and that without it the RH loan volume would fall off sharply. He said the only way the system can work effectively is to honor the packager's position; that, if the packager had to risk switching by the applicant and possibly lose some sales, he would stop packaging loans and return the paperwork burden to the county office.

The Chief, Rural Housing, said county supervisors are under instructions to have more than one advance contact with each applicant and to counsel the applicant short of influencing him to leave his packager. He said the State office requires a written release from a packager when the applicant decides he does not want the deal offered He also said he believes competitive bidding is not necesary because the appraisal serves to place a ceiling on the loan, and all bids would likely run to the appraised figure.

We recognize that some packagers might stop packaging loans if they are not assured of handling the construction or erection involved in their packages. However, FHA is the main or only source of RH credit for low income home

buyers in rural communities, so the packagers cannot turn elsewhere for customer credit nor ignore this big market.

While a packager may lose a given sale because FHA personnel explained available options to the applicant, he may gain a sale to an applicant packaged by a competitor. Loan packaging should not preclude the applicant from obtaining, within the bounds of FHA policy, what he wants and needs and at the most favorable price.

We concluded that the loan packaging practices in South Carolina carry certain unnecessary risks of placing some borrowers in housing unsuited to their needs or genuine desires. Accordingly, the State Director should amend the present policy by requiring county supervisors to step in and counsel applicants whenever it is evident that they are entering into housing arrangements that may not be in their own best interests. In addition, if the experience of the county supervisor indicates that significant savings are likely to result from competitive bidding, the applicants should be encouraged to seek such bids.

Eligibility of borrowers for loans and/or interest credits—RH

2. Many RH loans were made to ineligible applicants and many erroneous interest credits were granted borrowers as a result of continuing to use State office guidelines which had been superseded by National FHA Instructions. The State office had issued guidelines which permitted arbitrary reduction in a wife's regular income on grounds that there were small children in the family and she was of child bearing age, etc. Through oversight, these guidelines were not rescinded in April 1970 when National instructions were issued requiring that all of a wife's regular income be considered in determining whether the total adjusted income exceeded $8,000. This figure represented the maximum income allowed for eligibility for low to moderate income RH loans, the only Section 502 loan program then and now fully operative.

As a result of an advance audit report we issued dealing with the subject of loans to ineligible applicants (402-3-A), the South Carolina State Director rescinded the conflicting State guidelines in Februray 1971. Further, he informed all loan approval officers in the State that the National Instructions were binding. Also, the State Director instructed county offices to require that all borrowers who received improper RH loans under the previous, and erroneous, income classification system be requested to refinance their loans with other lenders at the earliest practicable date. We consider this plan for corrective action to be satisfactory. However, our advance report on the subject did not treat situations where interest credits were inaccurately computed as a result of the arbitrary reductions in the regular incomes of wives, and in some instances, other adult members of the household. As our county audits progressed and our Statewide borrower samples expanded, we discovered that many such erroneous computations of interest credits occurred as a result of the conflicting State guidelines.

Attached as Exhibit A are the names of 62 of the borrowers who received RH loans of $857,450 for which they were not eligible and/or who received more interest credit than they were entitled to. We concluded that the incidence of such improper loans and/or interest credits was widespread throughout the State.

The State Director should instruct all county offices to analyze all interest credits granted, as well as all RH loans made, since the aforementioned National instructions were issued. In addition to having borrowers who were ineligible for their loans refinance with other lenders, all erroneous interest credits should also be appropriately adjusted.

Verification of applicants' incomes

3. Two county office staffs (Williamsburg and Berkeley) were not verifying the incomes of all applicants before approval of loans. This resulted in loans to applicants whose incomes exceeded the maximum allowable for low to moderate incomes, and in erroneous interest credit computations as well (see Exhibit A). Some borrowers received more, while other borrowers received less, interest credit than they were entitled to under the criteria. Our audit sample included 13 loans in Williamsburg County and 4 loans in Berkeley County that were affected by the lack of verification of income. These loans totaled $216,100.

The interested county supervisors said they had been pressed for time and had relied on the applicants and/or their packagers to furnish accurate information. Our field contacts disclosed no evidence of fraud and the errors were due pri-

marily to oversight and misunderstandings of how to treat various sources of income.

The State Director should remind all loan approval officers of the dangers of determining eligibility and computing interest credits based on unconfirmed income figures. Further, district supervisors and office management assistants should be instructed to follow up and determine that applicants' incomes are verified throughout the State.

Bonus food coupons treated as income

4. County supervisors in Horry and Williamsburg Counties interpreted instructions to provide for including bonus food coupons in the applicant's current annual family income. This is at variance with the intent of FHA instructions on determining incomes and has resulted in insufficient interest credit being given to some borrowers.

According to FHA Instruction 444.1 current annual family income consists of net farm and non-farm business income plus all recurring dependably available income from salary, wages, pensions, social security, welfare payments, or other sources received by the husband and wife, and any other members of the family who are 21 years of age or older and reside in the home. Welfare, social security, and other payments made on behalf of minors will be included as current family income.

Our audits disclosed the following instances where bonus food coupons had been included in the applicant's current family income:

County and borrower	Interest credit	
	Insufficient	No effect
Horry:		
Johnson, Elva May		×
Jordan, Julian A	×	
Vaught, Walter B	×	
Williamsburg:		
Barr, William		×
Rich, Hodges, Jr		×

County office personnel told us that they were not certain whether their interpretation of instructions was correct, but they have not been told that it is wrong.

While it is appropriate to consider bonus food coupons in determining the soundness of a loan, it is not appropriate to include the bonus portion of the assistance in the eligibility or interest credit computations.

We found this condition in two of the 12 counties visited in South Carolina. The practice could be occurring, or come to occur, in other South Carolina counties, and elsewhere as well.

The FHA Administrator should clarify the Agency position on the propriety of considering bonus food coupons as a part of family income in determining loan elibility and the amount of interest credit to be granted.

BUILDING SITES

Selection and Preparation—Subdivision and Individual

5. In 10 of 12 county offices audited, we found indications of inadequate selection, preparation, and development of building sites, affecting numerous borrowers in subdivisions and some individual sites. Poorly located and developed sites have resulted in improper drainage, causing flooding which in turn caused septic tanks to overflow and function improperly. Also, we found inadequate roads and streets preparation accompanied by ineffective arrangements for perpetual care, and improper landscaping. Technical advice of the Soil Conservation Service (SCS) was usually not requested on the location and preparation of sites, and some local sanitarians erred in their approvals of septic tank installations. These conditions resulted because FHA personnel had not received the pre-training necessary to make the major decisions so vital to assuring that sites would be properly located and expertly developed. Further, these conditions have generated borrower complaints, and have lessened the value of the property and tend to defeat the Agency's goal of neighborhoods that serve as an asset to the people who live there and a credit to the community.

Our review disclosed the following major problems in connection with individual sites and subdivisions. Exhibit B, Photographs 1 through 20, present visual examples of some of the conditions observed, which were:

Inadequate roads and streets development with unpaved surfaces and without dedications to or acceptance by local authorities for perpetual maintenance in four subdivisions consisting of 46 houses in Sumter and Lee Counties.

Eleven subdivisions and five individual sites consisting of 61 houses subject to flooding and/or erosion in Clarendon, Lee, Greenville, Orangeburg, Williamsburg, Horry, Jasper, Sumter and Berkeley Counties.

Septic tanks and sewerage systems backing up and overflowing in toilet stools and bath tubs with resultant unpleasant odors. These conditions, which present potential health hazards, were noted in two subdivisions and one site consisting of 12 houses in Clarendon and Horry Counties.

Grading design of individual sites and subdivisions not suitably related to natural drainage ways to avoid erosion on or adjoining the sites in two subdivisions consisting of nine houses in Calhoun and Horry Counties.

Only one driveway for every two houses, and the culverts under the driveways crushed and clogged with dirt, blocking the drainage in one subdivision in Clarendon County consisting of 16 houses.

Sites, access roads and streets eroded in one subdivision and in one individual site consisting of 17 houses in Greenville and Clarendon Counties.

Open drainage ditches surrounding four houses in one subdivision in Clarendon County.

One subdivision in Clarendon County consisting of five houses located in close proximity to dilapidated dwellings with outdoor toilets.

Poorly landscaped yards and uprooted growth and trees in four subdivisions and four individual sites consisting of 32 houses in Lee, Orangeburg, Horry, Calhoun and Berkeley Counties. In one subdivision located in Horry County, a large pile of uprooted trees on a borrower's backyard had created a haven for rats. This borrower told us that a rat got into the house and bit her small son.

Four subdivisions and one individual site consisting of 22 houses in Sumter, Lee and Williamsburg Counties located in low lying areas with a high water table and on land unsuited for any other uses.

Many borrowers were experiencing drainage and sewerage problems, and as a consequence the danger of water well contamination and health hazards from flooded and overflowing septic tanks was prevalent. Borrowers interviewed in these subdivisions expressed dissatisfaction and disillusion with the environment they encountered.

The photographs in Exhibit B were taken coincidentally following a heavy rain. The residents told us they experienced serious drainage problems each time there was any significant rainfall. Generally, these conditions can be attributed to the accelerated pace of the rural housing program. The lending volume increased so fast that hundreds of builders and developers, many new to the housing and subdivision development business, rushed into the program. FHA's county staffs were overtaxed to keep abreast of the program expansion. In order to carry out the increase in the RH program, the State, and especially county office personnel, are working overtime to process the applications. According to FHA Bulletin 2267 (040), Criteria for Staffing County and State offices, the State was understaffed 76 positions.

Guidelines for ensuring adequate selection and preparation for building sites were loose and scattered in State and National instructions. Most noticeably lacking were specific instructions how and where to draw on the experience and expertise of other public and private institutions that could offer advice and counsel on where to locate and what to do to make the building sites suitable. Also, there was a lack of sufficient pre-training of FHA personnel to cope with the situation. FHA had continued to issue guidelines on subdivision and site preparation and planning, but for most of the problems cited herein, the instructions came too late. For example, FHA Bulletin 3790 (444) was issued on November 23, 1970, when the RH program was well under way. Some guidelines (National and State) were available before then, but were apparently inadequate in view of the conditions noted.

Many of the drainage problems we found might have been avoided if the technical assistance of the Soil Conservation Service (SCS) had been sought on determining the suitability of building sites. Some of these sites could have been made suitable by proper ditching, filling, and landscaping prior to beginning construction of houses. SCS personnel told us that, if they had been consulted about the locations of certain building sites, they would have advised FHA not to con-

struct houses on the sites because of the soil limitations and high water tables which cause flooding and preclude septic tanks from functioning properly. Also, SCS personnel told us in some instances developers had sought and received their advice, but had ignored it. They said FHA had rarely sought their advice on the suitability of building sites.

While local sanitarians were used extensively with respect to the location of sites and the adequacy of septic tank installations and water wells, their advice often proved to be less than competent. Many errors were made by local sanitarians who approved septic tank installations during dry spells and then found that during the wet seasons they would not function properly. Also, local sanitarians told us that their approval of septic tanks and wells did not guarantee they would work; it only meant that they were adequate and constructed according to their specifications.

County supervisors told us that fast expansion of the rural housing program had caught them less than fully prepared to make the major decisions so vital to assuring that subdivisions would be expertly developed. They said they had learned a lot through experience and felt they had profited by some of the mistakes that were made; however, most of them indicated they would like to have more specific guidance and training to prevent future problems of this type.

Many builders and developers told us they were new in the housing and subdivision planning business, and did not have the necessary experience to foresee problems. Some added they are interested in building good subdivisions, but that they needed guidance. County supervisors and developers also told us there was a scarcity of good building sites. Landowners, taking full advantage of the demand for sites brought on by the expanding RH program, have priced good land out of reach and have made available only land that requires maximum treatment and development. We concluded that in some instances developers and builders, hurrying to make sales, were not inclined to spend sufficient time and money to adequately prepare and develop sites. Further, county supervisors, rushed themselves, sometimes did not insist on proper preparation prior to launching building programs in some subdivisions.

The State Director said corrective action is well under way in the counties where these conditions existed. He said all county offices have been instructed to call on SCS for technical assistance and that written instructions are being prepared.

The State Director should initiate a training program of all personnel responsible for individual site and subdivision planning and development using FHA Bulletin 3790 (444) as a guide. Also, the State Director should require interagency coordination including the use of available SCS services on the selection and development of housing sites. The State Director should take action throughout the State to discontinue construction on all improperly developed subdivisions and individual building sites until all drainage, road, and sewerage problems are corrected.

RURAL HOUSING CONSTRUCTION

Construction defects

6. Our audit disclosed many instances of construction faults in FHA financed dwellings. These faults occurred because of poor quality control at the factories manufacturing modular and pre-fab units, incompetent erection and construction, and a less than adequate inspection by FHA. These conditions have generated borrower complaints and lessened the security value of the properties. Unless the conditions are overcome, the reputation of the Agency for providing quality-built, safe, sanitary and decent housing could be damaged.

The terms "modular" and "pre-fab" connote different meanings in different locations. For purposes of clarity, we use these terms herein to coincide with the meanings we found prevalent in South Carolina. "Modular" means a house manufactured at the factory in two sections and transported either on its own chassis or a flat trailer. The two halves are usually set on piers and joined together and then covered by brick veneer.

"Pre-fabs" as used herein means factory built houses of considerably more than two components which are erected on-site and usually placed on concrete slabs. The erection of "pre-fabs" usually involves more stick building than is normally necessary in the modular house, and the pre-fab units may or may not be brick veneered.

The rapid expansion of the RH program in South Carolina has attracted many builders into the program. Many are new and inexperienced in the construction and development of housing. Persons who formerly operated businesses unre-

lated to housing, such as auto and insurance agencies, etc., have come into the RH program as builders and developers. Some operate franchises for factory-built housing, usually modular or prefabricated units. Factory-built units are being used on a grand scale. They can be erected quickly, and many promoters believe, mistakenly we found, that they can be erected by unskilled labor. It takes longer to construct the custom-built house.

FHA county supervisors, construction inspectors, and members of the State office RH staff told us the advent of the factory-built unit has enabled the State to place many more people in new housing than could have been possible if all houses were stick-built. Despite the advantages of quick housing afforded by factory-built houses, there were many serious construction problems noted with this type house. While we found defects in houses of all types, including some stick-built types, the problems were far more acute with the factory-built modular and prefabricated units.

FHA personnel at the county levels were virtually unanimous in their opinion that the stick-built house is superior in quality and durability over the modulars and prefabricated units. This opinion was supported by the many builders and other knowledgeable persons we interviewed. Generally, these informed sources told us, and our visits with borrowers and inspections of the various models substantiated, that the modulars and prefabricated units as erected in the State cannot compare in quality and durability with stick-built houses. We are not suggesting that the factory-built house is unworthy of a prominent place in the housing field. We are suggesting, however, that (1) many of the modular and prefabricated houses reaching the RH program in South Carolina are in need of improvement at the factory, (2) some of the persons erecting these type houses in the State are not providing competent workmanship, and (3) FHA is not making strict inspections of the quality of erection to assure meeting the proper standards.

Modular houses

Factories producing modular houses in South Carolina are not required to be certified or licensed by any authority. Anyone can open a factory. During the past year or so several new companies have sprung up. Usually any contractor can buy modular units from the factory. Many persons previously not in the building trade have entered it in the past year or so apparently because they believed the manufactured houses to be a lucrative venture.

Our observations and interviews with FHA personnel, builders (including some who handle modulars), and other informed persons disclosed a high frequency of the following type construction deficiencies to be found in the modular units being sold to FHA borrowers:

(a) Poor workmanship in fitting bracing materials (2″ x 4″) for inside walls resulting in structural weaknesses.

(b) Use of 2″ x 2″ in bracings for inside walls, and for rafters in some models.

(c) Use of a single floor when a double floor is needed.

(d) Use of cheap grade plywood paneling. Paneling buckling out from walls.

(e) Use of cheap grade carpet to cover pressboard floors. Carpets coming up.

(f) Weak and uneven floors.

(g) Doors and windows that do not fit properly.

(h) Roofs, doors, and windows that leak water. Sagging roofs.

(i) Walls pulling away from ceilings, nails backing out of the floors and walls, and ceilings that are dropping down and becoming loose.

(j) Cabinets that are flimsy and cabinet doors that do not fit properly.

(k) Light fixtures dropping down from ceiling.

(l) Steel beams under modular rusting.

(m) Excessive space between brick and modular's walls, and less than the required number of tie-ins. Sloppy workmanship by brick masons.

(n) Foundation concrete piers not properly supporting modulars. Use of pieces of asbestos and wood between steel beams and top of concrete piers to level the modulars.

We were told that modulars are easily damaged while being transported to the building sites, that most building contractors do not have the proper equipment to set the modulars on the concrete piers, and that unskilled work crews are assembling the modulars, resulting in damage and construction defects.

Attached as Exhibit C are a series of photographs depicting various stages of erection of modular units. Most of the houses were uncommitted at the time of our visits, but are located in subdivisions where FHA has financed houses by

the same builders. It was necessary for us to use uncommitted houses to illustrate the usual erection process and the common defects that are apparent then but concealed by paneling and brick work at time of loan application. FHA instructions require only two inspections of modulars and pre-fabs: foundation and footings, and final inspection. FHA county supervisors and construction inspectors told us the faults depicted by the photographs (Exhibit C), as well as many of the typical defects informed persons told us about, are likely to go unnoticed as these conditions would not be apparent at the initial inspection and would be covered up by paneling, brick work, etc., at the time of final inspection.

We inspected modular houses in Mayesville subdivision (Sumter County), an all Negro subdivision containing about 40 FHA financed modular homes erected by Southern Builders, Turbeville, South Carolina. The completed homes have brick veneer on all four sides. These modulars are manufactured by Winston Homes, Inc., in Alabama, and are transported by trailer for assembly on the building site.

Exhibit C, Photograph No. 1 shows the entrance to the subdivision with the sign showing the houses are financed by FHA. Photograph No. 2 shows some of the modulars to be assembled, and Photograph No. 3 shows a trailer used to haul the modulars from the factory. Photograph 4 shows a unit with the wall exposed. This side together with the side of a second unit will form the middle wall. Examination of the bracing in the middle walls showed that the 2 x 4's were not properly fitted. Many of the horizontal 2 x 4's were too short and left space between the bracing and the upright 2 x 4's. The horizontal 2 x 4's had been glued to the back side of the interior paneling, and small nails and staples had been used to fasten the inside paneling to the 2 x 4's. We were told this type of bracing is inadequate and results in weak construction. (See Photographs 5 through 7)

The Vice President of Southern Builders and a FHA construction inspector told us the improper bracing and poor workmanship in the walls of modular units can be attributed to poor quality control at the factory. Both said there is need for improved quality at the factory, the construction inspector adding that these deficiencies would not be disclosed by the type of inspections made by FHA!

Photograph No. 8 shows a hole torn in the exterior wall of a modular. It appeared that this section of the wall had never been insulated. Photograph No. 9 shows the canvas covering pulled back, exposing part of the yellow insulation on the top, and Photograph No. 10 shows yellow insulation in a field where it had apparently blown from the top of modular sections previously parked in the area .

Photograph No. 11 shows piers on which two 12 foot wide modular sections will be placed side by side. This setup appears to have been properly prepared; however, we observed some piers at various sites that were uneven and leaning, and we also observed situations where the modular units were not properly supported by the piers.

Photograph 12 shows an example of poorly fitted piers where asbestos pieces were used to shore up the modulars. These photographs were in R J N and Sara Glen Subdivisions, respectively (Sumter County). This method of leveling modulars was observed under several modular units.

Photograph No. 13 shows an example of poor brick work on a curtain wall of an uncommitted house in Sara Glen subdivision. One member of the inspection team pushed this brick in with the toe of his shoe, indicating that not enough cement or too much sand was used in the mortar.

Photograph No. 14 shows another example of poor brick work on a Sumter County modular house that had burned. The photograph shows that too few tie-ins were used in the brick. Only six tie-ins were used in this entire wall, and FHA specifications require tie-ins 18 inches apart. The photograph shows mortar missing from the bricks at the top and that general quality of the brick work was poor.

Photograph No. 15 shows a view of the brick work on an uncommitted modular house in Glenwood subdivision. The space between the bricks and the modular wall substantially exceeds the specifications of one inch.

These photographs represent examples of some of the problems to be found with modular units.

We interviewed contractors, developers, bankers, insurance agents, borrowers, HUD officials, FHA personnel, and many others involved in the rural housing program. Following is a summation of their comments:

(a) Modular houses are suggestive of two mobile home units joined together and an exterior cover such as brick applied.

(b) The materials used in modulars are of minimal quality.

(c) The stick-built house is generally far superior to the modular in both quality of materials and construction.

(d) It is doubtful that the economic life of modular houses will equal the period of the mortgage.

(e) Many persons previously not in the building trade, such as car salesmen, insurance agents, etc., entered the housing business with the advent of manufactured houses.

(f) Inexperienced laborers assembled the modular houses and caused many construction faults.

(g) Opportunists are taking advantage of low income people by selling them low quality houses at prices as high, if not higher, than they would pay for a good quality stick-built house.

(h) Three building contractors stopped constructing modular houses because of service calls they had to make to correct construction defects.

(i) A building contractor claimed to have spent $20,000 last year in correcting construction defects on modulars.

(j) Some building contractors did not handle modulars because they wanted to retain their reputations of constructing quality houses.

(k) FHA employed a double standard in their housing inspections. FHA required more of the stick-builder than modular builder. The stick-builder has three inspections, if not more, during which the walls must be left open to enable the FHA inspector to view the wiring, plumbing, etc., while the FHA inspector makes only two inspections of modular houses, one when the foundation is laid and the final completed inspection.

(l) Modular houses will deteriorate rapidly and subdivisions with such houses are future slums.

(m) Borrowers complained about loose wall panels, loose carpet and floor tiles, water leaks in ceilings and around windows and exterior walls, loose ceiling panels and moulding, plumbing leaks, bath fixtures improperly installed, poor quality kitchen cabinets, promised appliances missing, and slowness and inefficiency of builders to correct construction defects.

(n) HUD officials said that 80 percent of the problems encountered in manufactured houses were caused by incompetent persons assembling the houses.

(o) The preparation of foundations must be exact; it is easy to damage houses while transporting them; undue stress can cause walls to pull away from ceilings, etc.; and proper equipment is needed to position the modulars on the foundation. The equipment needed to properly set modulars on the foundation is a road crane, but few builders have a road crane and instead use tractors and trucks to push the modular halves into place. Many of the work crews assembling manufactured houses are unskilled and do not possess the expertise to do the job.

An important step in the construction of modular housing is the positioning of the two sections forming the modular unit on the concrete piers. The two sections must be properly positioned on the piers if the two sections are to be evenly matched, if the floors are to be level, if the interior and exterior walls are to be straight, and if the outside finishing work such as bricking is to be satisfactorily completed.

Training is needed by every contractor who handles manufactured houses regarding the preparation of foundations and transportation and assembly of these houses. Many contractors have not had this training, and consequently foundations are not properly prepared, houses are damaged in transit, and houses are not properly assembled.

There is a considerable difference in the appearance of two modular halves positioned on concrete piers and this same house after it has been bricked around. The exterior brick can cover many defects of the type herein described.

Prefabricated Houses

The prefabricated houses were considered by some informed sources to be somewhat better in quality than modular units, but still inferior to stick-built houses and in need of further improvement at the factory. Some of the common complaints heard from borrowers were that the ceilings were pulling away from the walls (see Exhibit C, Photograph Nos. 16 and 17), and the ceilings were dropping down and the nails holding the ceiling to rafters were falling out (see Exhibit C, Photograph No. 18). Other complaints of borrowers were: The molding was pulling away from the ceiling in the kitchens because the floors were

sinking; carpet was coming up in the living rooms; tile was coming up in the kitchens; sections of the wall panels in the halls had buckled; commodes were leaking around the base; some windows would not open all the way; panels in bedrooms were buckling; molding was left off windows; and the floor vibrated and squeaked when walked on.

In addition, we were told by builders, contractors, bankers, insurance agents, FHA personnel, and many other informed persons the following:

(a) Prefabricated houses, while considered better than modular houses, are still inferior to most stick-built houses.

(b) Prefabricated houses are costing borrowers as much as stick-built houses even though they do not favorably compare in quality of materials and workmanship.

(c) Quality of materials is minimal.

(d) Builders use unskilled labor to erect them, resulting in many construction faults.

(e) Some builders stopped constructing them because of construction problems.

(f) Prefabricated houses will not last the life of the mortgage.

(g) Persons previously not in the building trade have entered it to sell prefabricated houses for quick profits.

(h) Persons wondered why people would pay as much for a prefabricated house as a stick-built house if given a choice.

Officials of some concerns handling pre-fabs told us they, too, had been concerned about quality control at the prefab factories and had visited the factories to determine the causes of the structural problems and find ways to correct them. They said they had spent considerable sums of money correcting fabrication faults and erection defects after the houses were put up.

One major handler of pre-fabs told us their former construction supervisor had allowed sub-contractors to get away with many erection problems before they replaced him.

Construction defects in HUD Section 235 financed prefabricated houses processed through FHA in Horry County had not been corrected on a timely basis. This resulted because the contractor had not been required to make repairs when the defects were reported. The contractor (Tri-County Builders) is now defunct, and it is doubtful that repairs will be made by the contractor.

We interviewed five borrowers who had purchased pre-fab houses from Tri-County Builders. Two of these resided near Wampee, South Carolina, and three resided at Four Miles, near Conway, South Carolina. Tri-County Builders erected pre-fab dwellings manufactured by National Homes Corporation. All five borrowers complained of construction defects and not being able to have them corrected. We verified the borrowers's complaints and found them to be valid. All said they thought the contractor had been ignoring them.

We learned that when the manufactured homes first entered the FHA program they were priced higher per square foot than stick-built houses of superior quality. Today the prices of factory built and stick-built houses are about the same. Some large scale handlers operate under franchises from the factory and employ subcontractors to erect the houses and commission salesmen to sell them and to package the loans. Some salesmen also serve as developers.

County supervisors and construction inspectors told us that there has been some improvement in the quality of both modular and pre-fabs since these units first entered the State. There has been some strengthening of the units at the factory, and double flooring in modulars is becoming more prevalent. They said, however, that there is need for further improvement in the basic unit.

Some county supervisors told us they have had to readjust their concepts of quality construction with the advent of the manufactured house. They said at first they found it difficult to accept these houses because they did not believe they were suitable for the RH program. They said there is still no doubt that the stick-built house is superior and that it remains to be seen how long and how well the manufactured house will hold up.

For one thing, county supervisors do not like being unable to see what is in the interior walls of manufactured houses. With the stick-built house they can see every facet of construction, and FHA procedure still requires three inspections of stick-built houses.

Some county supervisors told us that when they balked at accepting the modulars and/or pre-fabs they were told by the State office that they would have to accept them because they had been inspected at the factory by FHA and found to

be sound. County supervisors said the State office had emphasized the necessity for accepting manufactured houses as the only practical means of maintaining the RH lending volume at the programmed levels. They acknowledged that there are not enough stick-builders available to handle the building volume the State is experiencing.

Generally, county supervisors said the revision in FHA instructions requiring two, instead of three, inspections on manufactured homes had made more time available for other duties, but that it had precluded them from seeing some of the defects that were covered by the brick veneer.

Generally, county supervisors told us they were hard pressed to make timely and effective inspections of all housing and that the pressures from builders and borrowers, together with the hurried nature of the RH program, undoubtedly had resulted in some construction deficiencies not being forcefully dealt with.

Members of the State office RH division told us that prior to financing modulars and pre-fabs, they visited factories and inspected manufactured homes. They said the manufacturers were very cooperative in upgrading the units to meet the FHA specifications. They said there had been a need for a continuing inspection at the factory and on March 2, 1971 the State issued a bulletin requiring monthly inspections at the factories.

We believe this plan for continuing inspection was a step in the right direction, even though it came after thousands of these manufactured houses had already reached the FHA program and were occupied by borrowers.

We concluded that the use of the manufactured house in the FHA program has brought about the need for reappraising the quality of the manufactured house at the factory with an aim toward improving the basic structure and seeking means of eliminating the damage done in transit. There is also need for more intensive and strict inspections of the quality of erection and construction of these units to eliminate the problems we found.

The FHA Administrator should establish a policy for State office monitoring of the quality of manufacturing homes to assure compliance with HUD Bulletins setting forth minimum property standards. This policy should include provisions for periodic unannounced inspections at the factories by field personnel. Their reports should be sent to the National office so that other States can be alerted to adverse findings. In addition, FHA instructions should be revised to ensure adequate on-site inspections, requiring a minimum of three for all houses.

Stick-built houses

As previously noted the consensus among builders (including some handling exclusively manufactured houses) and FHA personnel and other knowledgeable persons, was that stick-built houses are unquestionably superior to factory-built houses. This conclusion is based, of course, upon the assumption that the stick-built houses are constructed to top standards of workmanship.

We concur in this comparison of the quality of the two methods and found generally that most stick-built houses are well constructed and completely inspected. However, we did report from Greenville County (411–230–A) that two large scale FHA oriented stick-builders had delivered houses to a number of borrowers containing construction defects.

In our county audit report we reported that Westwood subdivision in Greenville County had 100 houses occupied by FHA borrowers and that 200 more speculative houses were under construction and expected to come into the FHA program.

Two major builders in the subdivision, who together had built 70 FHA houses, were building strictly to the Minimum Property Standards (MPS); that is, these two builders did not, as some builders do, build above the MPS. We reported that the borrowers were experiencing buckling roofs, walls pulling apart and sagging houses. We had an FHA inspector from another county inspect these houses, and subsequently the State office Engineer inspected some of the same houses and others as well. It was found that heat was causing the trusses to contract causing the ceilings to rise and pull away from the non-supporting walls. This caused cabinets to pull away from the walls. Other defects were the omission of bolts holding shoe plates to foundations in split level models, thin rough plywood flooring, and hot water heaters resting on the ground, which accelerates rusting, instead of on blocks. Some of the problems were aggravated by water standing in the basements. There was a need for vent wells and more adequate landscaping.

The county supervisor had not visited these houses and had appraised them in his office by using house plans and relying on the reputation of the contractors. The county supervisor said his heavy workload had precluded him from making periodic inspections of speculative building as required by State policy. One of the large speculative builders involved had built 100 FHA financed houses in an adjoining county and had 500 more planned. Inspection of some of these houses disclosed defects similar to those in Greenville County.

We inspected houses in the area built by other builders. These other builders said that they always built above the MPS. In these houses we found none of the problems that existed in the other houses. These other builders said they could save $300 to $400 by dropping their standards down to the MPS, but that they would be doing a disservice to the occupants and in the long run damage their own reputations.

The State office engineer said there is need for a continuing reappraisal of the MPS as experience is gained through more building. The MPS presumes top quality workmanship, and with a building program moving at a rapid pace it is most important to maintain tight inspection programs.

We concluded that the booming FHA rural housing program minimizes the necessity for commitments or contract type building and thus encourages speculative building which is going on in Greenville County on a grand scale. Further, speculative building, by builders confident of a ready market, increases temptations to minimize and short cut on both quality of materials and workmanship, thus maximizing the importance of tight, periodic inspections by FHA. We believe construction, especially by large scale FHA oriented builders, should be closely monitored.

The conditions noted were confined to the Greenville unit where factory-built houses have been scarcely used on the FHA program. Most of the houses in the other counties we visited are manufactured houses. We found few problems with the stick-built houses in those counties.

We learned from borrowers in all counties visited that they are inclined to direct their complaints to the builder. This is the appropriate starting point for such matters. It was noticeable, however, that many borrowers who were dissatisfied with the quality of construction or erection of their houses, and who expressed irritation because their builders had not adequately responded to their complaints, still had not complained to FHA. This might be explained by the fact that many borrowers are not sensitive to the role FHA can play in matters involving major construction faults as a result of the minimal rapport that has been established with the Agency as a result of packaging. (See Details—1)

We understand the question of the adequacy of the MPS is under current review by the National office. We believe the conditions herein cited which affect stick-built and manufactured houses alike serve as additional evidence of the need for such an appraisal.

The State Director should direct district supervisors and other State office supervisory personnel to provide sufficient guidance to county supervisors and other county office employees to assure that the State office policy of inspecting speculative housing is followed. Further, he should insist that inspections of stick-built houses be timely and strict.

EMPLOYEE CONDUCT AND ACTIVITIES

7. Some FHA employees and/or their close relatives had private business interests which could, by nature of the involvement, present the appearance of conflicts of interest. The audit did not disclose any actual wrongdoing; however, there was need for analysis of these conditions by the State office in order to assure that the Agency's reputation is adequately protected.

A letter dated January 18, 1971, from the Secretary to all agency heads, said in part:

"There are few things which can so shake public confidence in the integrity of Government employees as a situation in which the private interests of a Government employee conflict, or appear to conflict, with his official duties and responsibilities. The mere existence of such a situation, regardless of whether or not it has resulted in any actual wrongdoing, has the potential to cause serious embarrassment and damage, not only to the particular Department or agency concerned, but also to the Government as a whole."

The South Carolina State office had demonstrated an awareness of the problems inherent in administering a large scale lending program. Some cases involving questionable relationship between employees and private interests doing business with FHA had been successfully dealt with, and other actions were pending. We found several other conditions in the State which the State office should examine to assure that the proper image of the Agency is maintained.

At Sumter a construction inspector had been the subject of an inquiry by the Federal Bureau of Investigation (FBI) with respect to a complaint from a pipe vendor that the inspector and his brother were involved in handling a quantity of stolen pipe that had been used as clothes line posts on building lots purchased with FHA loan funds. The FBI memorandum report was inconclusive, and the inspector had been questioned on the matter by the State Director. He denied the allegations. During our audit we found that this inspector had usurped the authority to counter-sign checks drawn on supervised bank accounts, such authority being expressly denied construction inspectors by FHA instructions. Further, this employee was having FHA borrowers furnish him supervised bank account checks signed in blank. These matters have been scheduled for further inquiry by OIG (A-401-77).

Our inquiries into other business relationships of employees and/or their relatives did not disclose any actual evidence that employees had taken, or allowed others to take, undue advantage of their positions. However, the conditions noted show the extent of the potential problem and the need for further monitoring. We cite some of the instances here:

In Williamsburg County an uncle of the county supervisor sold land to a developer who in turn was selling subdivided lots to FHA borrowers. The county supervisor was approving loans for the borrowers purchasing lots formerly owned by his uncle.

Also in this county and an adjoining county, the son of the construction inspector is building FHA financed houses, and the inspector had inspected some of the houses for FHA. The district supervisor instructed the inspector during our audit to discontinue making inspections on FHA houses built by his son. The propriety of the son continuing to build with loans processed through the office where his father is employed remains unresolved.

In Anderson County an FHA county committeeman is a brick contractor but told us he had not worked on any FHA financed houses after becoming a committeeman.

In Calhoun County a nephew of the county office clerk is married to the daughter of an FHA builder and the nephew is in charge of packaging FHA loans for the builder.

A county committeeman in Orangeburg County is half owner of a farm equipment business. The committeeman told us he had occasionally sold equipment to FHA borrowers. We found no evidence of favoritism or coercion during our limited inquiry into this matter.

Also in Orangeburg County the wife of an assistant county supervisor is a saleswoman for a local realty company which occasionally sells real estate to FHA borrowers. On at least one occasion the assistant supervisor's wife handled the real estate sale to an FHA borrower.

In Sumter County an FHA committeeman is employed full time as a salesman for a local realty company that sold at least four houses to FHA borrowers. The committeeman told us, and limited file review disclosed, that he had never certified to the eligibility of any applicant who did business with his firm. He said he had never sold property to an FHA borrower.

A county committeeman in Horry County operates a carpeting business and sells to FHA builders. He told us he did not believe he had sold directly to FHA borrowers.

In Lee County the county supervisor performs real estate appraisals for several local concerns including two banks. He told us that he earned approximately $500-$600 in 1969, $400 in 1970 and $100 during the first two months of 1971 through his independent appraisal work. He said he has never performed independent appraisals during duty hours and that in the past he was told by the State office to never let his outside work interfere with his official duties.

FHA National issuances have pointed out from time to time that because the Agency is operating a major lending program it follows that temptations and pressures directed toward its employees are to be expected. All FHA employees

have been cautioned of the dangers involved. One example of what can be expected is illustrated in a letter dated December 17, 1970, sent by a developer to at least eight county supervisors in South Carolina. The letter offered to pay $100 to each FHA county supervisor who closed the loan to purchase one of the developer's homes. The State Director sent the letter and a report to FHA headquarters, and on January 8, 1971, FHA Bulletin 3824 (207) was issued to all State and county offices warning of the dangers inherent in such matters. We found no evidence during our audit that the developer in question had done business with FHA borrowers.

FHA Instructions 207.1 gives a comprehensive set of rules affecting the conduct of FHA employees. While the instruction does not specifically cover every minute aspect of all the conditions herein cited, we believe the intent of the instruction is clear.

This audit is part of a Nationwide audit of FHA, and a National report will be issued incorporating our recommendations for improving Agency safeguards against conflict of interest situations.

In the meantime the South Carolina State Director should examine the conditions herein cited together with all similar conditions known to exist. Further, each employee should be requested to furnish information regarding any personal or pecuniary interest he or any of his close relatives have with FHA oriented businesses.

This information should be assembled and analyzed using FHA Instruction 207.1 as a guide. All situations offering a threat to the reputation of the Agency should be corrected.

IV—Memo Matters

The audit disclosed the following items on which corrective action was needed. OIG need not be informed of the action taken. Corrective action should be documented for OIG review during the next audit.

Some counties were having problems with loan supervision and security servicing. These problems create additional work for employees and cost to borrowers and place the Government's financial interests in jeopardy.

Following are examples of the conditions noted:

ABANDONED DWELLINGS

M-1. Borrowers had abandoned their rural housing (RH) dwellings, one in Clarendon and two in Horry Counties. County office personnel had not properly serviced the accounts and the condition of the houses was deteriorating. This places the Govenment's financial interest in jeopardy.

Observations of the dwellings disclosed the following: (1) Inside and outside paint peeling, (2) windows broken, (3) weeds growing in the drainage gutters, (4) yards cluttered with junk and trash, and (5) screens missing and/or torn. Also, two of the dwellings were not covered by insurance because the insurance policy contained an occupancy clause voiding the insurance coverage in the event of abandonment. Therefore, in case of loss, the county supervisor could be held personally liable.

The county supervisors told us that they were not aware of the abandonment clause in the insurance policy. They also said they had not properly serviced these accounts because of insufficient time.

The State Director should take the necessary action to initiate foreclosure proceedings or have the borrowers deed the properties to the Government on all abandoned property. Also, all county supervisors should be reminded to timely service accounts of this type to a conclusion.

SUPERVISED BANK ACCOUNTS

M-2. In Sumter and Greenville Counties, there were supervised bank accounts (SBA's) with dormant or inactive balances. Such accounts create additional work for employees and cause borrowers added interest expense. The accounts were not properly serviced because the time required for new rural housing loans had delayed followed-up on loan servicing problems.

The State Director should direct district supervisors to provide sufficient guidance to county supervisors to assure that funds deposited in SBA's are promptly and properly disbursed and accounts terminated when no longer needed.

K. K. King,
Assistant Regional Inspector General.

INELIGIBLE BORROWERS, ERRONEOUS INTEREST CREDITS, ARBITRARY REDUCTIONS OF INCOME, AND FAILURE TO VERIFY INCOMES

County and borrower	Ineligible	Interest credit	Incomes	Amount of loan
Anderson County:				
Crosby, Carlnell	L		R	$11,480
Fisher, O. B.	L		R	6,820
Fields, O'Dell M.	L		R	15,500
Johnson, Calvin T.	L		R	11,400
Jones, Paul E.	L		R	12,630
Latimer, David L.	L		R	14,300
Lee County:				
Baker, Samuel L.	L		R	16,500
Bradley, Elijah, Jr.	L		R	15,500
Branham, Jameson	L		R	8,400
Hopkins, William E.	L		R	15,500
Hancock, Charles E.	L		R	12,500
King, John and Dale	L		R	11,500
Williamsburg County:				
Boyd, James A.			V	4,300
Bruorton, Oliver William	L		R	15,000
Burgess, Joe Lewis	I		V	13,640
Burrowos, Louise P.			V	8,500
Green, Samuel			V	13,130
McBride, Essie			V	9,000
McClary, Jake A.	L		R, V	14,000
McCrea, Emerson		E	V	14,500
McLean, Joseph M.			V	15,500
Martin, Joe I.	L		R	18,000
Mayes, Weldon	I		V	9,500
Mayrant, Lewis			V	12,000
Patterson, Robert A.		E	V	14,750
Sim, Herbert H.	I		V	13,200
Singletary, Allison			V	13,080
Thomas, Samuel		E	V	11,720
Spartanburg County:				
Addis, Robert K.	L		R	15,500
Camp, Woodrow W., Jr.	L		R	17,000
Coan, John W.	L		R	13,900
Cooke, Chester A., Jr.	L		R	17,100
Davis, William A.	L		R	15,000
Dowis, William J.	L		R	9,500
Early, Danny, Jr.	L		R	17,000
George, William S.	L		R	14,000
McCoy, Charles D., Jr.	L		R	16,500
Ramsey, Orlander	L		R	15,000
Ross, David L.	L		R	15,000
Shehan, Bobby K.	L		R	8,080
Varner, Jerry D.	L		R	16,800
Westbrook, Julian E.	L		R	17,000
Clarendon County:				
Hardy, Lowell	L		R	13,150
Hodge, Howard	L		R	14,350
McFadden, Arron		E	R	14,040
Greenville County:				
Anderson, James, Jr.	L		R	17,400
Brown, James Milton	L		R	15,000
Ferguson, James L.	L		R	16,500
Johnson, Johnny C., Jr.	L		R	16,200
Lee, Rodney J.	L		R	17,400
McElreath, Jack K.	L		R	15,900
Miller, James B.	L		R	17,000
Miller, Ronald E.	L		R	17,400
Mulenex, Harvey E., Jr.	L		R	15,900
Pearson, Jerry R.	L		R	15,900
Presher, Darrell P.	L		R	15,900
Richards, Henry J., Jr.	L		R	16,500
Rodgers, Billy Joe	L		R	17,300
Seigler, John C.	L		R	16,400
Stroud, Donald N.	L		R	15,500
Wharton, Raymond C.	L		R	14,500
Horry County:				
Bromell, Cecil		E	R	14,450
Jackson, Charles M.	L		R	15,000
Jackson, Melton Brooks	L		R	15,000
Norris, Londale	L		R	10,500

Key to symbols at end of tables.

INELIGIBLE BORROWERS, ERRONEOUS INTEREST CREDITS, ARBITRARY REDUCTIONS OF INCOME, AND FAILURE TO VERIFY INCOMES—Continued

County and borrower	Ineligible	Interest credit	Incomes	Amount of loan
Berkley County:				
Ford, Lorine			R, V	$12,500
Gilbert, Larry E	L		R	17,500
Gourdine, William	L, A		R	13,500
Jackson, Lillie Mae			R, V	13,450
Jones, Patricia B		E	V	12,400
Swicord, Paul S		E	R, V	15,230
Calhoun County:				
Johnson, Nelson, Jr	I		R	12,900
Miller, James	I		R	12,600
Mitchell, George	L, I		R	13,900
Jasper County:				
Bright, Essie		E	R	7,650
Colter, James		E	R	14,620
Total				1,062,670

Key to symbols: L—Indicates an ineligible loan; I—Indicates an ineligible interest credit; E—Indicates excessive interest credit; R—Indicates that income of either husband/wife or adult member of the family was not included or reduced in determining the current annual family income; V—Indicates that incomes were not verified; A—Indicates that loan was approved on the basis that the borrower's wife was to quit work. However, it was determined that she continued working after the loan was approved.

Appendix 14(B).—USDA Internal Correspondence Concerning South Carolina Audit

U.S. Department of Agriculture,
Farmers Home Administration,
Columbia, S.C., November 4, 1971.

Subject: Audit of the Farmers Home Administration, S.C. State office in Columbia, S.C.—Report No. 401–17–A (for official use only).

To: Assistant Administrator, FHA, Washington, D.C.

In response to your memorandum of September 30, 1971, we make the following comments: In our reply, we are commenting only on the recommendations for the State Director.

Item 4. It has not been the policy in South Carolina to preclude the counseling of applicants whose loans are packaged. Our policy is that before a loan is approved, a discussion is held with the applicant to determine if the house proposed is in keeping with his needs and his ability to repay. It is our aim to see that the family is satisfied with the plans and specifications, and location of the dwelling. It is also our desire to see if the applicant understands his responsibilities for making payments, maintaining the property, paying taxes and keeping fire insurance in force. Effort is made to determine if the borrower understands the transaction and exhibits the ability and industry to carry out the objectives of the loan. Effort is continuing to train packagers to give applicants more choice in location and design of their dwelling. Effort is made to assist borrowers who may have acted too hastily to work out differences with packagers even to the extent of securing releases from packagers where written agreements may have been executed.

Item 5. Instructions have been sent to the field to review loans made in the 1970 calendar year and through February 11, 1971, where the spouse's income was arbitrarily reduced. All interest credit loans made in 1970 are scheduled for review in November and December, 1971. At this time any erroneous interest credit agreements will be corrected by making a new agreement to take effect on January 1, 1972. It is requested that we be permitted to wait until November–December, 1972, to review interest credit agreements made between January 1, 1971 and February 11, 1971.

Item 6. The importance for verifying applicants' income has been stressed at both District and County levels. We believe proper verification of income is being accomplished. This matter will receive followup at State Staff Meetings and on visits by the Staff of this Office. Food stamps are not now being counted as income. This situation occurred only in one District and as soon it it was detected, guidance was provided to eliminate the practice of counting food stamps as income.

Item 7. We are in the process of examining the instances given under details 7. When full information is received on the extent of involvement of the employees, mentioned decisions for eliminating the situations will be made. The matter of conflicts of interest has been discussed with District Supervisors in Staff Meetings and we are attempting to determine and correct instances where conflicts of interest or apparent appearances of conflict of interests are involved.

Item 8. Ever since the County Audit reports were received, the proper selection of sites and the development of subdivisions have received our attention. Individual and group training has been provided District and County Personnel on this subject. Soil Conservation Service is being requested to provide guidance for all subdivisions. The cooperation of Soil Conservation Service has been most helpful in supplying needed technical information for feasibility soil limitations for use of septic tanks, and location of dwellings and other facilities. Much work has been accomplished in improving the subdivisions listed in the County Audits and in other subdivisions in the State. Loans are not being approved in subdivisions until corrections deemed necessary have been done.

The importance of properly developed sites was discussed with all District Supervisors at a State Staff Meeting on October 21, 1971. Also, a one-day training session for District Supervisors was conducted on October 8, 1971, on the development and approval of subdivisions.

Item 9. Emphasis has been given to timely and forceful inspections by County Supervisors and Construction Inspectors. Inspection is being made on speculative housing. When loan processing starts on a speculative house, the house is inspected periodically until completion in the same manner, as if it were a house being built under contract.

Inspections are being made regularly of plants manufacturing modular houses. Group training was provided Construction Inspectors in April and individual training is being provided as time permits. We believe that inspections are forceful and the quality of construction has shown definite improvement.

E. W. BROOKS, *State Director.*

U.S. DEPARTMENT OF AGRICULTURE,
FARMERS HOME ADMINISTRATION,
Washington, D.C., January 6, 1972.

To: Regional Inspector General, OIG, Atlanta, Ga.
From: Assistant Administrator, FHA, Washington, D.C.
Subject: Audit of the Farmers Home Administration State office in Columbia, S.C.—Report No. 401-17-A (for official use only).

The attached copy of a memorandum from the State Director reports corrective actions completed and in progress for the above audit.

We concur with the actions taken by the State Director.

We have asked the State Director to provide the necessary follow-up to assure satisfactory completion of pending actions.

GEORGE C. KNAPP,
Acting Assistant Administrator.

Note to State Director: Please note the third paragraph above. Regarding Item No. 5, the County Supervisors, in addition to correcting erroneous interest credit agreements, should readjust the borrowers' income based upon current income information from the applicant. Regarding Item No. 7, please give us a report by February 4, 1972 on your recommendations for remedial action in cases of apparent conflict of interest.

U.S. DEPARTMENT OF AGRICULTURE,
FARMERS HOME ADMINISTRATION,
Columbia, S.C., January 21, 1972.

Subject: Audit of the Farmers Home Administration State office in Columbia, S.C.—Report No. 401-17-A (for official use only).
To: Assistant Administrator, FHA, Washington, D.C.

In response to the copy of your memorandum dated January 6, 1972 addressed to the Regional Inspector General, Atlanta, Georgia, we are providing the report requested.

As stated in our reply dated November 4, 1971, we have written reports concerning the instances cited. These reports have been reviewed and have determined that the instances cited do not, in our opinion, constitute a conflict of interest as defined in procedure. The reports received reveal no areas of favoritism.

In the case of the Building Inspector whose Son was constructing houses in the Counties where he was employed, the Building Inspector has been instructed not to inspect construction in which his Son has an interest.

We feel no action is necessary in the cases cited. The only other remedial action which we recommend is that all Personnel be kept aware of applicable procedure and regulations dealing with conflicts of interest. Cases coming to our attention wherein there is an appearance of a conflict of interest will be promptly investigated and appropriate action recommended.

E.W. BROOKS, *State Director.*

U.S. DEPARTMENT OF AGRICULTURE,
FARMERS HOME ADMINISTRATION,
Washington, D.C., March 2, 1972.

Subject: Audit of the Farmers Home Administration, South Carolina State office, Columbia, S.C.—Report No. 401–17–A (for official use only).

To: Regional Inpector General, OIG, Atlanta, Ga.

The following are the corrective actions taken on the "Recommendations for the FHA Administrator" contained in the subject audit:

Recommendation No. 1

Procedure Notice 293, dated January 26, 1972, clarifies the question of food stamps.

Recommendation No. 2

We have been working with individual states and monitoring manufactured homes. Our Architectural and Technical Services Staff is revising FHA Instruction 424.1, including a revision of that portion dealing with manufactured homes.

Recommendation No. 3

Instructions requiring three inspections in all cases has been prepared and is in OGC for clearance.

The attached copy of a supplemental memorandum from the State Director reports the corrective actions taken on Recommendation No. 7.

We concur with the actions taken by the State Director.

This concludes our reporting on this audit.

GEORGE C. KNAPP,
Assistant Administrator, Management.

20-482—73——18

Appendix 14(C).—FHA National Office Comment on South Carolina Audit

[The following comment was supplied after the Subcommittee hearings:]

There were nine recommendations which came out of the OIG Report on South Carolina, dated April 30, 1971. Three of these were for the Administrator; the other six were for the State Office. A recap of these recommendations and FmHA actions taken are as follows:

Recommendation I.—Clarify FmHA Instruction 444.1 with respect to the propriety of treating bonus food coupons as income in determining eligibility for loans and/or interest credits.

FmHA Response.—Procedure Notice 293 dated January 26, 1972, clarifies the the question of food stamps.

Recommendation II.—Establish a policy for State Office monitoring of the quality of the manufacturing of houses to assure compliance with HUD bulletins relating to minimum standards; have the State Offices submit any adverse reports to the National Office so that other states can be alerted to the conditions found.

FmHA Response.—We have worked with individual states and monitored manufactured homes. Our Architectural and Technical Services Staff has in process a revision of FmHA Instruction 424.1 including that portion dealing with manufactured homes.

The draft instruction has been reviewed by the State Offices, and it is being put into final draft.

Recommendation III.—Revise FmHA instructions to require at least three on-site inspections of construction for all housing.

FmHA Response: Instructions requiring three inspections in all cases has been prepared and has appeared in the Federal Register in January 1972. It sets new design and construction standards for subdivision development in eligible rural areas in which applications for loan assistance may be received from eligible families. The important emphasis will be on water and sewerage systems, street improvements and storm drainage. We expect to utilize our Community Services Water and Sewer Loan program more extensively in the development of Rural Housing Areas.

In water systems, the emphasis will be on providing community water systems with considerations necessary for acceptance of individual systems.

The emphasis on sewerage systems will be on providing community sewerage systems with rigid considerations for acceptance of individual systems.

Street improvement emphasis will be on providing hard surface streets and dedication to local public bodies. Detailed construction requirements for acceptable hard surfaced streets will now be included in Exhibit A to this instruction.

In storm drainage, we will put emphasis on providing a positive expedient runoff of storm water.

We are preparing new instructions on performing and planning site development, which we anticipate will be issued within 60 days.

With respect to the recommendations for state action—discussion in the audit, memoranda from State Director E. W. Brooks, and national team reports, including recommendations and actions reported, indicate that positive action has been taken to remedy the problems cited.

Further information on Recommendation VII was requested in the correspondence subsequent to the audit. Following is the recommendation and action taken thereon:

Recommendation VII.—Closely monitor all business relationships of FHA employees, using FHA Instruction 207.1 as a guide, to determine that the Agency is protected from the possibility of charges of conflicts of interest. Determine the circumstances of all conditions, including those cited in the report, involving

business relationships of employees and/or their close relatives with FHA oriented businesses.

FmHA Response.—Names of the specific employees involved in conflicts of interest situations were not given in the South Carolina State Office audit report. However, subsequent to the audit, investigation reports were received on individual employees and action was taken to resolve the conflicts.

South Carolina State Instruction 203.5A, "State Director's Guide in Personnel Management," dated September 21, 1971, and distributed to all offices in South Carolina, provides specific guidelines to assure that all employees are aware of the conflict of interest regulations and their responsibility for assuring that these regulations are not violated.

Exhibit A, VI, E, of S. C. Instruction 203.5A states that in June and December each year, the National Office issues a reminder to all employees concerning the conduct rule. This paragraph goes on to quote this reminder that is sent out to all employees semi-annually by the National Office.

S.C. Instruction 203.5A, Exhibit A, VI E 1 and 2, state:

1. Although other provision is made for discussion of standards of conduct, this matter should be stressed semi-annually.

2. In addition, a check is made to see that employees, including Committeemen, are familiar with provisions of FHA Instruction 207.1, Conduct. In County Offices, this check is made on the job by District Supervisors and/or OMA's, as appropriate. The timing for this activity is during orientation training and again by April 30 each year.

Paragraph IX B of Exhibit A requires County Office staffs to have a review of paragraphs I through VIII of the Exhibit by April 30 each year with the District Supervisor and/or OMA attending, if possible. This paragraph also requires the County Office staffs to furnish the State Director with a summary of the matters discussed during the review, questions raised, and how they were resolved. This shows the State Director whether the conflict of interest provisions were discussed, and gives him an insight into the problems the personnel under his jurisdiction are having with regard to conflict of interest situations so action can be taken to resolve any problems before they become a major issue.

The administrative burden of obtaining and reviewing approximately 12,000 additional conflict of interest statements would be monumental. Further, it is highly unlikely that the Civil Service Commission would authorize obtaining statements from so many employees.

The present practice for State Directors to review Ad-392's of State Office employees, statements from State Director, National Office employees and State Committeemen are reviewed in the National Office. The internal procedures for reviewing Ad-392's currently being received are adequate. However, no objection would be raised if all Ad-392's were to be reviewed in the National Office.

The Department of Agriculture's regulations (Appendix I to the USDA Employee Handbook) concerning employees' responsbilities and conduct are furnished to each employee. The Department's conduct regulations are also incorporated into FHA regulations as Exhibit A to FHA Instruction 207.1. FHA Instruction 207.1 is also distributed to all FHA employees.

To clarify the existing regulations on conflict of interest and to make the restrictions and guidelines more applicable to FHA employees and their responsibilities, we are preparing an Exhibit B to FHA Instruction 207.1 which pertains exclusively to conflict of interest as it relates to FHA employees. Exhibit B cites some specific activities, outside employments, and financial interests which would create a conflict of interest if engaged in by FHA employees or close relatives of employees. Exhibit B also gives guidelines to enable employees to more clearly determine whether a particular activity, financial interest, or employment may create a conflict of interest with the employee's position with FHA. This proposed Exhibit B has been furnished to selected State Directors for their comments and recommendations prior to issuance. We are currently analyzing the responses from the State Directors and plan to issue Exhibit B within the near future. It will be distributed to all FHA employees.

In states where there have been several instances of conflicts of interests, we have given the State Director individual guidance, by memorandum, to help him in correcting the conflict of interest situations and preventing such conflicts in the future within the area of his jurisdiction.

Appendix 14(D)—Questions Concerning South Carolina Farmers Home Administration Operations

Chairman Fountain's Questions

1. It is our understanding that the Office of Inspector General has been critical of certain practices which have occurred in South Carolina with respect to "packaging." Can you briefly summarize for us the most significant criticisms made by OIG with respect to South Carolina "packaging" operations?

Answer. Packaging practices in South Carolina tend to restrict the applicant's access to the expert counseling services of FHA on cost, location, size, design and other features of housing. No requirement for competitive bidding. Prevents an applicant from being counseled on switching to a seller other than the one who packaged the loan. Loan packaging practices in South Carolina carry certain unnecessary risks of placing some borrowers in housing unsuited to their needs or genuine desires.

2. Does the State office disagree in any significant respects with the findings of OIG concerning the South Carolina operations? If so, please give details.

Answer. Does the State Office disagree? Yes. We do not feel that packaging has removed FHA's role in counseling applicants to the degree OIG portrays. Loan packaging in South Carolina does not preclude counseling with applicants. *It is* and *has been* a requirement for the applicant family to come to the county office and discuss the proposed transaction before the loan is approved. FHA personnel discusses the plans and specifications for the dwelling, location, amount of loan, payments required, other obligations, such as taxes and insurance, and other responsibilities of the applicant. The applicants are asked if this is the house and location they want. On page 11 of the Audit Report No. 401-17-A in the fourth paragraph, appears the following statement:

"They found it undesirable that so much of the applicant-county office rapport, prevalent in pre-packaging days, had been lost through packaging, pointing out that under the system they usually saw the applicant only once—at loan closing."

This statement is incorrect. Normally, FHA personnel do not see the borrower at loan closing. They do, however, see the borrowers before the loan is approved. Farmers Home Administration cannot build the first house. We acknowledge that packagers have carried the word to the public (applicants). Packagers have reached many applicants who would not have been reached by Farmers Home public relations programs, public relations programs of OEO, Cooperative Extension Service and other private and public agencies.

The following additional answer to question 2 was furnished by the FHA National Office:

Chairman Fountain asked if the National Office of Farmers Home Administration disagreed in any significant respects with the findings of OIG concerning the South Carolina operations and if any actions had been taken as a result of OIG criticisms of packaging practices.

We do not agree with part of recommendation number 9 made by OIG; namely, that periodic inspections be made by FHA personnel of speculatively built homes. We have no authority for doing so because the FHA has no jurisdiction over dwellings which will not be financed with the agency. The dwellings may be sold to other than an FHA borrower. Inspections by FHA should be made only when a dwelling is being built under a conditional commitment or by contract for an FHA borrower. FHA Instruction 444.1 has been revised to provide that a loan may not be made for more than 90 percent of the appraised value of the security property if the dwelling is less than 1-year old and was not inspected by the Farmers Home Administration, the Veterans Administration, or the Federal Housing Administration while it was being built. This new lending limitation has caused contractors to request and build under conditional commitments with inspections being made which will accomplish the same end result as the OIG recommendation. The housing will be inspected.

We believe FHA Instructions for packaging applications are adequate and, therefore, have taken no actions as a result of OIG criticisms of packaging practices. We believe the problems with packagers have been resolved and the packaging system is operating properly in South Carolina.

3. What action, if any, has been taken by the State office as a result of OIG criticisms of packaging practices? Has any additional corrective action been taken on your own initiative to improve the situation? If so, please give details.

Answer. Farmers Home Administration in South Carolina has tried to improve and strengthen the packaging program. County Supervisors, assisted by State Office Personnel and District Supervisors, have met with builders and packagers in an effort to better train packagers in providing correct and up-to-date information, explaining to applicants the transaction more fully, providing a home that meets the needs of the family and what Farmers Home expects of the family. The State Home Builders Association has a committee which meets with FHA officials from time to time. Some suspensions of builders (packagers) have been necessary. Training and emphasis have been provided county personnel to strengthen their discussions with applicants prior to loan approval. Form FHA SC–430–1, Congratulations on Your New Home, has been developed for issuance to borrowers at loan closing or mailed to them shortly thereafter (copy attached). We have enlisted the services of Extension, OEO Agencies, State Housing Authority, Governor's Staff on Housing and others to counsel prospective applicants needing homes on selection, obligations and responsibilities. Counseling of applicants has been strengthened since the audits in 1971. The State Office has strengthened the monitoring of loans being made by county offices.

4. In the judgment of the State office, is the South Carolina "packaging" situation now satisfactory? If not, in what respects are you not satisfied? Is any further action now contemplated?

Answer. So far as the State Office is concerned, we believe packaging is generally satisfactory and are satisfied with packaging as a means of developing housing. It will be our goal to continually strive to make Farmers Home Administration personnel and packagers more proficient in counseling with applicants and developing loan packages.

CONGRESSMAN CLARENCE J. BROWN OF OHIO'S QUESTIONS

1. The OIG Report states that FHA in South Carolina has largely relinquished the counseling function to the packagers. Is there any attempt to monitor or follow up on the packagers advice and information to the prospective buyers?

Answer. Experience with packagers reveals that some packagers do a better job of counseling and development of dockets than others. This, we believe, is monitoring. The pre-loan approval conference with applicants is a form of monitoring. Investigations and audits by OIG are monitoring devices. Program reviews, information gained on servicing contacts and visits by District, County and State Office personnel to borrowers or contacts by borrowers with these levels of administration provides monitoring of the kind and type of advice packagers provide.

2. In the fourth paragraph of OIG Report on page 7, it states that "FHA regulations do not require competitive bidding . . ." In light of experiences demonstrated during these three days of hearings, do you not think it is advisable to REQUIRE competitive bidding, even if the criteria are met which are pointed out in the OIG Report?

Answer. I was not present at the hearing, however, from discussions with Mr. Stewart of my staff who was there on Wednesday and Thursday, we do not think competitive bidding is necessary in South Carolina. We did not agree with OIG on this point and have a firm conviction that competitive bidding would not substantially lower the cost of housing to borrowers in this state.

3. On page 8, the county supervisors have allegedly been instructed that the interests of the loan packager are to prevail. Is this statement true and if so, could you elaborate on what the "interests" of the packager are which the State office seeks to protect?

Answer. As we understand, one of the goals of this Administration is to provide improved housing for low and moderate income families. One of the necessary tools for providing housing is to have builders to construct the housing. Farmers Home needs good builders. Generally the builder is the packager. Farmers Home must have the "interests' of good builders in mind. Builders must be allowed a reasonable profit, must receive fair and impartial treatment from

FHA personnel and a spirit of cooperation must prevail. These are the "interests" of the packager (builder)) which this office seeks to protect.

4. On page 10, it is indicated that a packaged bid is higher because the contractor has to pay a salesman's commission, but in the second paragraph, a contractor stated that he would have submitted a lower bid if he had known it was going to be a competitive bid.

a. Do you ever conduct a construction cost analysis to determine the cost to the builder for a Farmers Home Administration insured house?

b. Do you have any standards as to what is a reasonable price for a buyer to pay?

c. If the contractor indicated he could have reduced the price if he had known there was competitive bidding, does this not indicate that a lower price could be charged even if a seller's commission was required?

Answer. a. We have, on a limited basis because our capability for cost analysis is limited. HUD replacement costs are used. When these figures are used discount points and closing costs are discarded. We are confident that construction costs have been kept within a reasonable degree of the cost of building and developing sites. Experience of personnel helps to keep costs reasonable, or as reasonable as materials, services, sites and other costs can be held.

b. Loan approval officials are trained in determining replacement cost of dwellings, comparables of the market for sale of similar dwellings, location and areas of location of dwellings, offsite conditions that affect values up or down and other factors in determining a reasonable price for a buyer to pay.

c. As stated previously, we do not believe competitive bidding would substantially lower the cost of dwellings for the buyer and if a sales commission were required would not lower the price but generally would increase the cost to the buyer.

5. It is alleged in the OIG Report that one packager carried a dozen proposals to the State office and complained about the slowness with which applications were processed. Could you explain the normal amount of time it takes for a loan to be processed? Is it somewhat contrary to the best interests of the buyer to have the packager complain to the State office because of the processing time and then have the proposals given a priority as the Report indicated?

Answer. Thirty to 60 days is the normal processing time for processing a loan. To process within this range the packager must present a fully developed package, employers must provide prompt response for information about employment and income verification, the county office must be staffed so that prompt attention can be provided all activities (loan making and servicing of all authorities FHA has to offer attorneys that will provide prompt title certification and loan closing services, applicants that will respond to conference requests prior to loan approval and other conditions. Attitudes of some FHA personnel about loan making need improving and this office is striving to improve the attitude of those personnel.

The State Office does not solicit packager complaints. A few packagers make unreasonable requests. It is also necessary to motivate some FHA personnel. Applicants also complain to the State Office about processing time. Some complaints by both packagers and applicants are worthy. Generally complaints of the nature described are not beneficial to the packager, applicant or Farmers Home. Time spent on complaints could be more productively spent on loan making and servicing.

6. The statement on page 12 that the State Director felt the only way to make the system work effectively was to honor the packager's position would seem to indicate a lack of concern about the buyer. Would you care to comment on that statement? Are we not interested in the buyer's position? What about the position of the Farmers Home Administration with regard to the legitimacy of the loans they approve?

Answer. Farmers Home is vitally interested in the buyer's position and with regard to the legitimacy of the loans they approved. The seller or builder gets his money. Farmers Home must service the loan for 33 years or until refinancing of the account is accomplished. Borrowers who are dissatisfied complain to county personnel, won't make payments, or move off and leave their homes and cause other servicing. We are interested in the borrower's interest and in the legitimacy of the loans we approve.

STAFF QUESTIONS

1. What is the approximate percentage of loans in South Carolina which are "packaged" at present? Does this percentage differ significantly from prior years? If so, please give details.

Answer. 95%+ of the Rural Housing Loans made in South Carolina are packaged. Since the housing loan program expanded in 1969 this percentage has not differed significantly.

2. Approximately what percentage of loans in South Carolina currently involve conditional commitments? Does this percentage differ significantly from prior years? If so, please give details.

Answer. Conditional Commitments have not been used significantly in South Carolina until recent months. Probably not more than 5% of the loans for the three years prior to June 30, 1973, have involved conditional commitments. Requests for conditional commitments have shown a marked increase in the last 4 months. This increase is due to a change in Farmers Home Administration regulations regarding financing speculatively built homes and providing interest credit to applicants.

3. Please provide a copy of the South Carolina instruction relating to packaging which required a "written release from the packager" prior to counseling which might result in the applicant switching to another developer. (Referred to on page eight of OIG report.) Please provide a copy of any change in or cancellation of the above instruction.

Answer. There were no S. C. written instructions requiring a written release from the packager. We had a policy put out verbally at staff meetings that should an applicant desire to switch from one builder (packager) to another the county supervisor should request a written release. This policy is still in effect.

The reason for this policy was to keep down friction at the county level between builders and the county staff. It was felt that when a decision was necessary the state office should say when and on what conditions an applicant would be allowed to switch. We do not believe that this procedure was detrimental to the applicants and we also believe it kept you gentlemen from receiving many complaints from builders (packagers) in your districts. Some builders collected a down payment from prospective applicants and we believe this procedure helped to retrieve some of the down payments made by applicants.

4. Please list the five builders you believe have done the largest volume of business under FHA loans in South Carolina during the past two or three years, with your estimate of the approximate dollar volume of FHA business for each such builder. In each case, please indicate whether or not the builder sells prefabricated or manufactured homes and, if so, the manufacturer of such homes.

Answer. 1. Arthur Ravenel and Company, Charleston, S.C.

1971 Calendar year—150	$2,100,000
1972 Calendar year—165	2,475,000
1973 Calendar year—100 (projected for remainder of year)	1,600,000

All conventionally built.

2. Artistic Builders, Larry R. Gibson, Easley, S.C.

1971 Calendar year—100	$1,700,000
1972 Calendar year—125	2,300,000
1973 Calendar year—125	2,400,000

All conventionally built.

3. St. Matthews Builders, William P. Dent, St. Matthews, S.C.

1972 Calendar year—150	$2,100,000
1973 Calendar year—100	1,500,000

All conventionally built. During most of 1971 this company was a sales outlet for Town and County and Stylemart Builders. Further comments will be made later.

4. Sumter-Lee County Builders, Larry Roof, Sumter, S.C.

1972 Calendar year—150	$2,100,000
1973 Calendar year—175	1,000,000

All conventional built. During 1971 Mr. Roof and Associates were a sales outlet for Stylemart Builders.

5. Mohow Construction Co., R. D. Belk, Sumter, S.C.

1971 Calendar year—100	$1,400,000
1972 Calendar year—120	1,800,000
1973 Calendar year—100	1,600,000

During 1971 approximately 25% of homes constructed by this firm were manufactured or modular homes and were purchased from Cale Yarborough and Town and Country Builders, both of Sumter. Possibly a few were purchased from Southern Builders at Turbeville, S.C. In 1972 and 1973 this firm has constructed conventionally built dwellings.

In 1971 Town and Country Builders and Stylemart Homes constructed approximately 500 homes each year in South Carolina. This is an estimate but, we believe, reasonably accurate. Town and Country mainly used National Homes manufactured at Thompson, Georgia and known as Knox Homes. Some National Homes manufactured at Martinsville, Virginia were used. Stylemart Homes, E. B. Garrington, used Galaxie Homes manufactured by Stylemart. Both of these firms have gone through bankruptcy and are no longer operating.

5. Please advise whether or not there have been greater problems in terms of delinquencies, foreclosures, abandonments, transfers, or defaulted properties, etc., in connection with "packaged" and/or manufactured homes than with non-packaged conventional construction.

Answer. We do not believe there have been greater problems in terms of delinquencies, foreclosures, abandonments, transfers or other defaults in connection with packaged and/or manufactured homes. Since 95%+ of loans have been "packaged loans" our comments here could be misinterpreted. We will say we do not believe manufactured homes, properly erected, have caused any more servicing than conventionally built homes.

Appendix 15.—Television Program Concerning Rural Housing Program Operations in Cameron County, Texas

Transcript of Television Program Entitled "Home Sweet Home"

(Frank Sullivan, announcer; Lee Harr, television interviewer)

PROCEEDINGS

Mr. Sullivan. The following report deals with a lengthy investigation into the curious developments surrounding a huge housing program which began in the San Benito area. A presentation of KGBT News. The information was produced exclusively for and by the Channel 4 News Department which has copyright of the contents of the following program.

These are the results of that lengthy investigation:

A massive federally financed housing program which hopefully would have produced at least 4,000 low-rent houses in the medium priced field in the Valley has exploded into a bitter controversy, a controversy so intense, in fact, that the chairman of one official city board would like the United States Justice Department to look into the program which eventually will mean a windfall of millions and millions of dollars for some building contractors.

Although only about 300 of the 4,000 homes have been constructed, the sponsoring agency, the Farmers Home Administration at San Benito, in just 18 months already has pumped more than $5 million into the program and much of the construction money has been paid out to a single contractor who threw up rows of the houses in the Port Isabel area.

But as the program spreads out to San Benito, Los Fresnos, Rio Hondo, La-Feria, and on up the Valley, the resentments, allegations, and deep-rooted suspicions nag at the effectiveness of the administration of the program. Some local contractors contend that in various ways nearly all construction eventually winds up with one of two builders.

Two former subcontractors for one of these builders say that, for some reason, government inspection of the homes during the actual construction is woefully inadequate and that too much shoddy unprofessional building, strangely, is being approved by the Farmers Home Administration inspector.

But the controversy really erupted when more than 40 persons, representing at that time only about 75 percent of the completed houses in the Port Isabel area, petitioned their Congressman for help. In every case these homeowners said they purchased homes constructed by Custom Design Homes of San Benito, which is far and away the largest builder under the FHA program, Farmers Home Administration.

They complained these new homes are falling apart at the beams. They can't get any relief from the builder or the Farmers Home Administration office of San Benito.

Mrs. Betty Hull of Laguna Heights was one of the first to complain and the person most responsible for organizing the petition campaign. She told KGBT newsman Lee Harr why many of the homeowners are complaining.

Mrs. Betty Hull. Well, it is the masonry and the brick that is mostly sand where bricks are just falling out; and the tile, they tell us not to wash them with water because they will come up; and the material, real cheap material in them; and the nailing of the homes, several carpenters have told us they wouldn't even stand a good norther, let alone a hurricane; and, well, it is just the whole building of the houses.

Mr. Harr. Have you complained to the people who built these homes?

Mrs. Betty Hull. Everybody has complained and we have even told them that we was going to send petitions in and one lady told them she is going to send it in and they said, "Well, just go right ahead and send it in. We don't care."

Mr. Harr. Why did you accept your home when it had so many faults?

Mrs. BETTY HULL. Well, mine, I haven't got as many faults as some of these poor people around here. Mine seems like a penthouse compared to some of them because after they found out they couldn't scare me by the petition, then I got some action out of them. But I still have some faults.

Mr. HARR. Some of these homes do have driveways. How—why do some have driveways while others do not?

Mrs. BETTY HULL. Well, the ones in the city, what they do have is so narrow they can't hardly drive on them, but they put those there because the city ordinance made them do that and out there in Laguna Vista and out here there is a few, very few.

I have got one and my neighbors, Lock, they have one and they put mine in I guess after the threat of the petitions and they told me they would put hers in because she complained too. Now there are some more out here but they said they had to pay for them, some of them $50.00, some of them $100.00, different prices.

And all the screen doors, they have to pay for those, and showers (?) if they want them, and things we shouldn't have to pay for.

Mr. SULLIVAN. Mrs. Hull's neighbor, Mrs. Stella Lock, complains that her house still is not complete although the Farmers Home Administration has approved the final inspection and paid the contractor.

Outlets for air conditioning in the ceiling and electrical outlets in the walls were cut too large and the excess space covered up with tape.

Floor tiles keep popping up. She said the builder told her not to wash them with water.

Mrs. Gorge Garza said shortly after she moved into her brand new house in May the sliding glass door popped out and later a window crashed into her baby's crib just moments after she had taken the child out.

Other windows are held in place with tape and in a neighbor's home the bricks have separated from the mortar and can be shucked out like peas from a pod.

Like most of the others, rain pours into Tony Bermuda's eight month old house. His plumbing runs wild and a leak between the walls has created a severe mildew problem which not only produced huge ugly stains on the walls but ruined clothes in a closet as well.

Mrs. Gregorio Fuente, Sr., says her son's home was made of bright blue brick. Today only smudges of that blue still are visible. The rest has dripped away with the rain.

Mrs. Marie del Refudio says she told the builders she didn't want air conditioning but she got it anyway and still is being billed for it.

Mrs. Herlindo Gonzalez told of her problems while sitting in the kitchen which should have been a bedroom as her house plans clearly indicate. She said she also told the builder she had ordered windows which stretched from the ceiling to the floor at the front of her house. The ones she got are half that size and much less expensive. The builder told her the government would no longer approve the larger windows.

Artenio Garza also complained he didn't get the house plan he ordered and even the wall paint is different from what he stipulated. When he complained he was told the walls were already painted and nothing could be done. He said he also was told he should be proud enough of his new house not to complain. He said company employees hung up on his wife when she did complain.

Other residents, many of whom for various reasons didn't sign the petition, pointed to other evidence that things aren't holding together: Tiles which aren't cut to fit the floors, windows and doors which sit at grotesque angles, holes simply knocked in the wall for bathroom plumbing, trim work which is unbelievably shoddy and nails which already are dripping ugly rust stains.

Many of the complaints do originate from nagging but nevertheless minor faults; yet many are those which involve construction that can influence substantially the cost of building a new house.

Most new residents, although the contractor denies this, also say they were promised driveways and sidewalks, but now they are told it wasn't put in writing. They also are finding that they can have screened doors and screened windows, but for an extra charge.

But, most significantly, some of the homeowners complain they didn't get the house they ordered. They say floor plans were drastically altered. A man experienced two decades in the building business says some of the homes do not contain the floor space they should, that they are short of specifications.

Jerry Dekkard worked as a painting subcontractor for the builder. He still wound up with a home he feels has too many faults. In fact, Dekkard, who saw many of the houses go together during construction, told newsman Lee Harr

in many cases the plate or frame of the house is not bolted to the foundation and will likely fly apart in the first heavy wind.

Mr. JERRY DEKKARD. Well, I found that most of these houses, the framing is poor on them, especially when it comes to the foundation, the plates being bolted to the foundation. I only know of three, or possibly four, houses where they have been bolted.

Mr. HARR. What about the foundations? Are they level?

Mr. JERRY DEKKARD. Well, I have one of these houses myself. And you can't sit level in my house. You sit in a chair and it feels like you have got a crooked leg. You can't hardly level up the bedroom furniture or the living room furniture, or nowhere. The foundation is not level. You can see this in quite a few of the houses. You look down your hallways or something, you can see where your floors are off level. You look along the edge of your baseboard, you can see cracks underneath them.

Mr. HARR. Would you say that the workmanship is up to par in these houses?

Mr. JERRY DEKKARD. No, the workmanship is very poor. That is the trouble with these houses. They are using cheap labor and they are not getting good workmanship out of it.

Mr. SULLIVAN. Another subcontractor was Jim McMall. He said, "There is no question, those people got a raw deal." He said he knows of 40 cases at least with serious sewage problems. He said some are so serious that walls are rotting away in some of the houses. Mall said some of the homes are supposed to pass at least three inspections by Farmers Home Administration personnel before they are released to the buyer.

Mall was asked if he thought the government inspection was adequate.

Mr. JIM MCMALL. In cases, yes. Some homes had a very thorough inspection. I think if there was any inadequacy, it would be because of the inexperience or the ignorance of the inspector. Now, I am not saying stupidity. The man is not stupid. But, as far as construction practices go, I think he has a lot to learn.

Mr. HARR. You did mention earlier—of course and you are mentioning it now—that you feel that he is completely unqualified practically for this job, that he has had no construction experience.

Mr. JIM MCMALL. No, I can't make that statement now, but when he started—of course that was in the service end of this company and servicing some of the earlier models—he passed several homes that shouldn't have been passed, construction details that shouldn't have been passed.

Mr. SULLIVAN. The fact that many of the homes received final Farmers Home Administration inspection before construction was completed is something that bothers Bill Moore who built and owns both the Sand Castle at Padre Island and Parkview Townhouse, a luxury apartment complex at Harlingen.

Moore, who for 22 years was vice president of Flynn Investment Company, one of the biggest home builders in this end of the country, says he never has seen government policies permit such practices.

Mr. BILL MOORE. Yes, I examined some checks and this method of disbursing to the contractor indicated on the checks the stage of construction and I do know that some of these people started making the payments on their home, their loans were closed and their houses were not complete. The driveways were put in months after their houses, the loan, the permanent loan, was closed and someone had to have certified that that house was complete.

Mr. SULLIVAN. But in addition to the government inspection, the City of Port Isabel has a building inspector whose duty it is to look into certain construction practices. The Port Isabel inspector, until he appointed another inspector four months ago, was Art Galvan.

Art Galvan is also mayor and also employed by Custom Design Homes. Galvan finds nothing wrong with this arrangement. His commissioners do, however. One of them, Quirino Martinez, said, "We had a lot of complaints when they first started building," that, "I tried to get them to build the houses right then." Martinez added that, "The mayor was the building inspector and worked for Custom Design Homes and that tied my hands."

Another who wholeheartedly disapproves of the quality of the houses constructed by Custom Design Homes is Charlie Vidik who is chairman of the Port Isabel Planning and Zoning Commission. He also disapproves of the mayor's relationship with Custom Design Homes and has urged homeowners with grievances to "unite and take proper legal action since the City of Port Isabel can do nothing as long as Galvan is mayor and keeps his present job."

The city's banker, Robert Hurst, charges, "They are creating an instant slum here." He said, "In 70 percent of the cases I know of, these people were told

there would be no payment for 90 days after construction, but," he added, "they were paying and the loan was closed before those houses were ever complete." Hurst said in many of the homes he has inspected he can push his fingernail through the mortar between the exterior bricks.

The building force behind Custom Design Homes is Bob Rankin who came here from Loma Linda in the Galveston area a little over a year ago. Of the homeowners who complained of the houses he builds, Rankin says, "They shouldn't because they never lived in such good houses," and that "a lot of criticism would jeopardize the government-sponsored building program."

Rankin added, "Any time a man gets a house like this for $40.00 or $50.00 a month, it is a good buy even if all the bricks fall in on him." Rankin also contends that many of the homeowners "are complaining simply because they are behind on their mortgage payments," and that many of them "have never taken their gripes to the proper people or," as he said, "been persistent enough."

Mr. BOB RANKIN. The complaints we have we are set up to take care of. And I would be willing to say that most of the ones that have complaints now, we don't know about them. Like I say, just recently as today some of the people have come in and showed me some things that needs to be done on a house and we have already sent people out to take care of it. I mean it is—it is our responsibility and we want to see this program go so we are not going to take a chance of putting this program in jeopardy just over a couple of houses.

Mr. SULLIVAN. A lot of people dispute that claim and one of the most outspoken is Bill Moore who has three employees who bought Farmers Home Administration dwellings built by Rankin's company. He told KGBT newsman Lee Harr many have been urged to not make additional payments until repairs are made.

Mr. BILL MOORE [continuing]. Work and they would point out the things on their homes that needed to be repaired and in questioning them I asked had they contacted the people in San Benito who supervised this program, Mr. Nesbit and a man by the name of Soto who was the inspector on the properties and the building inspector who I understand was the mayor at that time or is the mayor in Port Isabel, and they informed me that they had but there were no results to these complaints they made.

Having had 22 years experience in the mortgage business and having dealt with the Federal Housing Administration and the Veterans Administration, I thought in order to get the attention of someone in authority that they should send a letter—and did suggest that they do so and they did send a letter—with their payment saying they were not going to make any payments any longer if these repairs were not made.

They did receive replies and it was stated that an inspector from Temple would be sent to their properties and along with Mr. Nesbit a man who supposedly was from Temple, or probably was from Temple did show up on the properties, but instead of taking the side of the buyer and attempting to do something about these needed repairs—and may I state that there are many and they are very serious—Mr. Nesbit stated to these people—and this is their statement to me—that, "Buying this house was just like buying an automobile," that they had to make their payments or they lose their house. Nothing was done about the repairs.

I have looked at the same houses day in and day out, or at least two or three times a week since this time, and they get no results in phoning anyone. They are so inexperienced they don't know which way to turn. They know of no one to go for help. They have been to all the people they know, the administrators of the program, they have been to the builder, they have called—they have contacted the City Building Inspector in Port Isabel, and still they are helpless because of their lack of information, their lack of knowledge.

Mr. HARR. The attitude of the FHA office in many cases is that these people accepted the construction of these homes. Do you feel they are qualified to judge the quality of construction of these homes?

Mr. BILL MOORE. You can take the general run (?) of the population of this country and there is not one man out of a thousand to gauge—to guess as to whether a house is built right or whether a house is—anything further should be done to it. No, they are not qualified to know whether their house is right. They knew that their plans were not the same as the house they bought. They knew that things weren't finished. But when they were told that, "Look, you have to buy your own screen door," or, "You have got to pay for your own driveway," they are ignorant in this thing. They—there again, I say they are helpless.

Mr. SULLIVAN. The builder, Rankin, also has unique privy to the records of the San Benito Farmers Home Administration office. For one thing, Rankin referred to a list from the FHA, Farmers Home Administration, office which contained a complete account of homeowners and the current status of their mortgage payments. He said he had this list because he was going to see if he could help out with the collections of overdue payments due the government.

Speaking with even further knowledge of the Farmers Home Administration operation, Rankin said, "Wyatt 'Buck' Nesbit," who runs the office, "had stuck his neck out a lot for these people down here but didn't expect as much trouble as he was getting."

But in the FHA, the Farmers Home Administration, office the following day District Supervisor Cecil Vittetoe and Margarito Pena, an investigator from the State office at Temple, said, "The records are entirely private and are not to be used nor seen by anyone other than authorized Farmers Home Administration personnel." Vittetoe said he was not aware Rankin had access to this information and he added, "It is none of his business how these payments are coming in." But Rankin was worlds ahead.

At Port Isabel the following day the weekly newspaper, The Press, carried an advertisement placed by Custom Design Homes. The ad urged interested persons to "apply now for homes which are going to be repossessed by the Farmers Home Administration in two months, re-conditioned, then re-sold to new owners," indicating, of course, that Rankin knows at least 60 days in advance which homes will be repossessed by the government.

Well, Nesbit said old friend Rankin was trying to run a little bluff. He felt that he could spend $5.00 or $10.00 for an ad in the Port Isabel paper and get those people to make their delinquent payments. It would be to everyone's advantage.

Nesbit said that Rankin is "terribly interested in the program because it is one of the programs that really helps the poor people."

But it isn't the first time Rankin and Nesbit have helped one another. When Nesbit was in the Angleton office, Loma Linda, where Rankin was building at that time, was in Nesbit's territory and the two worked together very closely there; so closely, in fact, that when Nesbit was transferred to the Valley he urged Rankin to follow with the enticement that, "It is wide open down there." Nesbit says, nevertheless, he still was surprised when Rankin popped up awhile later and decided to build Farmers Home Administration houses here.

Like Rankin, Nesbit doesn't approve of the complaints that collectively or individually discredit them. He claims "Rankin has been bending over backwards to please everyone."

Of Rankin, Nesbit says: "His problem is that he is too easy-going." Nesbit said little else, saying he could not speak for the record, allow his picture to be taken, nor would he allow any of the activities in his office or employees to be photographed or interviewed.

Well, the administration of the building program by the San Benito Farmers Home Administration office also is getting heavy criticism from much of the building industry.

Santiago de la Fuente of San Benito says there is favortism in the FHA office, the Farmers Home Administration office. He says he tried for months, without success, to get a set of plans approved for a client while another contractor was getting several plans approved every week.

Fred and Benny Montalvo have been building homes for 14 years. Benny Montalvo says he tried, without success, to get six separate plans approved over a two-year period. His brother, Fred, complains that he lives in San Benito and has his customers there but has to go to Raymondville to do business. He says he never has any problem in the Raymondville Farmers Home Administration office. Benny did say, however, that one set of plans that has been consistently turned down over the years by the San Benito office was re-submitted on the advice of the Farmers Home Administrator investigator and that Nesbit quickly approved the plan this time around.

One of the first to build under the Farmers Home Administration was South Texas Lumber Company at Harlingen. Company manager, Warren Jackson, said when his company completed that first house back in 1965 there were Farmers Home Administration officials here from Washington and Temple to celebrate. He told newsman Lee Harr that times have changed.

MR. WARREN JACKSON:—run into so many problems. Well, frankly, just a runaround on a lot of that stuff. We just—just hasn't been worth our while to deal with things like that. It is just—there is just too much time lost.

MR. SULLIVAN: Jackson was told that the Farmers Home Administration says that the contractor has only to submit construction plans and cost to the Farmers Home Administration office for approval. After the approval, the Farmers Home says he can build houses for as many eligible applicants as he wishes.

Mr. WARREN JACKSON: Of course that seems to be some variance of opinion on things like that because I know many times we would have a customer go down there for we had already made a deal with him—the plans had been prepared and he was satisfied with our price—only to be told by them down there that he needed three bids.

On one particular occasion I think there was a man out toward Rio Hondo, he was very vehement about that. He said he didn't want another bid and they insisted that he get two more bids and eventually I think the job went to somebody else.

Mr. SULLIVAN: Jackson was asked if the same contractor generally got the job he originally planned for his client.

Mr. WARREN JACKSON: Well, of course that was what it had appeared to us. Now, we have no way of proving that but I mean it seemed like invariably these—this particular firm or firms would end up with it, with our customers who were originally our clients, I should say.

Mr. SULLIVAN: Jackson was asked if he, too, felt there was favoritism in San Benito's Farmers Home Administration office.

Mr. WARREN JACKSON: Well, it would seem that. Of course I couldn't prove it and, never having seen the bids or been there when the bids were opened up, but it would—my personal feelings are that something like that must have happened and it has happened too often. There are too many complaints from the different dealers.

The—well, as the old saying goes, where there is smoke there has got to be some fire. And now I could name you, well, several dealers right offhand who feel the same way about it as I do who has discussed the matter with me and are—well—I mean the same thing is just a recurring deal. They have lost things, the same thing. They have gotten the same general runaround. There has got to be something wrong down there. There has just got to be. If they don't want us to deal with them they just should say, "We dont' want you down there," period.

Mr. SULLIVAN. Yes Custom Design Homes already has been approved to build a minimum of 80 more houses in a subdivision located in the southern part of LaFeria, while other contractors faced with the prospects of bidding their construction and the alleged Farmers Home Administration interference say that most of the profit is gone out of the occasional jobs they get before Farmers Home Administration approval is even granted them.

But Bob Rankin and Custom Design Homes apparently do not share the same problems. Rankin said in every case where he built houses in Port Isabel he, personally, paid all closing costs for the people who bought from him and, for good measure, threw in the first year's insurance premium to "those people who could have a decent place to live."

The KGBT News Department has not attempted to reach any conclusion on this program and we made every effort to present the program in a manner that is impartial and fair to everyone concerned.

There may be persons who disagree with some of the contents of the show and, in that case, we will consider any and all requests for time for rebuttal.

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THE STATE OF TEXAS,
County of Cameron:

CERTIFICATE OF COURT REPORTER

I, Eric Schwab, Official Court Reporter of the 197th Judicial District Court of Cameron County, Texas, do hereby certify that the foregoing is a full, true, and correct transcription from my stenographic notes of the tape of the news program Home Sweet Home.

The quote marks in the foregoing transcription were put in at my discretion.

Witness my official hand at my office in Brownsville, Cameron County, Texas, this the 19th day of January, 1972.

ERIC SCHWAB.

Appendix 16.—Farmers Home Administration Response to Additional Questions Submitted by Subcommittee

Question 1. How close does FHA now expect to come to meeting goals of housing legislation? Has lack of available funds for full accomplishment been a factor? What other factors, if any? What effect is imposition of moratorium on interest credit likely to have in the future?

Answer. The portion of the National Housing goals to be met by USDA programs as reported in the Second Annual Report of National Housing Goals is shown below, with the accomplishments of FHA.

[Numbers in thousands]

Fiscal year	Housing goals	FHA accomplishments
1969	36	36
1970	66	51
1971	126	86
1972	180	92
1973	180	[1] 97
1974	180	[1] 90
1975	180	
1976	180	
1977	180	
1978	179	

[1] Estimate.

Major factors in determining the accomplishments during 1974–8 will be (1) the type of housing programs authorized after the Comprehensive Review of all Housing Programs is completed, (2) the personnel authorized, and (3) the salary and expense funds available to administer these programs.

Lack of available loan funds since the housing goals were established has not been a significant problem. The number of FHA personnel has remained almost constant. Adjustments, such as utilizing the private sector to package loan applications and inspect on a fee basis the dwelling being built, as well as better utilization of the Finance Office for handling loan payments and reports, had to be made in administering a long-term program that has more than tripled since 1968.

During the last three years over 50 percent of the housing loans have gone to low-income families. With the current interest rates and the moratorium on interest credit, many low-income families will be unable to pay the amount necessary for decent, safe and sanitary housing.

Question 2. Does FHA anticipate any further use of "interest credit" subsidies on a significant basis? If so, to what extent? Is there any requirement that such loans be made? Does FHA anticipate any problem in making suitable loans up to the amounts appropriated without use of interest credit?

Answer. As of August 16, 1973, FHA is again making loans with interest credit as directed by Judge Richey's court decision. We anticipate utilizing all funds authorized. Since we are again making interest credit loans, the remainder of the question no longer applies.

Question 3. What individual has responsibility for making allocations of funds to states? Exactly how does he (or she) do it? What specific formula was used to allocate FY 1973 funds? List factors in descending order of priority, giving relative weight.

Answer. The Administrator of the Farmers Home Administration is responsible for allotting rural housing funds to the different states. The factors considered in distributing the funds are interrelated and, therefore, it is difficult

to list them in the order of importance or to assign relative weights. Items considered for each state are:

Condition of housing in rural areas.
Rural population.
Mean income of rural families.
Average cost of dwelling and site.
Historical lending patterns.

The states are ranked with respect to each of the above factors and funds are allotted accordingly. Near the end of the fiscal year, all funds are "pooled" and all states had adequate funds in 1973 fiscal year.

We are providing a worksheet (Exhibit A) showing the factors and state ranking for 1973 allocations. There are some discrepancies on the sheet and in the system although in 1973 we did not have a problem, as there was no shortage of loan funds for any state. The allocation system has been under review for some time and is currently being restructured and improved. The actual formulation and details of the allocation are worked out in the division responsible for the respective program; for example, the worksheet in Exhibit A is for Section 502 loans and was done in the Single Family Housing Division.

EXHIBIT A

BACKGROUND INFORMATION FOR DISTRIBUTION OF RURAL HOUSING FUNDS, 1973 FISCAL YEAR

	(1)		(2)		(3)		(4)								
			Rural population[1]		Condition of housing (units lacking complete plumbing)[2]		Historical data[3]								
	Mean income[1]	Rank[1]	Number of families	Rank	Percent	Rank	Funds obligated 1972–73 through May 31	Rank	Number of loans	Total points: Subtotal	Total points: Rank	Average cost of land and home, first 6 months of fiscal year 1972	Points	Total points: Points	Total points: Rank
Alabama	$7,655	46	454,462	33	26	45	$51,830,300	44	4,201	168	5	$12,773	1	169	46
Arizona	8,746	23	120,471	14	12	29	21,317,200	32	1,805	98	31	15,639	15	113	20
Arkansas	6,894	50	319,208	27	23	42	55,294,830	45	4,557	164	7	12,923	2	166	44
California	9,248	17	680,046	43	3	3	33,666,960	37	2,054	117	20	16,640	25	142	31
Hawaii	10,761	4	44,163	3	12	30	4,089,870	12	195	49	43	22,042	51	98	16–17
Nevada	9,938	8	31,112	1	5	8	1,444,590	3	78	20	49	19,706	50	72	6
Colorado	8,062	32	158,082	15	7	16	6,217,890	12	479	75	36	16,442	21	96	15
Florida	8,302	30	532,983	39	9	22	22,584,230	27	1,555	118	19	14,709	11	129	25
Georgia	7,906	40	568,332	40	21	40	57,841,150	47	4,223	167	6	13,948	6	173	47
Idaho	8,155	31	110,148	12	5	11	24,676,090	31	1,540	85	34	17,503	35	120	21–22
Illinois	9,646	11	666,698	42	8	22	27,601,530	33	2,030	112	22	17,454	33	145	34
Indiana	9,369	15	584,292	41	8	23	41,697,540	40	3,103	119	15	16,192	19	138	28
Iowa	8,625	24	417,871	32	7	19	20,164,340	26	1,752	101	28	17,127	29	130	26
Kansas	8,012	35	260,463	21	7	18	10,549,670	19	908	93	32	16,882	27	120	21–22
Kentucky	7,756	42	467,926	34	31	48	28,826,410	35	2,158	159	9	15,726	16	175	48–49
Louisiana	7,697	45	378,337	29	19	38	15,569,380	23	1,243	35	13	13,339	5	140	29–30
Maine	8,486	27	169,493	16	15	34	28,016,440	34	2,075	111	23	17,735	36	147	35
Michigan	10,033	7	706,047	43	6	15	50,301,660	43	3,121	108	24	18,707	45	153	39
Minnesota	8,899	22	390,420	30	11	28	16,403,550	25	1,154	105	27	18,576	44	149	38
Mississippi	7,030	49	351,134	28	30	47	65,226,850	48	5,186	172	3	12,994	3	175	48–49
Missouri	7,981	37	482,980	36	15	35	49,204,820	42	3,748	150	10	14,579	9	159	42
Montana	8,617	26	109,427	11	8	21	3,051,090	7	232	65	38	18,097	38	103	18
Nebraska	7,888	41	187,501	17	6	13	5,851,150	10	491	81	36	18,869	46	127	24
New Jersey	10,681	5	249,924	20	3	1	10,985,480	20	729	46	46	17,236	30	76	7
Delaware	9,185	18	45,886	4	11	26	5,670,830	9	356	57	40	16,626	24	81	9
Maryland	10,919	3	264,824	22	11	27	12,083,910	22	780	74	37	17,307	32	106	19
New Mexico	7,919	39	99,208	9	19	37	8,057,680	15	616	110	24	15,459	14	124	23
New York	10,543	6	804,502	45	5	12	30,523,390	36	2,168	99	30	19,248	49	148	36–37
North Carolina	7,993	36	831,469	46	20	39	75,568,050	51	5,296	172	2	14,956	12	184	52
North Dakota	7,932	38	95,003	8	13	32	11,414,360	21	868	99	29	18,362	41	140	29–30
Ohio	9,921	9	800,809	44	10	25	48,598,550	40	3,324	118	18	17,071	28	146	33

EXHIBIT A

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	(1)		(2)		(3)		(4)								
			Rural population [1]		Condition of housing (units lacking complete plumbing) [2]		Historical data [3]								
	Mean income [1]	Rank [1]	Number of families	Rank	Percent	Rank	Funds obligated 1972–73 through May 31	Rank	Number of loans	Total points: Subtotal	Total points: Rank	Average cost of land and home, first 6 months of fiscal year 1972	Points	Total points: Points	Total points: Rank
Oklahoma	7,273	48	307,536	25	10	24	36,393,630	39	2,940	136	12	14,300	7	143	32
Oregon	8,624	25	232,765	19	4	8	10,203,120	18	685	70	38	16,385	20	90	12
Alaska	11,505	1	45,937	5	19	36	1,562,550	4	76	46	42	25,076	52	98	16–17
Pennsylvania	9,115	19	1,087,063	48	7	20	23,827,670	29	1,551	116	21	18,406	42	158	41
South Carolina	8,022	33	407,753	31	23	43	81,142,690	52	5,610	159	8	14,365	8	167	45
South Dakota	8,014	34	111,226	13	13	31	7,930,050	14	694	92	33	18,205	39	131	27
Tennessee	7,598	47	525,049	38	24	44	55,355,500	46	4,399	175	1	13,373	4	179	50
Texas	7,412	43	840,649	47	14	33	55,506,590	47	4,256	170	4	14,623	10	180	51
Utah	8,335	29	65,574	7	4	7	10,176,860	17	705	60	39	16,664	26	86	11
Vermont	9,868	10	91,827	8	6	14	8,291,910	16	686	48	46	15,992	18	66	3
Connecticut	11,053	2	199,427	18	3	4	3,453,510	5	216	29	49	18,236	40	69	4–5
Massachusetts	10,218	6	274,150	23	3	5	3,549,350	6	218	40	47	18,061	37	77	8
New Hampshire	9,545	13	100,648	10	7	17	6,277,260	13	467	53	41	17,257	31	84	10
Rhode Island	9,391	14	31,661	2	5	10	1,058,500	1	65	27	50	18,533	43	69	4–5
Virginia	9,351	16	498,769	37	26	46	72,906,020	50	4,851	149	10	14,992	13	162	43
Washington	9,111	20	297,495	24	3	2	22,495,400	26	1,436	72	38	16,449	22	94	13–14
West Virginia	8,423	28	311,715	26	22	41	24,154,480	30	1,722	125	14	16,624	23	148	36–37
Wisconsin	9,612	12	468,392	35	9	23	35,563,290	38	2,545	108	26	19,470	48	156	40
Wyoming	9,002	21	52,507	6	5	9	5,675,380	11	425	47	42	18,902	47	94	13–14
Puerto Rico			(4)		(4)		15,942,230	24	1,040	24	48	15,989	17	41	2
Virgin Islands			(4)		(4)		1,216,260	2	69	2	52	17,470	34	36	1

[1] Information obtained from U.S. Department of Commerce, Bureau of Census, 1970 census report, series PC(1)-C 21, section "Type of Income of Families and Unrelated Individual's," Mean Wage or Salary Income and Family Numbers. (Population up to 10,000.)

[2] Includes rural areas and rural communities up to 10,000 population that are located outside urbanized areas. Information prepared by Economic Research Service, January 1971.

[3] Form FHA 369-1, "Status of Allotments or Distribution" as of May 31, 1972, Insured Loans.

[4] Not available.

Question 4. Have there been significant complaints from State and local offices about FHA policies, regulations and procedures, particularly with respect to complexity and practicality?

Have there been complaints about the adequacy of personnel resources to properly implement policies, regulations and procedures?

Answer. No, state and local office employees have input in developing regulations and procedures. This participation is complemented by an employee suggestion award program for improving procedures.

The agency receives a "normal" number of complaints from state and county offices. FHA field personnel feel an almost limitless need for additional time to make and supervise the various FHA loans. The quality and timeliness of FHA service has always been, and will continue to be, constrained by available manpower. This concern of field employees exists in any Federal program where employees are dedicated and personally concerned with serving the public.

Question 5. To what extent has FHA requested additional personnel to handle increased housing volume during the past few years without success? Please give details, indicating whether FHA requests were turned down—

(a) by USDA.

(b) by Budget Bureau/Office of Management and Budget.

(c) by Congress.

To what extent has FHA increased personnel to handle increased housing volume?

Did appropriations exceed requested program amounts? If so, by how much?

Answer. The following table shows man-year requests and actual man-years for FHA. No breakdown of these figures by program is available. However, since the bulk of FHA program increases has been in housing, most of the increase shown would be related to housing. (Exhibit B.)

EXHIBIT B

U.S. DEPARTMENT OF AGRICULTURE—FARMERS HOME ADMINISTRATION STAFFING ANALYSIS, FISCAL YEARS 1971–74

[Dollars in thousands]

	Agency estimate		Department allowance		Budget		Act		June 30 actual	
	Amount	Man-years	Amount	Man-years	Amount	Man-years	Amount	Man-years	Amount	Man-years
1971	$149,206	13,815	$87,750	8,125	$87,750	8,125	[1] $88,750	6,389	$91,428	7,512
1972	130,983	13,017	102,750	8,718	95,550	7,900	[1] 100,415	8,300	102,050	8,220
1973	181,000	14,450	124,500	9,939	107,500	7,921	[1] 114,243	8,264	[2] 121,200	8,536
1974	139,420	10,412	119,603	8,932	116,000	8,523	116,000	8,523	[2] 116,000	8,523

[1] Does not include supplementals for pay raises.
[2] Estimated.

As of June 23, 1973, FHA employed 102 construction inspectors. These employees are specialists in construction and work exclusively in the housing program.

The following table shows action on program levels in the past four years. (Exhibit C.)

EXHIBIT C

U.S. DEPARTMENT OF AGRICULTURE—FARMERS HOME ADMINISTRATION—COMPARISON OF AGENCY ESTIMATE, OMB ALLOWANCES, AND APPROPRIATION OR AUTHORIZATION

[In thousands of dollars]

	Fiscal year 1971			Fiscal year 1972			Fiscal year 1973			Fiscal year 1974		
	Agency estimate	Appropriated or authorized in appropriation	OMB allowance (apportionment)	Agency estimate	Appropriated or authorized in appropriation	OMB allowance (apportionment)	Agency estimate	Appropriated or authorized in appropriation	OMB allowance (apportionment)	Agency estimate	OMB allowance (budget estimate)	Anticipated authorization in appropriation
Rural housing program:												
Low to moderate income housing loans	$1,407,000	$1,425,000	$1,420,000	$2,367,000	$1,555,000	$1,555,000	$2,500,000	$2,059,000	$1,858,000	$2,600,000	$1,084,000	(1)
Rural rental housing loans	37,000	37,000	37,000	37,000	35,000	35,000	72,000	70,000	138,000	200,000	44,000	(1)
Farm labor housing loans	15,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	7,500	----------	$10,000
Farm labor housing grants	5,000	3,761	3,761	2,500	3,767	6,730	15,000	2,500	2,176	20,000	----------	(1)
Rural housing site loans	1,000	1,400	6,225	5,800	6,225	6,225	5,800	5,900	5,900	5,900	5,900	5,900
Mutual and self-help housing grants	5,000	1,650	2,125	2,125	2,450	2,450	3,000	3,729	3,729	4,000	3,832	(1)
Above moderate income housing	100,000	----------	----------	50,000	----------	----------	----------	----------	----------	400,000	----------	----------
Very low income housing loans	20,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Total, rural housing	1,590,000	1,488,811	1,489,111	2,484,425	1,622,442	1,625,405	2,615,800	2,161,129	2,027,805	3,247,400	1,147,732	(1)
Farmer programs	830,500	502,000	434,000	622,000	706,000	706,000	752,500	704,500	874,500	896,000	719,500	719,500
Community programs	556,600	291,700	320,700	235,500	416,000	358,100	576,000	465,500	445,500	1,144,000	645,500	(1)
Total, FHA [2]	2,977,100	2,282,511	2,243,811	3,341,925	2,744,442	2,689,505	3,944,300	3,331,129	3,347,805	5,287,500	2,512,732	(1)

[1] Anticipated authorization is uncertain because of variances between House and Senate versions of appropriations bill.

[2] Includes only programs that are administered with FHA's salaries and expenses.

Question 6. What procedures, if any, does FHA have for realistically evaluating housing program capability of employees not classified as housing specialists who are performing such duties?

Has FHA ever really made an analysis of its personnel resources and the manner in which they are allocated?

Answer. Farmers Home Administration County Office employees (other than Construction Inspectors) are primarily loan officers responsible for making and servicing the wide variety of loans available through the County Offices. Their "program capability" is evaluated through District Supervisors' on-site reviews, visits from State and National Office program specialists and internal audits. Shortcomings in housing program operations are corrected through additional training on site or by formal training by State Office staff, and more recently, by courses at the Agency's training center at Norman, Oklahoma.

Preparation for the expanded housing activity was done primarily through training of on-board personnel. Generally, new housing program regulations were issued, then discussed at regional meetings with FHA State Office housing specialists who, in turn, trained County Office personnel. New personnel received training in the housing programs as part of their basic induction training, and received further training as the program changed, along with experienced personnel.

Further, most States hired architects and/or engineers to help assure adequate housing sites and construction. The additional training and specialized personnel (including Construction Inspectors) were added as the housing programs expanded over a period of years.

FHA has a work measurement system that has been revised and improved over the years. This system has served as the basic tool for adjusting and allocating personnel resources according to total workload. The system was last revised in 1969, and will be thoroughly reviewed and updated in fiscal year 1974 to reflect current operations.

In past periods of moderate increases in personnel, it was possible to add a few more employees in those states and counties which were experiencing the greatest increase in program levels (primarily housing). Because of the continuing large numbers of outstanding housing, farmer programs and community program loans, it has not been possible to move large numbers of employees into heavy housing program areas. In the past couple of years—because of reduced employment ceilings—some apparent imbalance between States has persisted.

Question 7. What significant steps, if any, did FHA take between the passage of the Housing Act of 1968 and January 1973 to increase the quantity and/or improve the quality of its housing inspection resources?

Answer. Both FHA program and technical instructions have been updated between the passage of the Housing Act of 1968 and January 1973. For example, in November of 1970, FHA Bulletin No. 3790(444) set forth guidelines for rural housing sites. In January of 1973, FHA Instruction 424.5 "Planning and Performing Site Development Work" was issued. FHA hired temporary construction inspectors to assist the county supervisor in areas of heavy workload during this period. Also, FHA hired architects to be a part of the state staffs and assist the offices in the technical processing of cases. Further, FHA initiated a training school for state and county personnel in Norman, Oklahoma to train personnel in the program and technical phases of our operations.

Question 8. How effective have these steps been in meeting the need?

Answer. We believe these steps have been instrumental in improving the quality of processing.

Question 9. How many fully qualified inspectors does FHA have? How do the number and location of qualified inspectors compare with need? (What data does FHA have showing number of qualified inspectors as compared with workload by state and county?)

Are inspectors utilized basically on a county basis?

Please describe procedures utilized for training and supervision of inspectors.

Answer. Normally inspections are made by FHA's 1723 county supervisors and 1306 assistant county supervisors. These employees are supplemented by a special position of "Construction Inspector." At May 31, 1973, we had 153 construction inspectors.

The supplemental construction inspector specialists are assigned to locations with heaviest workloads. While it would be desirable for such specialists to relieve other county office personnel of all construction inspection chores, this would not be an efficient use of manpower where a full-time need for inspections does not exist.

Employment status	Dec. 31, 1972	July 31, 1973
Temporary	44	34
Permanent	178	71
Total	222	105

The need for inspections is related to the rate of construction, which is affected by weather, availability of materials and labor, and current loan making activities. Knowledge of these factors is only available locally. Therefore, we rely on county supervisors to make their needs for inspection assistance known to their state directors.

Supplemental inspectors may (1) travel throughout the state, (2) serve one county office, or (3) serve a multi-county area.

County and assistant county supervisors learn to make inspections through (a) a prescribed course of individual study, (b) two- or three-days of formal training at the state office, and (c) on-the-job training under experienced supervisors. Supplemental inspectors are hired on the basis of their housing construction and inspection experience.

No inspector training courses are offered at the national training center.

Question 10. Does FHA plan to use fee appraisers or inspectors in the foreseeable future? If so, please provide details.

Answer. The FHA does not plan to use fee appraisers in the near future but we permitted five state offices (California, Mississippi, Georgia, South Carolina, and North Carolina) to utilize fee construction inspectors on a trial basis. We have evaluated the experiences of these five states (which varied greatly) and are preparing instructions to permit the nationwide use of fee inspectors.

Information we have on fee appraisers is that there would be too much administrative burden with the widely dispersed volume we have. In many rural areas, we would not even be able to recruit a satisfactory fee appraiser.

Question 11. Does FHA regard the HUD Minimum Property Standards as fully adequate for the rural housing program, or are there instances in which they may be inadequate?

Answer. The FHA regards HUD MPS as fully adequate for the rural housing program. FHA technical personnel have and do collaborate with HUD technical personnel on matters of mutual concern. In fact, "The Guide for the Construction of Farm Buildings", adopted many of the features contained in the Federal Housing Administration MPS. HUD has been in the process of revising the present HUD MPS (for 2 years) and it was determined that rather than revising "The Guide for the Construction of Farm Buildings", that we would adopt HUD's present MPS. These MPS were adopted totally except for our inspection procedure which is spelled out in FHA Instruction 424.1.

Question 12. Was use of an inspection checklist recommended? If so, if not implemented, why not?

What is the responsibility of the contractor and the authority of FHA with respect to correction of defects disclosed by inspections?

Answer. The National Office has had several employee suggestions recommending an inspection checklist and, in fact, several states have received National Office approval to use a construction checklist which they themselves designed. The Technical Services Division in the National Office is in the process of preparing an inspection checklist for nationwide use.

The contractor must complete the dwelling in substantial compliance with FHA accepted drawings and specifications. The FHA can cause the contractor to make changes at any stage of construction and, in fact, can stop the construction of the job until such time as necessary corrections are made. FHA does not have to close any loan until the construction fully complies with the accepted drawings and specifications.

Procedure calls for at least three inspections during the course of construction by FHA personnel to tell whether the contractor is in substantial compliance with the accepted drawings and specifications.

Question 13. Does FHA regard current warranty provisions and enforcement procedures as fully adequate to protect interests of the borrower? If not, please give details.

Answer. FHA believes that current warranty processes and enforcement procedures are in almost all cases adequate to protect the interest of the borrower

and the FHA. We do not have legislation or the provision to correct deficiencies for a bankrupt contractor as HUD does.

Question 14. Does FHA have procedures for evaluating the adequacy of State and local regulation of construction, in order to avoid unnecessary duplication of work done by local authorities and at the same time avoid reliance on inadequate local work?

Answer. FHA has taken the position that we are responsible to see that we obtain good planning and construction. Many localities require contruction inspections and several of these inspections are in effect duplications of our own inspections. FHA has instructed its personnel that while these inspections are helpful in seeing that the house is properly constructed, they are no substitute for our own required inspections.

Question 15. How reliable are inspection reports as a measure of the extent of deficiencies in FHA financed houses?

Are scheduled inspections always made at appropriate times when construction defects can readily be ascertained? If not, why not?

Are spot checks made to supervise the quality of work done by field inspectors?

Do FHA regulations permit builders to sell new houses as "existing dwellings" under circumstances which preclude inspection at normal phases of construction? If so, please give details.

Answer. Inspection reports prepared as prescribed in outstanding instructions are reliable as a measure of the extent of deficiencies "during construction."

Inspections are made at three stages of construction, namely: Stage 1 (First Inspection) When foundation excavations are complete and forms or trenches and steel are ready for concrete placement and the subsurface installations are roughed in.

Stage 2 (Second Inspection) When the building is enclosed, structural members are still exposed and roughing in for heating, plumbing and electrical work is in place and visible.

Stage 3 (Final Inspection) When all onsite and off site development of the structure has been completed and ready for occupancy. We, therefore, believe that there is very near 100 percent inspection coverage in all cases of new construction at appropriate times when defects can readily be ascertained. Some discrepancies have been noted but we are doing our best to correct them.

County supervisors, district supervisors and architects in the state offices do spot check field inspections. The proposed instruction allowing the use of fee inspectors nationwide provides for spot checks and supervision.

We have recently revised our regulations to preclude builders from avoiding inspections. Our regulations now provide for 100 percent loan only when the dwelling has had three or more inspections made by the Farmers Home Administration, Federal Housing Administration or the Veterans' Administration. If the existing new home has not had the required inspections, it is entitled only to 90 percent loans. ("WSC Special," Exhibit D.)

EXHIBIT D

SECTION 502 RURAL HOUSING LOAN POLICIES, PROCEDURES, AND AUTHORIZATIONS

Paragraph VII F is being revised to provide that loans up to the market value of the security may be made on homes that are newly built only if the construction is inspected by the Farmers Home Administration, the Federal Housing Administration, or the Veterans Administration, while the work is being done or the home consists of an existing home which is more than 1 year old.

Loans on homes that do not meet these requirements are limited to 90 percent of the market value of the security.

Upon receipt of this procedural change, the County Supervisor will immediately notify, in writing, all builders who are constructing homes with the expectation of selling them to Rural Housing Borrowers substantially as follows:

Effective March 16, 1973, Rural Housing loans up to the market value of the security may be made only when:

1. A conditional commitment has been issued by the Farmers Home Administration, or
2. The rural housing loan was closed prior to the start of construction, or
3. The required inspections were made by the Farmers Home Administration, the Federal Housing Administration, or the Veterans Administration during construction, or
4. The home is more than a year old.

Loans on homes that do not meet these requirements are limited to not more than 90 percent of the market value of the security as determined by the Farmers Home Administration.

This change in regulation is applicable to all homes on which construction is started after March 16, 1973, and to any homes that have been started before that date for which a Rural Housing loan application is not filed in good faith by an eligible applicant to buy the dwelling on or before June 14, 1973.

Question 16. Does FHA have authority to prevent builders from participating in its programs? If so, on what basis?

Is there any routine screening of—

a. A builder's technical competence?

b. A builder's fiscal responsibility, if only from standpoint of inquiring for negative information?

Answer. Yes. The FHA does have authority to prevent builders from participating if they are not qualified or if they are on FHA's suspension and debarment list.

a. FHA Instructions 424.1 and 424.5 provide that the applicant shall employ qualified contractors and technicians.

b. Further, these instructions provide that contractors' financial condition should be analyzed and a surety bond will be required in many instances.

Question 17. What are arrangements for sharing information with HUD regarding contractors, etc.? Please cite five most readily available examples of:

a. Significant information received from HUD.

b. Significant information provided HUD.

Answer. a. The Farmers Home Administration State Officers through the state architects and rural housing chiefs have continual liaison with the Department of Housing and Urban Development, Federal Housing Administration, and discuss such items as (1) the MPS, (2) subdivision approvals, (3) contractors doing business with HUD, (4) cost, and (5) market information.

b. We provide HUD with (1) cost information, (2) subdivision information, (3) market information, (4) information concerning contractors doing business with the Farmers Home Administration, and (5) experiences with building materials in the field.

Question 18. The 1971 OIG Report concluded that 13% of FHA housing loans had been made to ineligible borrowers. What analysis, if any, has FHA made of this situation? Please provide copies of any such analyses.

Answer. The 1971 OIG Report indicated that ineligible loans were made in 13 percent of the cases reviewed. The loans were determined to be ineligible due to excessive incomes of applicants, urban residency of the applicant without rural employment or rural landownership, adequate housing owned by applicants prior to FHA loan approval, and housing being located near urban areas. While each ineligible loan has been reviewed and corrective action taken to prevent further mistakes, a formal analysis of the total reported problem has not been made. However, procedures have been issued and discussions held during training sessions with our field staffs to cover each type problem. To illustrate, almost half (695 out of 1,424) of the ineligible loans involved housing which OIG concluded was too near urban areas. To eliminate this problem, we required each State Director to make a study of all urban areas (places with more than 10,000 population) within his state or states and then indicate with a line on a map those areas which are urban and rural. Furthermore, the requirement that an applicant must be either a rural resident, employed in a rural area, or own land in a rural area is no longer applicable.

Question 19. Prior to January 1973, what studies, if any, had FHA conducted with respect to defaulted (or otherwise bad) loans to determine the cause or causes of such bad experience? Please provide copies of any such studies.

To what extent, if any, could such bad experiences have been prevented by adequate counseling?

What information does FHA have as to the approximate percentage of packaged applications turned down, and the reasons for such refusals?

How does the situation compare with non-packaged applications?

Answer. No formal published studies were conducted, however, we requested that each State Director determine the actual reason for delinquencies in their respective jurisdictional areas and to provide this office with a summary of the principal reasons why RH borrowers are delinquent and the collection and loan making methods found to be effective in keeping delinquencies to a reasonable level.

The following is a compilation of the principal reasons reported for delinquencies.

Reasons:

1. Poor money management.
2. Loss of employment.
3. Sickness, accidents, death.
4. Lack of timely supervision.
5. Domestic problems.
6. Impulsive buying.
7. Borrower unable or unwilling to assume responsibilities of homeownership.
8. Large families—low income.
9. Crop failure—low farm income.
10. Double payments for rent and dwelling while dwelling is being built.
11. High taxes and insurance.
12. High housing cost.

Inflation, in general, was mentioned or implied in several reports.

Following is a compilation of the "Collection and loan making methods used to keep delinquencies to a reasonable level."

Methods:

1. Prompt contacts when payments are missed including supervision and servicing of accounts and counseling with borrowers.
2. Definite understanding reached with applicants and borrowers before the loan is made.
3. Thorough investigation of applicants before a loan is made.
4. Use of supplementary payment agreement-scheduling payments over 9, 10, and 11 months and when income is received for borrowers with farm income.
5. Adequately trained staff.
6. Finance only modest homes within families' repayment ability.
7. Use Conditional Commitments.

Before an RH loan is made, the applicant family must be interviewed by the FHA County Supervisor, at which time he determines the accuracy of information submitted to him and provides counseling to the applicant family concerning their responsibilities in connection with the loan for which they have applied. The County Supervisor will inform the applicant of any special loan approval conditions that must be met before the loan is closed. Other conditions, such as depositing loan checks and borrower's funds in a supervised bank account, requirements of fire and extended coverage insurance on all insurable buildings located on the property, that construction work to be paid for with loan funds may not be started until authorized by the County Supervisor, the borrower's responsibility for maintaining and accounting for the security property, and making payments on the loan when they are due are also discussed. We believe the counseling now required by FHA instructions is generally adequate.

Information is not readily available concerning these last two questions.

Question 20. How does quality (degree of risk, etc.) of loans under the Housing Act compare with those made in prior years? Is there a significant difference in quality of interest credit loans and other loans made under the Act?

Answer. Rural Housing Active Borrowers. Percent of Total Borrowers Behind Schedule as of January 1.

Year:	*Percent schedule behind*
1967	8
1968	9
1969	11
1970	12
1971	11
1972	12
1973	15

Percent of total borrowers with a low- or moderate-income and low- or moderate income receiving interest credits behind schedule as of January 1:

Year	Total low to moderate	Low-to-moderate interest credit
1972	12	14
1973	15	18

The percentage of borrowers behind schedule decreased substantially after January 1. As of March 31, 1973, 7 percent of the borrowers receiving interest credits as well as low- and moderate-income borrowers not receiving interest credits were behind schedule on their loan payments.

We believe that the quality of RH loans made after the Housing Act of 1968 to be as good as those made prior. We have had a slight increase in the delinquency rate each year.

Question 21. Please provide a brief description of the procedures used in determining whether or not a loan applicant will be able to make loan payments. Please state specifically whether or not FHA includes an adequate allowance for maintenance and repair of the loan property in evaluating repayment ability, giving details.

Answer. Before an RH loan is made, each applicant must complete a Farm and Home Plan or Family Budget to verify that the annual family income will be sufficient for an adequate standard of living, to meet FHA loan payments, pay property insurance premiums, real estate taxes, and other debts when due, and to maintain and protect the security of the Government.

Question 22. To what extent are borrowers counseled concerning fiscal responsibility and money management, etc.:

(a) before loan closing

(b) in event of delinquency problem

Answer. All loan applicants are informed of their responsibility for providing property insurance, payment of taxes, and making loan payments when they are due before a loan docket is completed or the loan is scheduled for closing. Specific understandings are again reached with delinquent borrowers concerning amounts to be paid on the loan and for payment of taxes and insurance, and the date they are to be paid.

Question 23. What inspections, if any, are made to determine conditions of collateral? Are they made only on delinquent loans or where a transfer is anticipated?

Does FHA have any procedures (counseling, etc.) for encouraging proper maintenance on a voluntary basis? If so, how successful have they been?

Is there any practicable way in which proper maintenance could be required?

Can recourse legally be taken against borrowers for mistreatment of property which results in loss to FHA? Has it ever been done? If so, to what extent?

Does FHA have any information as to how its procedures with respect to proper maintenance, etc., compare with those customarily used by private lenders?

Answer. In cases involving borrowers with loans on nonfarm tracts, periodic inspections ordinarily are made only if liquidation action is likely to be taken, the property has been abandoned, or when necessary to protect the interest of the Government. For farm borrowers whose accounts are current, an inspection of the property ordinarily is made every three years. An annual inspection is made only when such a borrower is delinquent or otherwise in default, or problems exist involving the security property. Maintenance of the Security Property by the borrower is a requirement of all loans. Borrowers are informed of their responsibility before the loan is closed, and when necessary on a continuing basis. If a borrower fails to maintain the property, he usually is also delinquent on the account. If the Government security is jeopardized, liquidation action by transfer, voluntary conveyance, or foreclosure is taken.

The practical way of getting borrowers to maintain their property is through proper understanding at loan making and closing that this will be required. The supervisor will counsel with a borrower to get maintenance carried out. Further action could be taken by getting local authorities to enforce local laws (such as weed laws or junk laws) to get a property maintained. FHA would be in a weak position to request foreclosure unless the situation was clearly one where the Government's interest was in jeopardy. We believe our servicing requirements would be similar to other Government agencies, but we do not have readily available information as to private lenders' requirements.

Question 24. Please describe the role played by attorneys in FHA-financed housing transactions, indicating specifically how they are selected, whom they represent and whether any limitations are placed on their fees.

Answer. The designated attorney is responsible for title clearance, other legal services, and disbursement of FHA loans, private lender's and applicant's funds at the time of loan closing. Specifically, the attorney is responsible for examining the title to the land, preparing, obtaining, or approving simple curative material, conveyance, and security instruments. He advises borrowers and sellers when

land is being acquired regarding the adequacy of the legal description of the security. He issues preliminary and final title opinions and provides other legal services necessary to closing the loan. He acts as escrow agent and disburses loan and other funds, required for closing the loan.

The requirement for the use of attorneys is the same in each state and the attorney is required to act as legal advisor and escrow agent for disbursing funds unless there is a low volume of real estate loans in the county and the escrow agent costs would be relatively high because of the cost of the fidelity bond(s). In those cases the attorney would not act as escrow agent because the county supervisor would be present for loan closing and disbursement of funds.

Attorneys are designated by the state director with the advice of a representative of the General Counsel's office as to the attorney's professional qualifications. Only in a rare case will there be less than two attorneys designated in a county. The number of designated attorneys in any county will depend upon the volume of real estate loans and transfers in the county and the number of approved title insurance companies in the county.

The attorney represents the applicant and the FHA. He is paid by the applicant from personal or loan funds. There are no limitations placed on the fees. However, if the state director finds that the fees charged by an attorney are not in line with that in adjoining counties, he will see that an additional attorney is designated or will approve another title insurance company to provide more competition and a larger number of choices for the applicant.

FHA regulations do not permit the attorney to represent any party other than the applicant and the Government. For example, if a contractor for construction of FHA financed dwellings or essential farm buildings has an attorney, that attorney could not be designated to represent the applicant and FHA.

The FHA does not have separate legal representation for loan closing. However, representatives of each Regional Office of the General Counsel of the Department answers any legal questions of state or county FHA personnel concerning loan making or may on an individual complex case be used instead of a designated attorney or may be used in any county or area where the state director is unable to obtain the services of either a designated attorney or an approved title insurance company or both.

Question 25. Is title insurance required in connection with FHA loans? Any difference in requirements in different States? How is title insurance company and/or agent selected? By whom? What control, if any, is there over cost of title insurance? What control, if any, over adequacy of protection provided by policy?

Answer. Title insurance is not required in connection with the closing of FHA loans. Whenever possible, under state laws, approved title insurance companies will be used and the applicant will be given the choice as to whether he uses title insurance or a designated attorney. In several states on the West coast, only title insurance is available for closing loans because attorneys do not do title work. For example, in California and Arizona only title insurance is available. The State Director approves a sufficient number of title insurance companies to give the applicant a choice between title insurance companies.

There is no difference in the requirements for title insurance in any state. The title insurance companies are approved by the State Director based on providing a satisfactory title insurance policy, the company's financial condition, reputation for doing business in the area, and which are licensed to do business in the state. There is no control over the costs of title insurance in the National Instruction. However, FHA endeavors to designate attorneys and approved title insurance companies in sufficient numbers in each county to give the applicant a selection of the service he desires. The adequacy of the protection provided by the policy is reviewed by FHA technicians in the state office with the advice of a representative from the Office of the General Counsel.

Question 26. What information, if any, does the National Office require be obtained from builders engaging in "packaging activities?"

Answer. FHA Insruction 444.1, paragraph XI A 1 provides that "Builders, brokers, contractors, and others, including organizations such as those providing self-help assistance, who can provide complete information on the applicant and the house that is to be built, purchased, repaired or rehabilitated may assist in the assembly and processing of loan applications." The county supervisor is responsible for determining that individual "packagers" can perform as outlined in the Instruction, but no specific requirements are set by the National Office. "Packagers" are advised and assisted as follows:

Persons who are planning to "package applications" are provided a pamphlet containing information on the packaging concept, how to start packaging, general

eligibility requirements for applicants, information required in the packaged application and actions taken after the loan package is received. The prospective packager is directed to first contact the county supervisor to obtain detailed information about the eligibility requirements for a loan and the size, type, cost, and location of homes the agency can appropriately finance, and reach a thorough understanding of how to proceed. The packager must provide a completed and accurate application which is dated and signed by the family. The information contained in the application must be correct and the packager is informed of the possible penalties for providing false information. The packager asks the applicant's employer to complete and send directly to the FHA County Office a "Request for Verification of Employment" form if the applicant is salaried. Complete information on the property to be brought, together with an option, a termite certification, plans and specifications of the house and site, including the water and waste disposal systems, a direction map to the property, and a plot plan must also be provided.

Question 27. Do FHA regulations (or other Federal laws or regulations) prohibit packagers from making undisclosed payments or other inducements to induce prospective borrowers to apply for FHA loans?

What precautions, if any, are taken to prevent such practices?

What information, if any, does FHA have as to the extent of such practices?

Answer. No, there is no instruction that specifically prohibits packagers from making undisclosed payments or other inducements to prospective borrowers but we believe the situation is adequately covered by the following explanation. Packagers complete and sign Form FHA-444-12. "Check Sheet for Rural Housing Loan Package" which provides a place for them to indicate and list all forms and materials submitted in the package. Immediately above the space for the packager's signature there is printed, in bold type, a warning which includes the provisions of Section 1001 of Title 18, United States Code relative to the providing of false, fictitious, or fraudulent statements or representations. One of the forms included by a packager is an option. The option should describe all conditions relative to the sale of the property, including payments or other inducements offered to the buyer or offered by the buyer. We can think of only a few select cases where an option would not be involved; such as when a family owns the land and engages a contractor who would package the application and construct the dwelling. Our field staffs are cautioned not to close a loan if they are aware that side agreements or undisclosed agreements exist between the packager or the seller and the applicant.

When we find that a packager has offered a buyer an undisclosed inducement to get him to buy a home, then we take immediate action to stop it and if flagrant, we recommend appropriate legal actions. To the best of our knowledge there have been no flagrant cases that would support legal action.

Question 28. In addition to the Cameron County, Texas, situation, have there been any other instances in which packaging operations have been suspended, either because of inability to process applications in an orderly manner or for some other reason? If so, please identify each such situation and provide details.

Answer. To the best of our knowledge, the agency is not aware of other situations like the one in Cameron County, Texas. We are, however, attaching a recent supplemental list of ineligible, suspended and debarred bidders which may be either packagers or contractors (the majority are contractors because if a packager is involved, we also hold the contractor responsible). A current, complete list will be prepared within three weeks.

Also attached is supplement No. 186 to Office of Plant and Operations Memorandum No. 24.

(NOTE: The material referred to is in the Subcommittee files.)

Question 29. Does FHA have any reason to believe that there may have been instances in which interests of packagers were given priority over legitimate interests of borrowers or the public?

Answer. Yes. Agency reviews, OIG audits and investigations, and GAO audits have indicated that the interests of packagers may have been given priority. Whenever these cases have come to our attention, action has been taken to assess the facts and to initiate appropriate corrective action as necessary.

Question 30. Please provide breakdown of components making up the anticipated 1974 deficit of $89 million, listing the amount attributable to:

(a) interest credits

(b) difference between interest paid and received

(c) loss due to property liquidation (in addition to realized losses, what is extent of future losses anticipated as result events becoming known in 1972? Please provide figures in each of the above categories for 1972 and 1973.

Answer. As shown on the following table, interest credits in 1972 were almost $31 million and the difference between interest paid investors and interest received from borrowers was almost $53 million. (Exhibit E.)

U.S. DEPARTMENT OF AGRICULTURE, FARMERS HOME ADMINISTRATION, DEFICITS, FISCAL YEARS 1972 AND 1973

[In thousands of dollars]

	1972 [1] actual	1973 [1] estimated
Income:		
Interest income:		
Interest on investments	1,458	1,568
Interest on loans receivable pledged for participation certificates	6,771	5,600
Interest on other loans receivable	18,956	26,400
Insurance charges	3,848	5,000
Other interest income	18	30
Other income	941	1,200
Total operating income	31,992	39,798
Expense:		
Interest expense:		
Interest on Treasury borrowings	7,332	11,000
Interest on participation certificates	11,017	9,646
Interest on withheld collections	14,061	19,000
Premium interest to noteholders	53,357	45,000
Interest credits on loans receivable	30,916	80,000
Writeoff of interest receivable	63	76
Other expense:		
Administrative expense		
Concession on block sales (fees to brokers)	4,180	5,930
Loans and other writeoffs	2,621	17,204
Other	712	560
Total operating expense	124,257	18,416
Operating surplus or deficit (—)	—92,265	—148,618
Less: Amounts recovered for participation certificate transactions	3,095	2,488
Net surplus or deficit (—)	—[2] 89,170	—146,130

[1] Fiscal year 1972 deficit is funded in 1974, 1973 in 1975.
[2] Does not add due to rounding.

No figures are available which specifically identify losses due to property liquidation. Such losses are included in the figure shown below for "Loans and other write-offs."

No information is available which would indicate that estimate for losses in future years should be revised.

Question 31. Please describe FHA procedures for collecting loan payments, indicating specifically when loan payments are considered delinquent and what action is taken with respect to delinquent payments.

Answer. Until June 30, 1973, each rural housing borrower signed a promissory note which provided for an annual payment with a due date of January 1 of each year. For loans approved after June 30, 1973, borrowers whose income is earned from salary or wages throughout the year will sign a promissory note calling for monthly payments. Those borrowers whose income is seasonal will sign a promissory note calling for annual installments to be due on January 1 of each year. Payments are made directly to the Finance Office in St. Louis, Mis-

souri, unless the county supervisor determines that the borrower should make his payments to the county office or a borrower becomes delinquent on his loan. In these cases, the county supervisor will inform the borrower that he is to make payments directly to the county office. Borrowers who sign an annual promissory note usually are required to sign a "supplementary payment agreement" which provides for payment on the loan when income is received by the scheduled payment date. The borrower is considered delinquent when the payment is not received by the due date of the promissory note.

The county office staff keeps a record of payments received in the county office. When payments are received in the Finance Office, a transaction record which indicates the amount and application of the payment is sent to the borrower and county supervisor. If the county supervisor does not receive a transaction record, he knows that the payment due was not received by the Finance Office. The county supervisor is then responsible for contacting the borrower, collecting the amount due, providing the supervision needed and servicing the loan account to protect the Government's interest. The state director is responsible for determining that all loans are serviced and borrowers are provided counseling and supervision needed to accomplish the objectives of the loan and protect the interest of the Government.

Question 32. Prior to June 1973, what internal fiscal reports, if any, were provided to FHA national office mangaement which were intended (or could be used) to identify problem areas as evidenced by such factors as foreclosures, abandonments, delinquency rates, etc?

What changes in reporting procedures, if any, are planned?

Answer. Reports are prepared quarterly to inform National Office management of delinquency rates by state and county, by loan program. Semiannual reports are prepared to show property in inventory. This report includes date acquired, inventory value, and if the property is under lease. A report is also prepared semiannually for delinquent Community Services type loans showing by borrower amount of delinquency for the past four years.

An annual report is prepared to show real estate loans liquidated through transfer, sale of property, voluntary conveyance, or foreclosure, and the inventory gain or loss on these transactions.

A study has been undertaken to improve the above reporting procedures. One of their first recommendations will be to combine the total loss on acquisition and disposition of security property in one report.

Question 33. Is FHA satisfied that its national leadership is getting prompt notice of potentially serious problems, where such problems could be disclosed through well designed reporting procedures?

Answer. We would like to have a faster and a surer way of obtaining notice of potentially serious problems. We receive reports from our field staff, from OIG, and from unhappy applicants and borrowers. Lately, with the advent of the Operations Review Program, we have been getting more timely information which allows us to take immediate action on problem situations. In the future, the Property Management Staff and the expanded Data Division, as called for in our new reorganization chart, will enable us to be more keenly aware of potential problems.

We act on this type of information as fast as possible and will continue to work to prevent problem situations to the extent possible.

Question 34. It is customary to provide State Directors with information concerning problems in other areas, even though such problems are not known to exist in their State at that point in time?

Were copies of OIG Report 6171 provided to State Directors? If so, when?

Answer. A semi-annual summary analysis of the OIG findings for each fiscal year is prepared and distributed to all State Directors. We are planning to advise our State Directors of the findings in our Operations Review Program on a quar-

terly basis. OIG Report 6171-2-H was included in the appropriate summary and a copy was provided to each State Director for information and use.

Question 35. What procedures are involved in foreclosures? On what basis is a determination made to follow foreclosure procedures rather than voluntary conveyances or transfers?

How successful has FHA been in collecting deficiency judgments, or amounts otherwise owed on FHA loans, from borrowers whose homes have been foreclosed, conveyed or transfered? Please provide statistics.

Answer. Foreclosure action by the Government is taken in default cases when liquidation action has been decided upon, a substantial net recovery can be obtained on the FHA accounts, and foreclosure is determined to be the most practicable method of liquidation by which the interest of the FHA can be best protected. Voluntary conveyance or transfer is the preferred method of liquidation. However, these methods of liquidation can be used only if the borrower is agreeable to liquidation. Foreclosure or forced liquidation is necessary when the borrower is unable or unwilling to voluntarily liquidate his loan account, or when an intervening lien or judgment which effects title of the security property has been filed and foreclosure is necessary to clear title to the property. In such cases, foreclosure action is taken in accordance with state laws.

The following statistics give information on Rural Housing Judgments, cumulative as of January 1, 1973.

Write-Offs:

Principal, $31,586,019

Interest, $2,394,445

Collections:

Principal, $135,336,069

Interest, $11,161,047

Question 36. Where transfer is made to a buyer not eligible for an FHA loan under normal circumstances, does FHA make a new loan? If so, under what circumstances?

What percentage of transfers, if any, have been made to buyers not using FHA financing?

Answer. When transfer is made to a buyer not eligible for an FHA loan, the new buyer assumes the total outstanding RH debt or that portion of the debt equal to the value of the security property. Repayment terms may not exceed five years for nonfarm property or ten years for farm property, and the interest rate is higher than the interest rate to an eligible borrower. We do not have data as to the percentage of property transfers made to buyers not using FHA financing. If other financing is used, the FHA account is paid in full.

Question 37. Please provide the names of all manufacturers of prefabricated or modular homes known or believed by the National Office of FHA to have sold, or to be selling, substantial volumes of such homes under FHA financing. Where feasible, please give your best estimate of the number of homes involved and the area in which operations conducted.

Answer. The National Office Housing staff has general knowledge and in some cases specific knowledge of manufacturers of prefabricated or modular homes doing business under FHA financing. However, to provide the most accurate information in the time frame available, they called the architects/engineers in seventeen of the various states that were known or thought to be using this type structure. The results reported for FY 1971, 1972 and 1973 are shown in Exhibits F and G. The exhibits list the manufacturers that are doing a substantial volume of business in one or more states. Only those states in which a particular manufacturer is supplying a substantial portion of the total RH program is listed following the name of the manufacturer.

EXHIBIT F

MANUFACTURERS OF PREFABRICATED OR MODULAR HOMES DOING A SUBSTANTIAL VOLUME OF BUSINESS UNDER FHA PROGRAMS—LIST BY MANUFACTURERS

Manufacturer and State	Number of units
National Homes, Inc: Lafayette, Ind., Horseheads, N.Y., Martinsville, Va., Tyler, Tex., Effingham, Ill. (Best homes):	
Georgia	611
Indiana	500
Ohio	236
Virginia	175
Texas	86
Colorado	50
New York	23
South Carolina	10
Mississippi	20
Total	1,711
Pacific Buildings, Inc.:	
Mississippi	993
Arkansas	200
Total	1,193
Kingsberry Homes, Inc. (Also acting as Boise Cascade Co.):	
Alabama	200
Ohio	169
Indiana	175
Arkansas	56
New York	18
Oregon	15
Total	633
Imperial Homes: Georgia	475
Capital Industries, Inc.:	
Pennsylvania	350
New York	50
Total	400
Adrian Homes: Georgia	365
Nationwide Homes, Inc.:	
Virginia	300
North Carolina	10
Total	310
Pease Homes, Inc.: Ohio	270
Butler Homes: Georgia	270
Continental Homes, Inc.: Virginia	200
Poloran Products, Inc. (Operating also as Hauser Homes and American Modular Homes.):	
New York [1]	25
Pennsylvania	150
Total	175
Leatherman Homes, Inc.: Ohio	150
Deluxe Homes: Pennsylvania	100
WECO Homes: Mississippi	92
New World Homes:	
Alabama	40
Mississippi	24
Total	64
Sigma Homes: Alabama	60
Superior Homes (now not on our accepted list, however): Missouri	60
Summey Building and Supply:	
North Carolina	50
South Carolina	10
Total	60
Medlock Co., Inc.: Texas	50
Union Manufacturing and Supply: Colorado	50
Bohemia Lumber Co.: Oregon	40
Lumber Components: Alabama	40
Johnson Manufacturing Co.: Oregon	35
Transamerica Homes: [2] North Carolina	30
20th Century Homes: Missouri	29
Suburban Homes: Indiana	25
Craig's Redibilt Homes: Texas	25
Gibralter Homes: Delaware, Maryland	20
Modular Housing, Inc.: Arkansas	19
Del-Mar-VA-Homes: Delaware, Maryland	18
Century Homes: Missouri	16
Interstate Homes: Colorado	10
Virginia Deluxe Homes: Delaware, Maryland	10
Nanecoke Homes: Delaware, Maryland	10
Wakefield Homes: North Carolina	10

[1] American Modular now out of business.
[2] Transamerica Homes now out of business.

EXHIBIT G

MANUFACTURERS OF PREFABRICATED OR MODULAR HOMES DOING A SUBSTANTIAL VOLUME OF BUSINESS UNDER FHA PROGRAMS—LIST BY STATE

State and manufacturer	Number of units
Georgia:	
National Homes	611
Imperial Homes	475
Adrian Homes	365
Butler Homes (new and very local)	270
Total	1,721
Mississippi:	
Pacific Buildings	993
WECO Homes	92
New World Homes	24
National Homes	20
Total	1,129
Ohio:	
Pease	270
National	236
Kingsberry	169
Leatherman [1]	150
Total	825
Indiana:	
National	500
Kingsberry	175
Suburban	25
Total	700
Virginia:	
Nationwide	300
Continental	200
National	175
Total	675
Alabama:	
Kingsberry Homes	200
Sigma Homes, Inc.	60
Lumber Components Co.	40
New World Housing	40
Total	340
Arkansas:	
Pacific	200
Kingsberry	56
Modular Housing	19
Total	275
Texas:	
National	86
Medlock	50
Texas—Continued	
Craig's	25
Total	161
New York:	
American Modular	25
National	23
Capital Industries	50
Kingsberry	18
Total	116
Missouri:	
Superior [2]	60
20th Century	29
Century	16
Total	105
North Carolina:	
Summey Building Supply	50
Transamerica	30
Nationwide	10
Wakefield	10
Total	100
Oregon:	
Johnson Manufacturing	35
Bohemia	40
Boise Cascade	15
Total	90
Colorado:	
Union Manufacturing & Supply	50
National	50
Interstate	10
Total	110
Maryland:	
Del-Mar-Va	18
Gibralter	20
Virginia Deluxe	10
Nanecoke	10
Total	58
South Carolina:	
National	10
Summey	10
Winston	5
Stylemark	5
Total	30

[1] Very local.
[2] Now not on our accepted list, however.

Question 38. Is FHA national office management satisfied that current conflict of interest regulations are adequate? If not, please give details.

Answer. Yes, they are updated when the need arises.

Question 39. Do FHA regulations (or other laws and/or regulations) prohibit former FHA employees from doing business with FHA within one year after termination of employment with FHA? If so, under what circumstances? If not, is FHA aware of any possible irregularities in connection with activities of former employees?

Answer. An employee may not, after his Government employment has ended, represent anyone other than the United States in connection with a matter in which the United States is a party or has an interest and in which he participated personally and substantially for the Government.

He may not, for one year after his Government employment has ended, represent anyone other than the United States in connection with a matter in which the United States is a party or has an interest and which was within the boundaries of his official responsibility during the last year of his Government service.

Former employees of the FHA and their spouses, and former designated attorneys of the FHA and their spouses, are not eligible to receive loan assistance until one year from the date of separation for the employee or termination of the designation for the attorney, except upon prior approval of the state director. Prior approval will not be given if any advantage would be given to the former employee or his spouse, or the former designated attorney or his spouse, over any other person as a result of his employment or designation by the agency.

The Office of the Inspector General has reported several instances that a conflict of interest existed where former employees were packaging FHA applications for a contractor. There was also an instance where a former employee was working as a manager of a contractor's office in a specific county and acting for that contractor by submitting conditional commitments to FHA.

FHA does not believe that the instances reported by OIG in two audit reports were in violation of the statutory conflict of interest provisions in 18 USC 207 and 208. Neither do we believe they were in violation of any administrative provisions regarding conflict of interest.

The reports revealed no evidence that former employees in their employment with contractors used inside information or the names of rural housing applicants gained while employed with FHA. The facts do not substantiate that the former employees were acting as an agent for the contractors in connection with any official proceeding or other particular matter which was under their official responsibility as employees. There was no evidence that the former employees were negotiating with or had any arrangements concerning prospective employment with the contractors while participating personally and substantially for the Government in any matter in which the contractor had a financial interest. Neither does the evidence reflect that the former employees or their employer gained any advantage or reecived any preferential treatment from FHA because of his former FHA employment.

Question 40. Where existing FHA loans are refinanced through private sources, do the resulting funds become available for relending in the same area? If not, would it encourage refinancing if this were the case?

Answer. No. The resulting funds go to the investor holding the refinanced note or return to the fund and are indistinguishable from other receipts. Since loan funds are generally adequate, the prospect of relending refinanced loans in the same area would provide little change in current operations.

Appendix 17.—Excerpts From OIG Audit Reports Relating to FHA Rural Housing Operations

(A) Subdivision Development and Building Site Preparation

Audit Report—Audit of the Farmers Home Administration Program in Cross County With Headquarters at Wynne, Ark., as of January 11, 1971—Report No. 412-94-T

III—DETAILS

Rural housing program

Subdivision planning and development.—1. Inspection of the FHA-financed Jimmy Ray Subdivision, Cross County, Arkansas, by the Arkansas State Department of Health, as a result of a complaint, disclosed septic tanks were installed too near domestic water wells to meet Health Department regulations. In addition, raw sewage was found in open ditches creating a health hazard. This occurred because FHA had not adequately determined that septic tanks and related facilities installed for dwellings in the subdvision met Health Department regulations before approving loans. A centralized (city) sewer system for the entire subdivision or indivdual dwellings and filtering system with a central collection system for filtered sewage and pumping facilities will be necessary to alleviate the problem. At present, each of the 30 existing dwellings is served by individual water wells and septic tanks.

The Arkansas State FHA Office had halted further loans in the subdivision until the condition is corrected and has issued certain instructions to prevent a recurrence. The subdivision contains 65 building lots. As of December 31, 1970, FHA had approved loans for 30 dwellings for $375,250 on 30 lots.

Details are:

During the audit, Henry N. Means, District Engineer, Arkansas State Health Department, and Douglas Rye, Architect, Arkansas State FHA Office, accompanied by the County Supervisor, visited the Jimmy Ray Subdivision for the purpose of following up on a complaint about the installation of water wells and septic tanks in this subdivision.

Mr. Means advised us that a licensed well driller reported to the Arkansas Well Drilling Board that water wells were being drilled too near installed septic tanks in violation of Health Department regulations. In turn, the matter was referred to his agency for follow-up action.

Mr. Means said his inspection showed that septic tanks and related field lines were installed less than 50 feet from domestic water wells, which was in violation of Health Department regulations and created a health hazard. He stated that septic tanks should be located no less than 100 feet from domestic water supplies to assure Health Department standards are met.

Mr. Means stated that the soil in the subdivision was of the type that had low absorption characteristics. As a result, sewage in individual septic tanks and related facilities had become entrapped. The soil became overloaded with excess water and sewage and caused plumbing fixtures in individual dwellings to function improperly. Mr. Means stated, and we observed, that sewage was backing up from septic tanks and sewer lines into bathroom facilities, creating an unsanitary condition. We noted that several residents had attempted to correct stopped up plumbing by puncturing the soil near field lines and digging small drainage trenches from the end of sewer field lines to a larger drainage ditch. However, this left raw sewage in and around open ditches in the subdivision, creating additional hazards to the health of the residents.

In our sample of borrowers contacted, we found this adverse condition pertained to RH loans made to Borrowers David B. Anderson, Ruddie Hamilton, Enos Mays, Jr., and Lloyd E. Williams.

Borrower Anderson, who had had continuing trouble with his plumbing, told us he had registered verbal and written complaints with H. F. Henson and Sons,

Incorporated, subdivision developer and contractor, and the FHA. At the time of our visit, the sewer line would not function properly as water backed up into the commode when flushed. Also, sewage backed up into the bathtub when the washing machine was used. The borrower's case record showed FHA made followups on the written complaint on December 8 and 29, 1970. Mr. Means advised that tests of the well water of the borrower showed no contamination, at present, but that additional tests should be made at 30-day intervals.

Borrower Hamilton told us water from sewer lines backed up into the bathtub when the washing machine was used. He stated he had not reported the condition to the contractor or FHA.

Borrower Mays stated he began to have trouble with his septic tank about January 1970. The trouble noted was sewage backed up into the bathtub, and the commode seemed stopped up. He had contacted H. F. Henson and Sons, contractor, several times about this problem but had not sought the assistance of FHA. After making several contacts, they finally came out and dug a drainage trench from the end of the field line to the drainage ditch beside the road. Borrower Mays said this did correct the sewer problem inside his dwelling, but there was an offensive odor created outside. He also mentioned that he reported damage to his septic tank to the contractor who promised to repair it, but never had. We noted that the septic tank on this borrower's lot was approximately 35 feet from the water well.

Similarly, Borrower Williams had encountered problems with his sewer system about September 1970. Instead of reporting the condition to the contractor or FHA, he employed the services of Ellis Septic Tank Service in November 1970. This firm cleaned out his septic tank and sewer lines, and he then dug a drainage trench from the end of the sewer field line to the drainage ditch in front of his dwelling. He stated this corrected his problem inside his dwelling but did not provide relief of the problem outside.

We also observed small drainage trenches in front of dwellings owned by FHA Borrowers Clyde E. Baskins, Thomas E. Clements, and William C. Cothern. These drainage trenches appeared to drain sewage from a sewer line into the open drainage ditch in the same manner of those of Borrowers Mays and Williams.

As a result of the visit by Messrs. Means, Rye, and Claxton, noted above, the State FHA Office determined there should be no further loans closed in the subdivision until an acceptable solution was found to eliminate the water and sewage problem and so notified the Cross County FHA Office by memorandum on December 31, 1970.

Also, under date of January 4, 1971, the State office issued Arkansas Bulletin No. 1634 to supplement FHA Bulletin No. 3790 (444). The bulletins refer to "Guidelines for Rural Housing Sites" and make mention that no rural housing loan will be made to finance housing in existing or proposed subdivisions which do not have a central water and sewer system when ten or more dwellings are to be FHA-financed.

Mr. Claxton advised us that he understood from James Henson, Secretary of H. F. Henson & Sons, Incorporated, that he had employed Bond Engineering Company, West Memphis, Arkansas, to assist in finding an acceptable solution to the problems. Mr. Henson stated to us that he was working diligently to try and find an acceptable solution to the problems of this subdivision.

FA should pursue this matter to a satisfactory conclusion to assure the prevailing conditions in the subdivision are corrected. Before RH loans are closed for single dwellings, as well as those clustered in subdivisions, steps should be taken to assure that all Health Department regulations for sanitation will be complied with.

Jodie Anderson, Chief, Rural Housing, agreed with our recommendation. He advised that they were in the process of drafting an additional procedure to implement existing instructions. The procedure will require all FHA borrowers obtaining RH loans to seek the assistance of the Arkansas State Health Department concerning the installation of septic tanks and water wells on their real property, whenever applicable. He further mentioned they were in the process of working out a memorandum of understanding with the Federal Housing Administration, which agency will, in the future, review and make an analysis of all new subdivisions within the State before the State FHA Office authorizes the approval of loans in any subdivision.

III—DETAILS

Rural housing construction

FHA-financed subdivisions.—1. We noted sewer and surface drainage problems and the lack of an adequate access road in FHA-financed subdivisions in this county unit. The following problems, by subdivisions, were disclosed:

Poplar Grove Subdivision—FHA has financed 35 houses in this subdivision (located at Poplar Grove, Arkansas), totaling $284,840. All of the houses except two are served by a central water system and all have individual dwelling sewage disposal systems. At the time of our inspection, we noted raw sewage on the surface of the yards of 27 of the 35 houses in the subdivision. Open ditches draining raw sewage were a common sight. Two houses (Otto Davis and Daniel Drayton) which had been occupied for about one year had not had the bathtubs hooked up and these tubs were draining underneath the houses, causing the inside walls to mildew. Borrower Davis stated that he had contacted FHA and the contractor that built the house about the situation, but he was unable to get the bathtub hooked up during the year he had lived in the house.

In the cases of the two houses served by water wells, we noted that the distance between the water wells and septic tanks was about 50 feet. Arkansas State Health Department (ASHD) regulations require a distance of 100 feet. Individual dwelling sewer systems did not meet ASHD regulations due to the inadequate size of sewer disposal fields. Septic tank field lines were installed within 10 feet of property lines in violation of ASHD regulations. Lot sizes in the subdivision were as small as 50 feet by 100 feet and some houses were closer than seven feet apart. Pictures on pages 9, 10, and 11 of this report illustrate some of the conditions described above.

FHA borrowers living in the subdivision stated that the odor from the raw sewage was nearly unbearable during warm weather. Other people living in the Poplar Grove area stated that the odor from the subdivision was terrible and that the subdivision was a disgrace to the Federal Government because of the raw sewage conditions and the small lot sizes.

Mr. Clifton C. Jackson, Construction Inspector, stated that 200 square feet of field lines were installed for each individual sewer system in the Poplar Grove Subdivision. He stated approximately 450 square feet should have been installed based on percolation rates of the soil.

Mr. David Patrick, Phillips County Sanitarian, stated that the lots in the Poplar Grove Subdivision were too small for adequate size sewer disposal fields. He stated that the raw sewage present on the surface of the yards in the subdivision was a health hazard, and that he would not permit any more houses to be built due to the sewage problem.

The construction contractor and developer of the Poplar Grove Subdivision, Mr. Ike Van Meter of Marvell, Arkansas, stated that he was willing to try to correct the sewer problems in the subdivision.

Mr. Wilson stated that the Rural Housing Specialists in the State FHA Office (Douglas G. Rye and Sherman Williams) had inspected the Poplar Grove Subdivision before and during development, and they raised no objections as to lot sizes, spacing of houses, or septic systems. He stated that Poplar Grove Subdivision was the first subdivision financed by FHA in Phillips County, and he now realized that they had made a mistake in permitting the contractor to build on the small lots and not requiring the dwelling sewer systems to meet ASHD standards. He stated that FHA had discontinued making loans in the subdivision.

Dorothy White Subdivision.—FHA has made six RH loans in this subdivision (located in Postelle, Arkansas), totaling $50,100. Our inspection of this subdivision revealed raw sewage present on the surface of the yards of FHA borrowers. One borrower's back yard (Genoia L. W. Herring) was almost entirely covered with raw sewage. Borrower Herring complained about the odor caused by the sewage and the health hazard involved.

The sewage problems in this subdivision were caused by poor percolation ability of the soil. According to Mr. Jackson, percolation test made after the dwellings were constructed revealed that the soil in this subdivision was not

suited for the septic tank systems that were installed. He stated that FHA did not require percolation tests before the houses were constructed.

Mr. Wilson stated that no further loans were being made in this subdivision. He stated that the contractor had agreed to try to correct the present sewer problems.

Zachary Subdivision.—We noted four FHA-financed houses in this subdivision (located one mile south of Marvell, Arkansas) that were having sewer problems. The borrowers involved stated that during periods of wet weather, their commodes and bathtubs would not drain and in some instances sewage would back up into bathtubs and commodes.

This condition was caused by inadequate surface drainage. Surface water covers the sewer disposal fields during periods of wet weather, and this water saturates the soil to such an extent that sewage cannot be absorbed into the soil, and makes the sewer systems inoperative. Proper surface drainage should eliminate the sewer problems in this subdivision.

Mr. Wilson stated that he would contact the developer of the subdivision and try to arrange for proper drainage.

Batchelor Subdivision.—Six FHA RH borrowers in this subdivision (located six miles south of Marvell, Arkansas) are not served by an access road. At the time of our inspection, the nearest access road was about 150 yards from the dwellings. This condition has existed for six months, and borrowers complained about the inconvenience that the lack of an access road had caused them. Loan funds had not been withheld from the six loans closed to ensure the completion of the access road. See the picture on page 11 showing the incomplete access road which is not usable or accessible in its present condition.

Mr. Wilson stated that when the six loans were closed he did not foresee the problems that developed later in getting the access road constructed; therefore, he did not withhold any loans funds from the builder to ensure that the road was constructed. He stated that he intended to withhold $1,600 from the next four loans closed in this subdivision to ensure that the developer constructs the access road. He stated that wet weather has prevented the developer from constructing the road during the previous six months.

The problems in the above mentioned subdivisions have weakened FHA security interests in the property, caused inconvenience and discomfort to the borrowers, created servicing problems (some borrowers have threatened to quit paying on their FHA accounts if the problems are not corrected), and could result in derogatory publicity for FHA and the Federal Government.

Subdivision planning and development should be strengthened to ensure that future subdivisions have proper drainage, sewage disposal, and access roads. Corrective action should be taken on the problems cited.

Audit Report—Farmers Home Administration, Person County Office, Roxboro, N.C., as of August 16, 1971—Report No. 412-121-A

Building site preparation.—2. Site preparations were inadequate in the majority of FHA constructed houses in the county. The county supervisor said he had not required contractors to perform landscaping in the past in an effort to reduce construction costs. This has resulted in deterioration of the properties lessening their security value. Also, some borrowers will require subsequent loans to correct the conditions noted. Consequently, the Agency's goal of having every neighborhood designed and constructed to assure that it is an asset to the occupants and a credit to the community has not been met.

An example of the problems involved is the case of Borrower Junious L. Poteat, who received an $11,000 rural housing loan on February 18, 1970. This borrower's yard was flooded at the time of our visit. We also detected a strong odor in the front yard and noted water standing on the septic tank location. The borrower said that water stands under the house when it rains, the commode will not flush and overflows, and that surface water drained into the unprotected well. There was no evidence that landscaping had been done.

The county supervisor said he was working on a subsequent loan with Borrower Poteat for landscaping the yard. He said the borrower is now working in South Carolina and he had been unable to work out all the arrangements. According to the county supervisor, the District Sanitarian had inspected this lot, and the District Sanitarian believed that the septic tank problems were due to crushed filter lines coupled with poor site preparations.

Another example was Borrower Pearl Clayton Allen, who received a $14,750 rural housing loan on October 16, 1970. This house had a carport but no driveway had been constructed nor had any landscaping been done. The borrower said the contractor had brought a load of dirt and piled it up in the front yard about a month ago and had not returned. She said the contractor had promised to finish the yard and driveway, but did not do so. The borrower's loan docket showed that no provisions had been made in the construction contract for the driveway or landscaping of the lot.

The county supervisor said Borrower Allen was working out the landscaping arrangements with the contractor. He said that if these arrangements were not adequate, he would seek a subsequent loan and execute a contract for the driveway and landscaping. The contractor was not available for interview.

We visited most of these areas during dry periods. We noted erosion in the housing sites, particularly in the McGhees Mill, Hurdle Mills, and Hicks Heights area. These erosions would indicate that these areas are subject to flooding during wet seasons.

The county supervisor said that in the past, in an effort to reduce construction costs, he had relied on the borrowers to do their own landscaping. He realizes now that the average borrower is not capable of doing his own landscaping, and does not have the funds to hire professional help. He also said he is working on a landscaping plan which will be made a part of the construction contract. In this regard, FHA Bulletin 3790 (444) dealing in part with grading and surface drainage should be used as a guide. He also said he will survey the housing sites for other sites that need improvement.

The Chief, Rural Housing, said the State office issued North Carolina Bulletin 2157, "Improving the Quality of Houses Financed with 502 RH Funds," on August 31, 1971, which deals in part with site preparations as follows:

> 3. *Site Preparation:* Too many houses are being built on sites with serious drainage and other problems. Each site must be properly graded before construction is started. Rough grading as well as finish grading, including walks, drives, seeding and landscaping, should be performed by the contract method with the general contractor assuming the responsibility for completing the work. We cannot leave these items to be performed by borrowers who have neither the equipment nor the ability to do the work.

The county supervisor should fully implement the State Bulletin and include landscaping as part of every construction contract.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, PENDER AND NEW HANOVER COUNTIES, BURGAW, N.C., AS OF FEBRUARY 18, 1972—REPORT NO. 412-195-A

Building Site Preparation.—2. Site preparations were inadequate for some of the FHA constructed houses in the county unit. The county supervisor had not required the contractors to perform complete landscaping in the past in an effort to reduce construction costs. Also, building sites were not properly graded and drained before construction was started in six of 14 houses visited. As a result, some borrowers are experiencing problems with drainage and sewerage systems. Details are as follows:

> Borrower L. J. Ezzell, Jr., received a rural housing (RH) loan of $14,500 on August 26, 1971, for the purchase of a new existing dwelling. The sanitarian had approved this lot for septic tank installation on the condition that ditching around the lot be done. The ditching was not done and the borrower is experiencing problems with the sewerage system. Soil Conservation Service (SCS) prepared an Open Ditch Drainage Work Sheet on January 18, 1972, and the contractor ditched around the lot and extended the septic tank filter lines. The septic tank filter lines are still seeping sewerage. The borrower said the condition was much improved, and that he had been told by SCS and the contractor that the seepage was due to the wet conditions of the lot. They also told him that when the lot is completely drained, the matter should correct itself.
>
> Borrower Clifford W. Horrell received an RH loan of $15,000 on July 9, 1971, for the purchase of a new existing dwelling. This lot is located next to Borrower Ezzell's property and the same conditions existed for both borrowers.

Borrower Morris J. Tatum, Sr., received an RH loan of $15,500 on July 9, 1971, for the construction of a new dwelling, and moved into his house on October 13, 1971. The sanitarian had approved the lot for septic tank installation on the condition that ditching around the lot be done. Landscaping and ditching was not done. This lot was flooded at the time of our visit on February 16, 1972. The borrower's wife said they had not experienced problems with the sewerage system. The lot was too wet and muddy to make a visual inspection of possible sewerage seepage; however, we did not detect any foul odors.

Examples of other problems involved are the cases of Borrowers Clarence H. Giddeons (RH loan of $15,500 on September 24, 1971); Dempsey D. Hoffman (RH loan of $16,500 on September 30, 1971); and Raymond W. Lanier (RH loan of $13,600) on May 14, 1971). Minimum landscaping was done of these lots and all these lots were flooded. We drove onto Borrower Hoffman's driveway and got stuck in the mud. We did not attempt to drive onto the other borrowers' driveways. Borrowers Giddeons and Lanier said they had not had problems with the septic tanks. Borrower Hoffman was not available for interview.

The county sanitarian said that in the past he had been approving some FHA housing sites with reservations because he was aware of the scarcity of good, well-drained building sites in the county. He added that if the lots are properly prepared, minimum lots could be made acceptable. He said in the future he would withhold his approval of the septic tank installations if the lots were not properly prepared.

The county supervisor said that in an effort to reduce construction costs he had required only the minimum landscaping which was in some cases lot clearing. He had assumed that the ditching had been done on Borrower Ezzell's and Horrell's lots. Only after the borrowers complained about septic tank problems did he become aware that the ditching had not been done. These houses were purchased as existing dwellings and the contractor had promised to do the ditching. He had not followed up to ensure that it was done. He said he was aware of the conditions of Borrower Tatum's lot and had instructed the contractor to finish grading and ditching around the lot as soon as possible. He said that heavy rains had delayed the work.

The county supervisor said that because of the rural housing boom, select building sites were scarce. This had required construction in some less desirable areas which require considerable landscaping, and in some instances, ditching was also required to properly prepare the lots.

The district supervisor said site preparations have been a problem because of the costs involved. He suggested that the housing sites be surveyed to determine what is needed to make the sites suitable. Where the costs of site preparations would be prohibitive, the county supervisor would have no alternative other than to reject the site.

The county supervisor should fully implement North Carolina Bulletin 2157 dealing in part with building site preparations. He should require that lots be graded and drained before construction is started. Also, he should provide a detailed landscaping plan in the construction contract to include ditching, where necessary.

SPECIAL AUDIT OF SUBDIVISION LOAN ACTIVITIES—FARMERS HOME ADMINISTRATION, GUERNSEY AND MUSKINGUM COUNTIES, WITH HEADQUARTERS AT CAMBRIDGE, OHIO, AS OF MARCH 8, 1972—REPORT NUMBER 402-4-N

III—DETAILS

Subdivisions.—1. Action was needed at the State Office level to assure that the County Office strengthen its review of applications for housing in subdivisions. Our reviews disclosed that about $385,000 in RH loans had been made for housing in the West Muskingum subdivision where the well water supply was marginal, and possibly unsafe; streets were gravel, steep and eroded in many places, with no assurance that required hard surfaced streets would be established. These conditions were particularly significant since the contractor plans to construct 40 more homes in the subdivision. Also, RH loans have started to be made in another 40-lot subdivision which had gravel streets and for which no assurance was obtained that hard surfaced roads would be established. These conditions existed because new procedure regarding subdivisions was not properly applied. Consequently, the borrowers in these subdivisions may not have received the decent, safe, and sanitary housing prescribed by FHA, and this could ulti-

mately affect FHA's security and prevent the borrowers from graduating their loans.

On November 23, 1970, FHA issued the FHA Bulletin 3790 (444) entitled "Guidelines for Rural Housing Sites." This bulletin stated:

"Situations have developed recently in which essential facilities such as water, waste disposal, streets and surface drainage systems did not comply with local and state requirements and FHA regulations. In some cases there was inadequate assurance that community types of water and waste disposal systems would continue to provide adequate service and that the rates would be reasonable. Unacceptable installations have been noted in newly developed subdivisions, on sites in existing subdivisions, and on scattered lots."

"The enclosed 'Guidelines for Rural Housing Sites' is designed to assist you until more detailed guides are developed."

These guidelines stated is part ". . . in subdivisions of more than ten homes, loans for new homes with individual well or septic tanks may be approved only if the State Director determines that central systems are not feasible in the subdivision or community in which it is located . . ." These guidelines further stated in effect that hard surfaced streets are mandatory when the street serves, or will serve more than 10 sites in the foreseeable future. The general rule is that if a private developer will hard surface the streets, homes will be occupied only after streets are completed. Under certain conditions the final finish may be postponed if warranted by seasonal weather problems. In such cases however, an all weather street must be provided prior to occupancy. A performance bond or similar assurance must be provided by the builder-developer to assure that the streets will be completed within one year. If a local public body will provide final hard surfacing then subgrade and base must be properly prepared. Written assurance should be obtained from the public body that suitable hard surface will be provided within a reasonable period, usually not more than a year.

The following subparagraphs detail the water and road problems we noted:

Streets.—Streets in the pubdivision were inadequate. We observed that many of the streets in the subdivision, which were gravel, were eroded because they were located on very step terrain. Also, the street condition has had an adverse affect on borrowers' yards. This was specifically noted in the case of borrower Jerry C. Nicholson. His front yard was badly eroded caused by drainage from the road, and gravel had washed from the road onto his yard.

Our interviews with the contractor and township trustees disclosed that they have no intention to hard surface the roads in the subdivision. The township trustees pointed out that they do not have funds to hard surface them and cannot take them over because of an inadequate base, too narrow, etc. They said that the streets would have to be in nearly perfect condition before they could take them over because the subdivision is located in a very steep area, which would allow for easy erosion.

The County made loans in this subdivision without any assurance that the streets would be hard surfaced (15 of the 22 loans were made after the FHA 3790 bulletin was issued). The County Supervisor said that this was done because the Chief, State Office, Rural Housing, had verbally informed him that it was proper to continue making loans in existing subdivisions, even though the provisions in this bulletin would not be met.

He said that he met with the township trustees regarding streets in the West Muskingum subdivision and they informed him that they did not have sufficient money to hard surface them. He added that he thought FHA has the responsibility for continuing to make loans in these areas because FHA had indicated to contractors that they would loan to eligible applicants. Also, he thinks that FHA should continue to make loans in the subdivision to low and moderate income people because if they do not, somebody else will make loans to higher income people in the same area. In his opinion, if they stop making loans in subdivisions existing prior to November 1970, it will reduce their loan making considerably. Also, by making loans in subdivisions, they can make more loans with less administrative time.

We interviewed the State Office Chief, Rural Housing, who confirmed that he had verbally informed the County Supervisors to continue making loans in subdivisions underway at the time Bulletin 3790 was issued, but which were not meeting the provisions of the bulletin. He said that when the Assistant Administrator for Rural Housing visited the West Muskingum Subdivision around May 1971, the Assistant Administrator voiced his displeasure over the subdivision not having hard surfaced roads. At that time he (Chief, Rural Housing) changed his position on the necessity for hard surfaced roads. He

now believes that they were needed even though a subdivision was started prior to the issuance of Bulletin 3790.

Another example of a subdivision not meeting the new FHA guidelines for roads was the Crestmont Estates Number 3 (Jack Newcome Subdivision). No assurance had been obtained regarding hard surfaced roads. The County Office contended that an assurance was not needed because the subdivision was laid out prior to the issuance of FHA Bulletin 3790. This subdivision was laid out for 40 lots. Lots 1–13 will face a hard surfaced main road, while lots 14–40 will have a gravel road. The tract map on this subdivision was prepared on September 28, 1970. Three FHA loans had been made in the subdivision. A rural rental housing loan of $57,000 on November 20, 1970, and two RH loans ($17,400 and $17,500) on August 17, 1971.

We informed the State Office Chief, Rural Housing that the County Supervisor in Cambridge still believed that FHA would continue making loans in subdivisions without hard surfaced roads, when the subdivision was started prior to November 1970. He said that they probably have not sufficiently clarified the State Office's position regarding subdivisions.

All houses in the West Muskingum Subdivision were financed by FHA. The reason for this appears to be the contractors' sales advertising which was geared to selling to FHA borrowers. An example of this advertising was the classified ad run in the Zanesville Times Recorder for all of December 1970. The ad was as follows:

"We have really got a good thing going for you. It has to be good when you can buy a new 3 bedroom home in West Muskingum Subdivision with water and sewer, full basement, large bath, nice kitchen with lots of cabinets, built-in range and ready for occupancy including 100 by 150 foot lot for $17,500 with nothing down and 7¼% interest."

After discussing the problems with the County Supervisor, he stated that they have no plans to approve any more loans in the West Muskingum Subdivision until they have central water and hard surfaced roads. He said they had taken this position as a result of the questions we raised. During the audit, they informed the contractor that until he established a definite plan for providing a dependable water system to present and future homes in the subdivision, no additional FHA loans in the subdivisions would be approved. At our exit discussion on regular Audit No. 412–37–N, management advised that there was a good chance of getting central water into the West Muskingum Subdivision. The County Supervisor said that the Marysville Water District is open to having the subdivision included on their water system. He said the contractor was contacting people to see if they would be willing to become users.

The State Office should assure that the County Office discontinue making loans in subdivisions that do not comply with, or have no plans for complying with, FHA subdivision requirements. Also, continued efforts should be made to have the subdivisions cited meet FHA requirements. Further, it can be seen that the causes of the conditions reported herein were not limited to the County Office. Therefore, all counties should be informed in writing as to the State Office's position regarding the requirements of FHA Bulletin 3790 (444). Additionally, the State Office should determine whether similar problems exist in other counties, and where found, take action to have subdivisions meet FHA requirements.

State officials advised that the County Office was taking action to have wells tested in West Muskingum Subdivision. Also, State officials said they will: (1) ensure that all houses in the West Muskingum Subdivision have adequate and safe water; (2) see that subdivision requirements have assurance of being met before more loans are approved; (3) issue written instructions to County Offices to clarify subdivision requirements; and (4) ascertain whether other County offices are having similar problems.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, STOKES COUNTY OFFICE, DANBURY, N.C., AS OF DECEMBER 20, 1972—REPORT NO. 412–221–A

III—DETAILS

Loan supervision and servicing

Subdivision Planning and Development.—1. Better planning during development of the Timberline subdivision could have prevented conditions that may lessen the security value of about 90 rural housing (RH) loans secured by Gov-

ernment mortgages totaling $1,300,000.00. Erosion caused ditches, of depths from three to four feet, in front and rear of FHA financed houses. Septic tanks malfunctioned in some instances due to building sites not being properly prepared. Dwellings constructed are basically of the same design and give a stereotyped appearance to the subdivision. The county supervisor needs to evaluate these conditions and take corrective action prior to approving and closing loans in this and other subdivisions of the builder.

Subdivision Planning.—In planning the Timberline subdivision, sufficient consideration was not given to drainage which has caused erosion. The subdivision was built with the street running up and down hills and most of the drainage was toward streets and away from borrower dwellings. Provisions were not made to provide guttering or underground storm sewers, which are needed because of the rapid flow of water down hills. Ditches, three to four feet deep, have eroded in front of the houses.

The county supervision stated that attempts were made to anticipate problems that would occur as the subdivision was developed. However, the magnitude of the drainage problems was not fully realized until the erosion appeared. In some instances, the builder, Fortis Enterprises, has made some corrections, such as cementing sewers that collect and carry away drainage in central areas.

Building Site Preparation.—Native cover was destroyed in preparing the building sites. This was to construct houses on concrete slabs, to expedite building of the houses, and to facilitate loan making. Most of the houses are basically of the same design and are located to give a stereotyped appearance to the subdivision. Also, erosion problems noted above, and septic tank problems noted below, are the result of these site preparations.

AUDIT REPORT—FARMERS HOME ADMINISTRATION PROGRAM, CRAIGHEAD COUNTY FHA OFFICE, JONESBORO, ARK., AS OF JANUARY 22, 1973—REPORT No. 412-220-T

III—DETAILS

Rural housing program

Street Development in Subdivisions.—1. Rural Housing loans totaling approximately $280,000, involving about 20 dwellings, had been made in four different subdivsions which were not served by adequate streets. Steps had not been taken to assure completion of planned street improvements.

FHA Bulletin 3790 (444), dated November 23, 1970, requires subdivision streets to have properly prepared subgrading and bases. Final hard surfacing may be provided later by local public bodies if assurance is obtained in writing that such surfacing will be provided within a reasonable time, usually not more than one year.

The requirements of the above noted FHA Bulletin were not followed in four subdivisions served by the County Office. Street conditions in the subdivisions are discussed below:

Coleman and Blaylock Subdivisions—Assurance agreements had been obtained from public officials in these communities to provide street hard surfacing within one year. Over one year had elapsed at the time of our audit and hard surfacing had not been provided. The streets in the Coleman subdivision were poor, and we noted that streets in the Blaylock subdivision were so poor that they were practically impassable during wet weather.

Ozbun Subdivision—Written assurance for street hard surfacing had been obtained from public officials in September 1972, but the agreement had not been honored. Streets were all but impassable at the time of our inspection in January 1973.

David Subdivision—Rural Housing loans had been made in this subdivision without any agreement for street improvements. Streets were in poor condition. A letter of assurance for street hard surfacing was obtained from public officials during the audit.

Mr. Garnet McDaniel, Acting County Supervisor, stated that the assurance agreement was overlooked in the case of the David Sudivision. He stated that he was powerless to enforce street completion in these subdivisions if public officials did not honor the agreements.

The State Office should provide assistance to the County Office, as necessary, to assure completion of street improvements by the public bodies involved. In future cases, steps should be taken to assure that contractors provide adequate street subgrades and bases before Rural Housing loans are approved.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, COFFEE AND ATKINSON COUNTY OFFICE, DOUGLAS, GA., AS OF APRIL 6, 1973—REPORT NO. 412-235-A

III—DETAILS

Loan supervision and servicing

Subdivision Development.—1. The Kirkland Heights Subdivision was not fully developed before Rural Housing (RH) Loans were made to three borrowers. The extension of the new city sewage system proposed for Kirkland Heights was not constructed and streets were not paved or adequately graded to provide proper drainage. The former county supervisor (CS) did not follow FHA guidelines for rural housing sites in new subdivisions or specific instructions issued by the State office regarding requirements to be met by this subdivision before making loans. Three homes were completed and were being occupied by the RH borrowers. The development plans for the streets and sewers have still not been carried out. The families were experiencing flooding conditions after heavy rains and difficulty in reaching their homes through the muddy streets and drives. In addition, two homes had to have temporary individual septic tanks installed, which had become inoperative and were a health hazard to the families. Moreover, the contractor who built the homes and held an option on the other building sites, had filed a petition for bankruptcy, and no further development of the subdivision is planned at the present time.

FHA Bulletin 3790 (444), dated November 23, 1970, provides guidelines for rural housing sites and the development requirements for new subdivisions. Full development should be completed and approved systems in operation before RH loans are closed.

In our review of records we noted that the following RH loans were made for homes located in the Kirkland Heights Subdivision, Pearson, Georgia, in Atkinson County:

Borrower William B. Core received an RH loan of $14,000 on December 22, 1971 for a home to be constructed by the Clement Construction and Supply Company, Inc., on lot No. 1, Block-B of the subdivision.

Borrower William R. Moore received an RH loan of $12,950 on November 29, 1971, for a home to be constructed by the same builder on Lot No. 2, Block-B.

Borrower Areletha C. Churchill received an RH loan of $13,350 on August 2, 1971 for a home to be constructed by the same builder on Lot No. 6, Block-A.

Our visit to the subdivision and interviews with the three borrowers disclosed the following conditions: The installation of individual sewage disposal systems was approved by the County Health Department for temporary service until the city sewer lines could be extended to the homes of Borrowers Core and Moore. At the time of our visit, both borrowers complained of inoperative septic tanks and sewage backing up into the houses. We observed ditches in the back yards of both homes which had been dug by the borrowers to relieve the backed-up condition. The ditches were filled with sewage.

Borrowers Core and Churchill complained of flooding in their yards after heavy rains because adequate street drainage had not been provided. Water was standing in the front yard of borrower Churchill and the dirt drive could not be used. Borrower Core had a similar problem but had relieved the condition by digging a ditch across his yard to the street.

In a letter dated August 26, 1971, the City of Pearson, Georgia, advised the District Supervisor that the city was obligated only to maintain the street paving and water and sewage system in the Kirkland Heights Subdivision and was not responsible for their construction.

In a letter dated September 7, 1971, the State office outlined the requirements for street paving and drainage. It also required that the extension of the sewage system proposed for the subdivision be completed and in operation and that no loans be made until all the requirements had been met.

In a letter dated September 21, 1971, the State Office authorized loans to purchase two houses under construction, Core and Moore, provided the city first provide water and sewer service to these houses.

These instructions were received prior to closing the loans of borrowers Core and Moore, but were not complied with. Borrower Churchill's loan had already been closed; however, construction on the house had not started when the instructions were received. Due to the distance between the existing city sewer line and Churchill's original building site, the borrower exchanged Lot No. 6 for Lot No. 2

in the same block. The new building site could be connected with the existing sewer line. This was the basis on which the construction of Churchill's home was permitted by the County Office even though the requirements of the subdivision development had not been met.

We contacted the City Superintendent of Public Works, who told us that the city had no plans to develop the existing sewer system to serve Kirkland Heights Subdivision. He said a survey was being made to determine the feasibility of extending the existing sewer line to serve the two homes not presently connected. Service would be limited to these two homes and a connection fee of $100 per house would have to be charged if the extension could be made.

We were informed by the County Office that the builder had filed petition for bankruptcy on February 8, 1973 and that any recourse the borrowers had with the contractor would not result in correcting the conditions noted.

The county supervisor said that he had received word from the City Superintendent of Public Works that the city sewer lines would be extended to serve the homes of Borrowers Core and Moore.

The county supervisor should continue to encourage the city of Pearson, Georgia to extend adequate sewage lines to the homes built under the Rural Housing Loans in the Kirkland Heights Subdivision, as planned, and to develop adequate streets and drainage facilities. Also, this area should be considered ineligible for future Rural Housing Loans until adequate facilities are provided and the subdivision development is completed in accordance with FHA requirements. The borrowers should be required to restore and maintain the operation of the temporary sewage systems until no longer needed.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, LAMAR, MONROE AND UPSON COUNTIES, BARNESVILLE, GA., AS OF MARCH 27, 1973—REPORT NO. 412-237-A

Building sites

Selection and Preparation—Subdivisions.—2. In four of the five subdivisions in this unit, we found indications of inadequate preparation and development of building sites. We found improper drainage, an unsatisfactory well, and general dissatisfaction among the borrowers.

FHA bulletin 3790 provides that waste and water disposal systems must be designed to meet state and local requirements. The bulletin also provides that hard surfaced streets are mandatory except under certain circumstances.

We visited the following subdivisions:

Sutton—The roads in this subdivision are inadequate. Large holes are in the streets, which make them difficult to travel, especially during rainy weather. The water and sewer systems were private. The county sanitarian told us several lots had been subdivided and commitments taken before the Health Department was consulted. He stated that private water systems would not have been recommended for this area due to the topography and other features of the land; instead, a central system would be highly recommended. In this connection, we interviewed one of about five borrowers in this subdivision. This borrower's water had heavy deposits of iron in it. The floor of the pump house was covered with iron deposits. The tile in the shower had been tarnished from the iron. The borrower told us she could not wash clothes because the iron stained them.

Fletcher Heights, Hillcrest and Willis Heights Subdivisions—There were about 8, 20 and 5 FHA financed houses, respectively, in these subdivisions. The roads in these subdivisions were inadequate. One borrower in Willis Heights told us he thought the roads would have been paved by now. He had been living in this subdivision for a year. He added that, prior to buying the house, the broker told him that the streets would be paved and street lights erected. This influenced him in purchasing the home. Conditions in Fletcher Heights and Hillcrest were similar.

These conditions have generated borrower complaints, have lessened the value of the property and tend to defeat the Agency's goal of neighborhoods that serve as an asset to the people who live in them and a credit to the community. The C/S told us that no more houses will be built in these subdivisions until the streets are paved.

The C/S should coordinate with applicable officials prior to the development of future subdivisions. He should work with county governments in an effort to bring streets up to FHA standards.

Loan supervision and servicing

Building Site Preparation.—2. Proper site preparation and landscaping could have prevented drainage and sewerage problems. These problems occurred because FHA county offices have relied on the borrower method rather than the contractor method to perform grading and landscaping. Also these problems could be prevented by coordination with Soil Conservation Service (SCS) in selection and preparation of building sites. Drainage and sewerage problems were noted in 75 of 153 individual housing sites and in 14 of 33 subdivisions (242 FHA houses) in 15 of the 23 county units. Three of the 14 subdivisions were started before the guidelines for FHA subdivisions were effective. The FHA investment in the above houses totals about $4,669,360.

Guidelines for development of rural housing sites are in FHA Bulletin No. 3790 (444). This bulletin recommends that FHA obtain technical assistance from available State and Federal Agencies concerning roads, drainage, water supply and waste disposal systems. FHA Instruction 424.5 dated February 7, 1973, now requires county offices to obtain SCS advice concerning the types of soil and characteristics that may cause drainage problems and SCS recommendations for solutions. Also, N. C. Bulletin 2157 dated August 31, 1971, was updated in July of 1972 to require each building site to be properly graded before construction is started. This bulletin urges that rough grading as well as finish grading, including walks, drives, seeding and landscaping, be performed by the general contractor because these items cannot be left to the borrowers who have neither the equipment nor the ability to do the work.

Subdivision Planning.—Generally, county office personnel have not requested the assistance of Soil Conservation Service (SCS) concerning the site preparation for proper drainage prior to the approval of the subdivisions. SCS recommendations and proper implementation could have prevented the flooding of housing sites and soil erosion caused by the lack of water control in 14 subdivisions in nine counties. (See Exhibit B for listing of county units and number of subdivisions per unit.) Because of inadequate drainage, raw sewerage has overflowed the septic tank lines in subdivisions in the Danbury, Hertford, Kenansville and Winton County units. It was apparent that the excessive moisture had caused damage such as warped floors and cracked walls and could have caused other defects noted in Details—3. Also, 18 borrowers in two subdivisions have obtained subsequent loans of about $10,000 to improve the sites and correct drainage problems. In four subdivisions, the building sites have not been properly cleared of uprooted trees and brush, resulting in unattractive appearance of lots. All parts of the roads have not been accepted by the State for maintenance in three subdivisions. Two of the subdivisions were started prior to current instructions which provide that the roads are to be State maintained. (See Exhibit C for examples of conditions noted in the subdivisions.)

Individual Housing Sites.—Exhibit B of this report is the listing of the nine county units where site preparation was inadequate for individual housing sites. In six counties, the county office has relied on RH borrowers to perform the grading and landscaping on individual housing sites in an effort to reduce construction costs. Borrowers lacked the funds, equipment, and experience to do this, and consequently, site preparations were inadequate, or not performed. Also, the borrowers have been slow and did not properly complete the development work. Where landscaping was to be done by the contract method in the other three counties, the construction contract did not specify the landscaping work to be done and in two of the counties the contracts did not include funds for the landscaping. This had resulted in inadequate landscaping and site preparations that caused flooding, erosion, overflowing septic tank lines, and wetness under houses. FHA Bulletin 3790 (444), FHA Instruction 424.5 and the Minimum Property Standards handbook require adequate landscaping and provide instructions for layout.

The following are examples of damage from inadequate landscaping. Landscaping was done by the contract method in the Williamston County unit; however, ditching or complete site preparation was not done. The septic tank filter lines were seeping sewage in the wards of five borrowers. The borrowers said the commodes overflowed when it rained. The county sanitarian said the septic tank installations for four of these borrowers' houses were approved during a dry period. He now recommends cutting a drainage ditch or building up the lot to

correct the drainage and sewerage problems. Also, moisture damage such as buckled floors, separated floor boards, and buckled ceilings were noted in the houses of two of the borrowers.

Our visits to 19 individual building sites in Johnston County showed that nine lots had drainage problems. The county supervisor said he realized that there was a problem with wetness under the houses and water standing in the yards. He said that they were working on this, but had not stopped the problem.

Moisture condensation caused damage to two houses in the Pittsboro County unit and could damage four others where the same moisture condensation conditions exist. The building sites had not been property graded or prepared. The houses of two borrowers showed evidence of damage from moisture condensation. The kitchen cabinets have separated from the ceiling in one house and the molding has separated from the ceiling in the bathroom and living room of the other house. We noted standing water or wet soil, damp floor joists and eroded yards at these houses and the houses of three other borrowers.

The Marshall FHA county office has permitted landscaping to be done by the borrower method in an effort to reduce costs. The borrowers are experiencing drainage and sewerage problems. The FHA county office did not include funds in their estimates for services planned to be performed by the borrowers. Consequently, houses remain without finished grading and sufficient funds are not available to complete the development.

We visited 18 houses in the Sylva county unit. At 13 sites, we noted standing water or wet soil under the houses and eroded yards. Also, the septic tank lines were seeping sewerage into the yard of one borrower. The borrowers in six instances were to complete the landscaping which was not done. Also, complete grading was not provided by the building specifications when the work was to be performed by the contract method.

Most drainage and sewerage problems cited, especially in low lying areas, could have been prevented through coordination between FHA and SCS and requiring the building contractors to perform the site preparation and landscaping. These sites could have been made suitable by proper ditching and filling before construction started. SCS officials in the counties told us FHA had rarely sought their advice on the suitability of building sites. Further, closer supervision by the State Office could have assured that counties were obtaining expert advice concerning site location and preparation.

The county supervisors said they relied on borrowers to do landscaping in an effort to reduce construction costs and the pressure of other work precluded follow-up to assure that the work was done. They were aware of the services available from SCS, but did not consider it feasible to have SCS inspect each and every housing site. At the time the houses were built the sites were determined by the county health department to be adequate for septic tanks according to the county supervisors. Most of the county supervisors concerned said that they did not possess the technical ability to foresee the problems which arose, but could now see that additional landscaping and drainage will be required for many of the housing sites and recognize the necessity of coordinating with SCS.

The FHA State Office recognized the importance of proper site preparations and issued N. C. Bulletin 2157 in August of 1971, revised in July 1972, to encourage landscaping by the contract method instead of by the borrower who normally does not have the ability or the equipment. Also, the Joint Memorandum on Cooperation between the FHA National Office and SCS was executed on August 11, 1972, and consisted of a reaffirmation of the services of SCS available to FHA. The FHA State Office reaffirmed this memorandum at the State level and informed all counties of this action in January of 1973. State Office officials said that in the past FHA Instruction 444.8 Exhibit A, was used as a guide, but this instruction did not require coordination with SCS and did not contain much information on grading or drainage. They also stated that a series of meetings with county office personnel was planned for instruction in planning and performing site development work. They said that on individual sites, where the borrower can do his own grading and landscaping, they should be allowed to reduce the construction cost. Further, they are reluctant to make an iron clad rule that landscaping be done by the contract method where the borrower has the equipment and ability to do his own landscaping. In these cases, they will instruct the county supervisor to require rough grading before the start of construction and finsh grading to be completed when the house is completed, with inspections by the county supervisor. They said that they would take action to

correct problems as found in older subdivisions that were started before FHA guidelines were effective.

The planned training program should be initiated as soon as possible to insure that all FHA personnel responsible for individual site and subdivision development are properly trained. The services of SCS should be used consistently in the selection and preparation of building sites. A survey should be made of all existing subdivisions throughout the State, and action taken to discontinue construction on all improperly developed subdivisions until all drainage, road and sewerage problems are corrected. As a minimum, the State office should issue guidelines to the county offices to assure that all borrowers that are allowed to perform their own site preparation and landscaping are fully qualified and have resources to complete the development.

EXHIBIT B

SITE PREPARATIONS—SUBDIVISIONS

County unit	Number of subdivisions visited	Number of subdivisions with inadequate sites	Total number of houses in subdivisions with drainage/sewerage problems	Total amount of loan funds on these sites
Danbury	1	1	90	$1,300,000
Greenville	12	3	33	450,210
Hertford	2	2	11	184,000
Kenansville	3	1	6	93,100
Laurinburg	1	1	2	26,650
Louisburg	3	2	38	532,000
Smithfield	5	1	5	74,400
Tarboro	1	1	22	350,000
Winton	5	2	35	550,000
Total	33	14	242	3,560,360

Note: See Details—2.

EXHIBIT B

INDIVIDUAL HOUSING SITES

County unit	Number of sites visited	Number of sites with drainage/sewerage problems	Total amount of loan funds on these sites
Bakersville	14	9	$135,600
Greenville	15	9	139,700
Hertford	14	6	46,350
Marshall	12	12	184,100
Pittsboro	40	6	98,550
Sanford	13	3	45,000
Smithfield	19	9	137,000
Sylva	18	13	198,790
Williamston	8	8	123,910
Total	153	75	1,109,000

EXHIBIT C

SUBDIVISION PLANNING

(See Details—2)

Danbury County Office—The Timberline subdivision was built with the street running up and down hills and most of the drainage was toward streets and away from borrower dwellings. Ditches, three to four feet deep, have eroded in front of the houses. Failure of septic tanks to properly function was a problem in the low lying area of the subdivision where landscaping had disturbed the natural formation of the land. Six of the 11 borrowers interviewed in or near the low lying area, had or were experiencing some septic tank malfunctions.

Greenville county unit—We visited 12 subdivisions following a period of heavy rainfall, and noted some flooding in all the subdivisions, but the worst conditions existed in the Imperial Estates (13 FHA houses), J. W. Harrells (five FHA houses), and Emory Wood (15 FHA houses) subdivisions. The county supervisor

had discontinued financing FHA houses in the Emory Wood and Imperial Estates subdivisions. Some roads in these subdivisions had not been accpted for maintenance by the Highway Commission as the subdivisions were begun prior to the time FHA guidelines on subdivisions were effective. The subdivisions are located on low-lying areas which were flooded at the time of our visit. An FHA borrower, resident of Emory Wood Subdivision, said the school bus would not pick up the children in certain areas of the subdivision because of the condition of the roads. Six houses in these subdivisions have visible damage due to excessive moisture. Subsequent RH loans of $10,000 have been made for 18 borrowers to improve the sites and correct drainage problems. Although the houses were built before the FHA guidelines on subdivisions were effective, the county supervisor had taken the initiative in correcting these conditions to protect the Government's loan investment. Also, in the J. W. Harrells subdivision, the builder left uprooted trees and brush on the sides and back of borrowers' yards.

Kenansville County Office—Portions of the back yards in the King Subdivision (15 FHA houses) had not been completely cleared of tree stumps and roots, nor had the back yards been planted to grass. An SCS representative said the area of the subdivision is between two or three water sheds. Usually such areas are wet low-lying areas. The Duplin County Health Department Sanitarian said he had disapproved about five lots in the subdivisions for septic tank installation because the sites had a high water table. One borrower had to extend the nitration lines of his septic tank to prevent the lines from overflowing.

Hertford County Office—The building sites in the J. G. Wood (six FHA houses) were not properly graded to be suitably related to natural drainage ways and prevent erosion on or adjoining the sites. At the time of our visit, there were indications that the entire subdivision had recently been flooded. A block and lot drainage plan had been developed for the contractor by an engineering firm; however, the plan was being implemented lot by lot as the houses were sold. The SCS technician said the land as it is, is not suitable for housing sites because of flooding. Two building sites in the Four Forks subdivision (5 FHA houses) were not properly prepared or graded to be free from flooding. The yards of two borrowers were flooded and signs of soil erosion were noted on the housing site of these borrowers. Flooding caused the septic tank filter lines to overflow and seep into the back yard of one house. The contractor also left uprooted trees and piled up brush in back of the borrowers' yards.

Winton County Office—Septic tank malfunctions were noted in two of the five subdivisions in the county unit. The Brinkly subdivision contained 17 FHA financed houses. Three borrowers interviewed complained that the septic tanks filled with water causing slow drainage from the houses. In the Bryantville subdivision, we observed sewage bubbling from the septic tank fields of two of the 20 FHA houses. The county supervisor said there is a widespread problem with septic tanks in the county and people must adjust to using as little water as necessary to prevent septic tank flooding.

(B) Water and Sewage Disposal Systems

Audit Report—Farmers Home Administration, Missouri State Office and Selected County Offices, Columbia, Mo., as of April 9, 1971—Report No. 402-1-K

III—DETAILS

Water and sewage disposal systems

1. Water and sewage disposal problems existed in eight FHA County Units. Individual sewage disposal systems were installed in lots too small to provide adequate septic tank absorption fields; were located in areas where the soils were not suitable as absorption fields; and, in some cases, were not properly constructed. In six subdivisions where the majority of dwellings were financed with RH loan funds, effluent was not properly absorbed in the soil and represented a public nuisance and a health hazard. These conditions existed, in part, because (1) technical services from State and County health authorities were not fully utilized during the design and installation of individual sewage disposal systems, (2) soil surveys and other soils information developed by SCS soil scientists were not used to plan and design sewage systems, (3) systems were not always inspected during construction to assure proper installation, and (4) guidance from the State Office was limited in this area. Some County Offices had not required

recommendations from Missouri Geological Survey and Water Resources for wells drilled with loan funds. Details are as follows:

a. *New Madrid County (New Madrid)*—Individual water and sewage systems in the M. J. and W. V. Conran Subdivision were not properly planned, designed, and installed. All of the 15 houses constructed on this tract were financed with RH loan funds. Interviews with borrowers in the subdivision disclosed that the drinking water was discolored and produced an offensive odor. Effluent from individual sewage disposal systems had saturated about one acre of the subdivision, and represented a public nuisance and a health hazard to the community.

The FHA County Office had an oral agreement with the County Sanitarian to design and inspect sewage systems but not water systems. The Sanitarian had approved four sewage systems in the subdivision. However, the lots were not large enough to provide an adequate subsurface absorption field, and he was unable to design systems that would meet requirements of the Missouri Division of Health. The Sanitarian said that his agreement with FHA did not include questioning the size of the lot. Rather, he assumed the County Supervisor had the authority to build houses on lots that did not meet minimum lot requirements of health authorities. He informed us a community waste stabilization lagoon was needed to alleviate the problems.

b. *Scott and Mississippi Counties (Sikeston)*—Two individual sewage disposal systems for dwellings located in the Haraway Subdivision (also called the "Pinhook Community") in Mississippi County were not functioning properly. Effluent from both systems was flowing on the surface and represented a potential health hazard for the homeowners and other residents of the community. One system failed to meet minimum FHA building requirements. The specifications for both systems showed a lack of correlation between family size and septic tank capacity. Also, the County Office had not used services available from county health officials during the design and installation of sewage systems.

Interviews with county health officials serving Mississippi and Scott Counties revealed that FHA had not sought their advice and assistance as had other Federal Agencies having housing programs. Both officials informed us they had no authority to inspect these systems unless requested but would be happy to do so.

c. *Stoddard County (Bloomfield)*—FHA was financing the construction of dwellings with individual sewage disposal systems in an area (Peaceful Acres Subdivision in Essex, Missouri) where the soil is not suitable for use as septic tank absorption fields. The subject subdivision is located about 2 miles from the Pemmerton Addition, an FHA-financed subdivision, which has been experiencing serious water and sewer problems since 1967. The water and sewage problem in the Pemmerton subdivision is being reviewed further and a separate report will be prepared.

Our visit to 3 of the 15 borrowers with dwellings located in the Peaceful Acres Subdivision disclosed that effluent was flowing to the surface causing dissatisfaction to the borrowers and a health hazard. In one instance a borrower's 7-year-old daughter contacted hepatitis, which may have been caused by the open sewage. Discussion with homeowners in Peaceful Acres and surrounding areas, disclosed that in and around Essex, Missouri, the soil is not suitable for on-site sewage disposal systems because the area is seepy with a seasonal high water table. Stoddard County is not served by a county health official.

d. *Phelps, Maries, and Pulaski Counties (Rolla)*—RH borrowers in the Cool Brook Estates subdivision were experiencing problems due to inadequate septic tank sewage disposal systems. Sewage from the disposal systems was flowing on top of the ground and creating potential health problems. Also, a borrower living in another area was experiencing similar problems with his sewage system. The individual sewage systems were not inspected by local health authorities. The health offcials expressed concern over the fact that FHA personnel were not contacing them on water and/or sewages. They stated soil in this subdivision was not conducive to individual spetic tanks.

e. *Newton and McDonald Counties (Neosho)*—Individual water and sewage systems were not inspected and/or approved by applicable State and County health authorities. Twelve wells financed by loans in our sample were drilled without recommendations from the Missouri Geological Survey and Water Resources as required by Missouri Administration Letter 116(424). Individual sewage disposal systems for 24 dwellings were not developed in accordance with conditional commitment requirements and/or the "Guide for the Construction of Farm Buildings." Effluent from one system was flowing on the surface and causing a potential health hazard. The services of the Newton County Sanitarian had not been used during the installation of systems under his jurisdiction. He advised

that percolation tests should be performed for individual sewage systems, especially in subdivisions.

f. *Washington and Jefferson Counties (Potosi)*—Individual sewage systems were not always inspected by County Office personnel during construction. Visits of five homes in Washington County, where local health officials did not approve or inspect sewage systems, disclosed that two septic tank systems were not installed to meet FHA requirements or those recommended by the Construction Inspector. One system had effluent surfacing at the end of the lateral line.

g. *Taney and Stone Counties (Forsyth)*—Two individual sewage systems located in the Murphy's Addition were installed on lots that were too small to provide adequate absorption fields. Effluent from both systems had been drained into an open pit. One community well for two dwellings was not approved by the Missouri Division of Health.

h. *Bates and Cass Counties (Butler)*—One dwelling lacked an acceptable sewage disposal system. Effluent emptied through drain tile that was not connected to a septic tank.

The State Office has recently issued two bulletins pertaining to new requirements for sewage and water systems. However, these directives lack sufficient detail to assure prescribed requirements are uniformly inplemented by County Supervisors. On March 24, 1971, the State Director issued Missouri Bulletin No. 1233 (444) which states, in part, ". . . no RH loans will be approved or commitments issued involving a septic tank waste disposal system unless the local health department will provide a written notice of approval of the septic tank for the individual case file." Another bulletin to be issued states as follows: "With reference to health department clearance for septic tanks, the National Office requires certification from the Health Department that the septic tank is properly installed. This will require inspection during construction. For wells, we will need to have a sample tested by the Health Department. If the water does not meet standards, a chlorinator or other device will be installed."

The bulletins provide little guidance to the type of agreement to establish with local health departments. For example, development of inspection guidelines and responsibilities to be used by both agencies is needed to provide an appropriate plan of action. In regard to testing water supplies, clarification is needed as to what standards are applicable since there are different types of water tests. Some tests consider purity alone without considering other factors that affect suitability for domestic use.

State Office officials expressed concern as to how sewage systems in some counties would receive proper inspections. The Chief of the Rural Housing Staff estimated there were about 72 Sanitarians serving certain counties in the State. He stated Sanitarians in 5 counties were presently inspecting and approving sewage disposal systems. In addition, he estimated a total of 30 counties could be serviced in this manner. He commented that it was not always practical (especially in southern Missouri) to follow recommendations for drilled wells from the Missouri Geological Survey and Water Resources.

Since the characteristics of soils in certain areas influenced some of the problems, valuable information and assistance could be obtained from the Soil Conservation Service. "Soils and Septic Tanks," Agriculture Information Bulletin 349, prepared by the Soil Conservation Service provides detailed information on the proper relationship between soils and septic tank sewage disposal systems. It states, "In planning a septic tank sewage disposal system, first find out if the soil can absorb the liquid sewage, the effluent, that flows from the septic tank."

In addition, it provides ". . . some soils, regardless of the size of the lot, are not suitable for use as septic tank absorption fields." The bulletin provides that soil surveys published by SCS in cooperation with State agricultural experiment stations and other Federal and State agencies can be used to predict the behavior of a sewage absorption field with reasonable accuracy.

The State Director should take the following actions: (1) instruct District Supervisors to take action to assure County Supervisors obtain appropriate recommendations for drilled wells from the Missouri Geological Survey and Water Resources; (2) establish guidelines for sampling water from individual wells to ensure the water is pure and suitable for domestic use; (3) require County Offices, where applicable, to establish working agreements with county health departments that define inspection responsibilities for sewage and water systems; and (4) advise County Supervisors to contact local SCS District Conservationists and Soil Scientists to obtain advice and assistance pertaining to planning and designing sewage disposal systems in relation to soil characteristics of proposed building sites.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, LENOIR COUNTY, KINSTON, N.C., AS OF JULY 9, 1971—REPORT NO. 412-92-A

III—DETAILS

Rural housing

Building Site Preparation.—1. The county supervisor did not use available technical assistance from Soil Conservation Service (SCS), resulting in borrowers in Farmers Home Administration (FHA) and HUD-Section 235 financed dwellings experiencing problems with sewerage systems in the Forest Hills subdivision. The HUD-Section 235 loans were processed by FHA. This condition occurred because the county supervisor did not seek the advice of SCS in connection with this subdivision. SCS would have recommended ditching to reduce the high water table.

Forest Hills subdivision contained nine occupied dwellings, 21 plotted lots, and 13 more lots planned in the future. Two of the residents of this subdivision are FHA borrowers with loans totaling $25,800. Four HUD-Section 235 loans in this subdivision totaling about $56,000 were processed through Farmers Home Administration. Of the nine residents seven had experienced septic tank malfunctioning problems. The developer had dug a ditch at the rear of the houses which had corrected some of the problems; however, four residents, including one FHA borrower, were still experiencing problems with the septic tanks.

Residents complained that sewerage backs up in the toilet stools and seepage stands in the backyards when it rains. Seepage was observed standing in the backyard of one resident. We were informed by the residents that the developer had been notified of the situation and he had worked on some of the septic tank filter lines. The FHA office had not been notified nor was it aware of these problems.

The septic tank installations had been inspected and approved by the County Health Department. The Sanitarian Supervisor, Lenoir County Health Department, said he did not use SCS soil data, but relied on percolation test results to determine the feasibility of septic tank installations. He said that if the water table level is found to be too high, the septic tank installation is not approved until the builder or developer corrects the condition. Percolation tests taken on May 6, 1969; October 16, 1969; February 11, 1970; and April 9, 1970 in the Forest Hills subdivision showed the water table level to be at an acceptable level for septic tank installations.

The District Conservationist, SCS, made a preliminary survey of this subdivision on July 22, 1971. He described the soil in this subdivision as Leon soil which has severe limitations on septic tank filter fields because of the high water table. He found the water table on July 22, 1971, to be 24 inches which was average for Leon soil during seasonal low water table. According to the District Conservationist, this water table level is too high for proper septic tank functioning. He said that proper ditching would reduce the water table to an acceptable level, and he would provide planning assistance upon request from FHA or the developer to reduce the water table.

The developer of this subdivision said he was aware of the septic tank malfunctionings, and he had dug some ditches to reduce the water table. He said that he will do additional ditching, or whatever is necessary to correct the situation.

The county supervisor said he had not received any complaints of septic tank malfunctionings in this subdivision nor had he been aware of the problems there. FHA Bulletin 3790 (444) dealing in part with site preparation was not operative at the time this subdivision was developed; however, the county supervisor said he is now consulting with SCS on soil data.

The county supervisor should discontinue financing dwellings in areas that are experiencing sewerage problems until existing problems have been corrected by the developers.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, PENDER AND NEW HANOVER COUNTIES, BURGAW, N.C., AS OF FEBRUARY 18, 1972—REPORT NO. 412-195-A

III—DETAILS

Rural housing

Individual Water Systems.—1. The county supervisor did not ensure that individual water systems were tested for bacteriological content prior to making the final inspections in compliance with North Carolina Administration Letter 23

(424), Approval of Individual Water and Waste Disposal Systems. The Pender County Health Department had not tested well water for FHA financed houses in the county until six weeks to three months after the families moved into the houses because the wells had not been chlorinated. The procedures in effect in New Hanover County were satisfactory. As a result, some FHA borrowers in Pender County were using drinking water that was unfit for human consumption.

The Pender County Health Department sanitarian said the county supervisor had required the testing of individual water systems, but had not required the wells to be chlorinated. He said that a water test on an unchlorinated well would in all probability return positive. The sanitarian had been letting the system flush itself out before taking the water sample, usually six weeks to three months after the families moved into the houses. Thus far, water samples taken after the system had cleaned itself had been negative.

The sanitarian added that he recognized that a change in procedures was necessary, but the pressures of other work had prevented him from making these arrangements or bringing them to the attention of the county supervisor. He had been annotating on Forms FHA-NC 424-3, Health Authority Approval—Individual Water Supply and Sewage Disposal Systems, that a water sample test would follow and approving the individual water system. His approval at that point meant that the installation of the individual water supply system complied with N.C. State Board of Health Bulletin 476. He said that when he received the water sample results, he mailed them to the borrowers, and did not notify FHA of the results. He said he has now instructed the contractors to chlorinate the wells as soon as the system is connected, and that he would withhold his approval until the water sample results were received. He would in turn furnish the results to FHA.

The county supervisor said he had relied on the Pender County Health Department approvals and was not aware that the water samples had not been taken before the final inspections were made. He said that New Hanover County was served by the Consolidated Board of Health, New Hanover County and City of Wilmington, and that these matters were handled through them. He had assumed that Pender County was following these same procedures. He said he had accepted the Pender County sanitarian's certification on Forms FHA-NC 424-3 as approval of the individual water system, and had closed the supervised bank accounts assuming that the county health department had chlorinated the wells. He added that he had not been aware that it was the responsibility of the contractor to chlorinate the wells. During the audit he contacted the contractors and they said they would chlorinate the wells as soon as the systems are connected. In this manner, the water sample results would be known before the final inspection date. The county supervisor should fully implement North Carolina Administration Letter 23 (424) to ensure proper bacteriological testing of individual water systems prior to making the final inspections.

SPECIAL AUDIT OF SUBDIVISION LOAN ACTIVITIES—FARMERS HOME ADMINISTRATION, GUERNSEY AND MUSKINGUM COUNTIES WITH HEADQUARTERS AT CAMBRIDGE, OHIO, AS OF MARCH 8, 1972—REPORT NUMBER 402-4-N

The following subparagraphs detail the water and road problems we noted:

Water Supply.—Our reviews of loan files and interviews with bank and well drilling personnel revealed that the quantity of well water was marginal in the West Muskingum Subdivision. All 22 houses in this subdivision were financed by the Farmers Home Administration for approximately $385,000.

We interviewed 19 borrowers in this subdivision. Several complained about the inadequate supply of water from their wells. One borrower complained that they could not drink the water because of the taste, and one family moved from the subdivision because of the supply and quality of the water. Borrowers interviewed also complained about the road condition in the subdivision.

Some of the borrowers comments are shown below:

Fred Mealey—They do not drink water because of taste. They drink the water from their sister-in-law's house.

John B. Holzschuher—They do not drink the water because of taste (house located next to Mealey's). They moved out of the house and contractor Rodgers bought it back from them.

Michael Martin—Mrs. Martin said if they watered their yard, then she would be unable to do washing for the rest of the day. In commenting on the roads, Mr. Martin said that he tore the muffler system off his car.

Peter Rapol—They do about two or three washer loads of clothes and then run out of water. It takes a couple of hours to build back up. They do not water their yard because they would run out. They were wondering what they were going to do this winter because the roads are so steep.

Robert Wetzel—(Note: This house built by a different contractor who had bought a lot in the subdivision). There was not enough water and they can only do one load of clothes per day. They have to choose the use to which their water is put (i.e. cannot water lawn and take bath).

Virgil Pickerill—Roads are very poor.

Richard Stoops—Dust from roads affects them quite a bit.

Thomas Davis—Big holes in roads caused him to drag the bottom of his car numerous times.

Jerry Nicholson—During the winter he had a wrecker come out several times to pull him out of ruts.

Our interview with the Vice-President of the Mutual Federal Savings and Loan of Zanesville, Ohio, also raised a question regarding the water supply in this area. He stated that he questions whether there is sufficient water for people to live there. He said that they had trouble getting water in that area of the County. He wonders what the area will be like five years from now, and if owners will be able to get their money out of the houses.

We interviewed a driller of wells in the West Muskingum Subdivision. He said that the flow rates for the wells were generally what he would consider not adequate. Eleven of the flow rates were three gallons or less per minute and he thought an adequate supply would be four to five gallons per minute. However, he thought most of the wells in the subdivision were adequate because they had a large drawdown (supply of water in well casing). This was confirmed by our review of well logs which showed drawdowns ranging from 75 to 130 feet. This would indicate water supplies ranging from 150 to 260 gallons.

The well driller also informed us that the "Big Engine Salt Water," a ridge of porous sand approximately 3 miles by 21 miles, runs about 300 feet below the West Muskingum Subdivision. This prevented the drilling of deeper wells to increase the water supply in well casings, because of salt water that would be encountered.

Our reviews of Forms FHA 422–8, Appraisal Report, disclosed five instances where the Assistant County Supervisor had shown the water supply to be inadequate based entirely on the water systems' low flow rate (3 gallons per minute). However, he subsequently explained to us that the borrowers had a sufficient supply of water because of the amount of water in the well casings in addition to their water flow rate.

County officials stated that the only guidelines they had regarding water quantity was Farmers' Bulletin 2237—Water Supply Sources for the Farmstead and Rural Home. This bulletin showed the quantity needed in gallons per day (e.g., 30–70 gallons per day per person). However, it made no reference to peak periods. Based only on the number of gallons per person per day, it would appear that a 3 gallon per minute well would be sufficient.

In our opinion, the well should be able to meet water demands during peak periods. We obtained a book prepared by the Midwest Plan Service, entitled "Private Water Systems," which gave information regarding peak use rates. It pointed out that a correctly designed water system will supply the quantity of water needed every day throughout the year. Additionally, it will deliver water at a rate that will meet the temporary large demands that occur each day. The book showed how to estimate the peak use rate and stated that the home water systems should be capable of supplying the peak use rate continuously for one hour.

The houses in the West Muskingum Subdivision have 1½ baths with 3 bedrooms. The Midwest Plan Service Book cites a peak use rate of 10 gallons per minute for such houses. Based on this rate, most houses in the subdivision have an inadequate water supply. For example, a 3 gallon per minute well with 200 gallons of storage would not supply the 600 gallons needed for one hour (peak use rate).

Most of the families in the subdivision were young and had three members or less. Based on peak use rates, there could be a future problem when the size of the family increases.

In addition to the supply of water being marginal the quality of water is questionable. This was based on the comments of borrower Fred Mealey and former borrower John B. Holzschuher previously mentioned. At our suggestion borrower Fred Mealey requested a water test from the Muskingum County Department of Health. The sample taken on January 12, 1972, was a "Total Coliform Bacteria Test." This test indicated the water was unsafe due to some type of pollution.

State officials believed that this borrower might not have unsafe well water. County officials had heard that the water sample was taken from a cistern.

We pointed out that the borrower informed us the sample was taken from his water tap. He said the cistern connecting to his water system was turned off. However, based on the questions raised, he plans to have health officials take a water sample from his well again during March 1972.

At the time borrower Mealey obtained his loan, there was no FHA requirement for well testing, nor was there a requirement by the Department of Health Until the borrower requested it during the audit, the water had not perviously been tested.

Our reviews disclosed that the County office had not requested the Department of Health to test any of the wells covered by the 15 loans approved in the West Muskingum Subdivision after November 23, 1970 (the date FHA Bulletin 3790 (444) was issued). That bulletin stated in part . . . "Individual wells should be tested for quantity, chemical quality and bacteriological quality . . ." County officials said they had just not complied with this requirement.

The water problem noted in the subdivision raises a question as to whether FHA will be able to have homes refinanced in the future. The Vice-President of the Mutual Federal Savings and Loan, Zanesville, Ohio, states that they would loan only about 50 or 60 percent of the value of the property instead of its usual 90 percent. Officials of the First National Bank, Zanesville, and the First Trust and Savings, Zanesville, were also interviewed. They indicated that they did not want to refinance loans in areas where water problems exist.

Roy Keely, Chief, Rural Housing, State Office, said that they probably had not been adequately following up to determine whether counties are complying with FHA requirements. He did point out that they have recently issued a bulletin (Ohio Bulletin No. 1128) dated February 8, 1972 (during the audit) emphasizing individual water and waste disposal requirements.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, TENNESSEE STATE OFFICE, NASHVILLE, TENN., AS OF MARCH 23, 1972—REPORT NO. 402-12-A

III—DETAILS

Loan processing and supervision

Water and Sewage Systems.—1. Follow-up action is needed by the State office to insure that all counties fully implement FHA requirements relative to private water and sewage systems in FHA financed rural housing. Our audits disclosed that private water and/or sewage systems were either not being tested or certifications of approval by local health departments were not obtained in 16 of 27 units audited. Furthermore, in five counties, septic tanks in private sewage disposal systems did not always meet the minimum liquid capacity standards. Counties have generally been slow in implementing the water and sewage requirements thus permitting health hazards to occur and remain undetected.

Guidelines and requirements for private water and sewage disposal systems in FHA financed housing are covered in FHA Bulletins 3790 (444) and 3925 (444). Also, Tennessee Bulletins 1097 and 1106 have been issued that pertain to this same subject. We believe these guidelines and requirements are sufficient; however, they are not being effectively implemented at the county level and no specific follow-up has been made by the State office to assure compliance.

Ineffective implementation of the water and sewage requirements was reported in Bedford, Cannon, Fentress, Hamilton-Rhea, Hardin-Wayne, Henry, Johnson, McNairy, Macon, Overton, Roane, Rutherford-Williamson, Scott, Shelby, Tipton and Unicoi-Carter county units. Septic tanks with insufficient liquid capacities were noted in Cannon, Hardin-Wayne, Overton, Roane and Scott Counties. In at least two counties (Cannon and Tipton), we reported specific instances of raw sewage flowing from the field lines of private sewage disposal systems. Such conditions endanger the health and safety of FHA borrowers and the general public.

All counties should be instructed to fully comply with the guidelines and requirements of private water and sewage systems in FHA financed housing. Also, State office supervisory personnel should follow-up on this matter when visiting county offices and take appropriate corrective action on any instances of noncompliance.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, STOKES COUNTY OFFICE, DANBURY, N.C., AS OF DECEMBER 20, 1972—REPORT NO. 412-221-A

Septic Tank Malfunctions.—Failure of septic tanks to properly function was a general problem in the low lying area of Timberline, where landscaping had disturbed the natural formation of the land. Six of 11 borrowers interviewed in or near the low lying area, had or were experiencing some septic tank malfunctions. The problems had been corrected for Borrowers Stroud, Lambertus, and Blake, but had not for Borrowers Kiser, Niten, and Zigler. The county supervisor had not been contacted by the borrowers concerning these problems.

The county sanitarian stated that part of the reasons for the septic tank malfunctions is due to the preparation of the building sites. He stated that the earth has been moved around in such a manner that the natural tendency to absorb effluence is disturbed.

The county supervisor stated that Fortis Enterprises came into the office with an idea to build from 50 to 100 houses each year. They wanted the approval of FHA so that houses could be sold under the rural housing program. To build this number of houses each year, Fortis Enterprises wanted to prepare sites that support houses with basic design features. Also, the location of the dwelling on the lot was to be the same throughout the subdivision. The county supervisor stated that he had recommended to Fortis Enterprises that all native cover should not be destroyed, and that the houses should not be located in such a manner to give a monotonous appearance to the subdivision. However, Fortis Enterprises stated that to build on such a large scale, it was necessary that plans and arrangements not be variable. The county supervisor stated that septic tank conditions were corrected when the developer was contacted. The county supervisor also stated that problems incurred due to drainage have been corrected on the subdivision being planned and built in Walnut Cove, North Carolina.

The security value of these government secured loans could be weakened unless prompt action is taken to correct these conditions. The malfunctioning septic tanks present a health hazard, and the gullies and ditches are dangerous to the safety of the borrowers and their families. Stereotype construction and appearance give a monotonous appearance to the subdivision. These conditions do not reflect the purpose for which the rural housing program was intended, which is to provide safe and sanitary housing to eligible borrowers.

Approving and/or closing loans should be discontinued until the erosion and septic tank malfunction problems are corrected. In the future, attempts should be made to design and locate houses in such a manner as to avoid the monotonous appearance of straight line and stereotype construction.

AUDIT REPORT—FARMERS HOME ADMINISTRATION PROGRAM, CRAIGHEAD COUNTY FHA OFFICE, JONESBORO, ARK., AS OF JANUARY 22, 1973—REPORT NO. 412-220-T

Individual Dwelling Sewage Disposal Systems.—2. Serious sewage disposal problems were being experienced in the FHA-financed Midway Subdivision caused by soil conditions which prevented adequate functioning of individual dwelling septic systems. The County Office was continuing to make additional loans in the subdivision in spite of the known soil problems.

The Midway Subdivision consists of five FHA-financed dwellings with loans totaling $66,210. Five additional dwellings are planned in the subdivision, and FHA conditional commitments have been issued. We interviewed four borrowers in this subdivision and three of them were having problems with their sewage disposal systems. The borrowers interviewed stated that raw sewage backed up into bathtubs and commodes and the systems would not operate during periods of wet weather. Raw sewage was surfacing in the yard of at least one borrower (M. Christine Reid) creating an odor problem and health hazard. This borrower's loan was closed in May 1972.

Mr. Hosea McDaniel, Craighead County Sanitarian, stated that the dwelling septic systems would not function properly because the soil in the subdivision had poor percolation and was not suitable to accommodate the septic systems installed.

Mr. Garnet McDaniel agreed with the conditions as reported but pointed out that an engineering survey had indicated the soil would be suitable for household septic systems. He stated that, in view of the problems already experienced, he would cancel the existing conditional commitments and would try to correct the existing sewage problems.

Appropriate action should be taken to correct the existing sewage disposal problems in the Midway Subdivision. No additional FHA RH loans should be made in this subdivision until the existing problems have been corrected and steps taken to avoid similar difficulties in the future.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, COFFEE AND ATKINSON COUNTY OFFICE, DOUGLAS, GA., AS OF APRIL 6, 1973—REPORT NO. 412-235-A

Construction defects

2. We visited, and interviewed, 12 borrowers of Rural Housing Loans and found that six of the houses contained construction defects which the recipients had not corrected themselves, or had been unable to get corrected by the contractors, and one of the houses was incomplete when the final inspection was performed by the county supervisor. This condition was caused, in part, by the bankruptcy of the contractor on five of the homes; failure of the contractor on one of the homes to abide by his warranty obligation; and, in part, by the reluctance of the borrowers to correct such defects and incompletions themselves. Failure to correct such defects will result in the accelerated deterioration of the buildings because of exposure to water saturation and weather, and economic loss to collateral on which the FHA loans were secured.

Instructions in FHA 424-1 in part, set forth the responsibility of the contractor to comply with all the terms of the contract before final payment is made and during the warranty period of the contract. The instructions also provide that borrowers have the responsibility to maintain the structures in good condition throughout the life of the loan to insure that the interest of FHA is protected.

Cases noted were:

Borrower William B. Core—The septic tank sewage system was not functioning properly. The borrower said that water was backing up into plumbing in the bathroom and sinks. The borrower also said that he had to dig up the sewer line to get drainage. At the time of our visit, raw sewage was standing in an open ditch dug by the borrower.

Borrower William R. Moore—The septic tank sewage system was not functioning properly. The borrower said that water was backing up into plumbing in the bathroom and sinks any time that they used the system in rainy weather, or any time that they used their automatic washing machine regardless of the weather conditions. They used open drainage ditches to prevent the sewage system from flooding the home during the above conditions.

The septic tank sewage systems for the two homes noted above had been approved as a temporary sewage facility by the Atkinson County Health Department only until public sewage lines could be extended into this area. The temporary approval was based on the very low-lying area in which these homes were located. (See Details—1 for improper subdivision development for FHA Housing.)

Borrower Billie R. Purvis—The septic tank sewage system in this home was not functioning properly. During rainy weather water would back-up and overflow into the bathroom when the commode was flushed. This home was constructed out of concrete blocks, and moisture would seep through the north wall when it rained.

Borrower Joseph A. Tomberline—The kitchen cabinets were separating from the ceiling in this home, and the formica counter top surface had separated at the back where it was sealed to the cabinet back.

Borrower James W. Townsend—Water leaked into the home around the front door when it rained. Water also entered a bedroom through a broken window pane. The brick veneer had cracked around the windows and doors in four

places allowing moisture to enter the home during rains. There was no insulation installed on three sides of the utility room, and only over part of the area of the fourth side which joined the kitchen and dining room area of the home. This allowed cold wind to enter the living area of the home, making this area very uncomfortable in the winter months. One of the stove burners had been inoperative from the day of occupancy, and improper plumbing fixtures had been used under the kitchen sink, resulting in an overflow of water under the sink.

The former county supervisor performed the final inspection on this home on January 9, 1973. At that time the utility room was incomplete, and the broken window and improper plumbing fixtures were discussed by the contractor, borrower and the supervisor. At this time, according to the borrower, the contractor promised to return the following week and correct the defects. On the basis of this promise, the final inspection report had been signed by the borrower and the supervisor without the defects being noted on the report. The contractor failed to return as promised.

The contractor of the five homes noted above declared bankruptcy, leaving the borrowers little or no recourse for getting the cited defects corrected. Since the responsibility for the corrections and completions apparently will rest with the individual borrowers, the CS should use available methods, including subsequent loans, if feasible, to correct the defects and insure that the interest of FHA is protected.

Borrower Thomas J. Moffett—The septic tank sewage system was not functioning properly, causing water to back up into the bathroom when the commode was flushed. The contractor failed to finish brick veneer corners properly in the carport, leaving holes large enough for rodents to enter the building. The hole in the eve providing entrance for the utility service pipe was much larger than the pipe, leaving holes large enough for rodents and insects to enter the building. The screws mounting the window shutters had pulled loose from the brick wall, causing the shutters to bang against the wall during winds.

The above defects had been brought to the attention of the contractor and the CS. The CS should insist that the contractor abide by his warranty obligation which was still in effect.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, NORTH CAROLINA STATE OFFICE, RALEIGH, N.C., AS OF MAY 23, 1973—REPORT NO. 401-19-A

Individual Water Systems.—4. The FHA county offices have been slow in implementing the RH program provisions for obtaining bacteriological tests of individual water systems. In 11 counties, bacteriological analysis of the water was not on file for 92 of 219 loan dockets we reviewed for houses with individual water systems completed in 1972 and 1973. Generally, the tests were not obtained because the county offices had relied on building contractors to obtain the water tests or did not assure the local sanitarians obtained tests. In two counties, the sanitarians said they did not have the time or were reluctant to make the tests, and in one county, the county supervisor falsified the water test forms. (See also Details—1.) As a result, at least 22 borrowers in five counties were using water unfit for human consumption. Positive steps are needed to insure that all county offices obtain bacteriological tests of individual water systems.

FHA Bulletin 3790 (444) was issued in November 1970 to notify the county officers of the need for testing individual wells for bacteriological content. In April of 1971, North Carolina Administration Letter 23 (424) outlined the steps to be taken to ensure satisfactory water supply for individual wells. Final inspection of an FHA financed house, which permits the borrower to move into the house, is not to be made until the Health Department's approval of the individual water system is obtained.

Following is a listing of county units where the water was not tested.

County office	Number of—			
	Loans reviewed	Houses with wells	Wells not tested	Test results positive
Carthage	20	5	4	3
Caswell	29	21	19	9
Danbury	17	13	13	(2)
Hertford	26	11	6	(2)
Louisburg	138	98	8	[1] 8
Marshall	14	12	9	1
Nashville	25	10	3	(2)
Pittsboro	23	9	8	1
Reidsville	20	7	7	(2)
Sanford	31	13	13	(2)
Snow Hill	20	20	2	(2)
Total	363	219	92	22

[1] This review was made in the investigation. (See Details—1.)
[2] In these counties, the local sanitarians have not found contaminated water in the county and we did not request they make tests of old wells for purpose of the audit.

The county supervisors are not fulfilling their responsibility of seeing that water tests are made. The county supervisors have relied on the contractors and county sanitarians for ensuring that the water tests are made. An example of this is the reply by the county supervisor to our audit of Stokes county, with headquarters at Danbury. The county supervisor replied, "The auditor was told that it was our opinion that the decision as to whether the test would be made lies with the sanitarian." Apparently, this county supervisor is not aware that the testing of water is an FHA requirement, not that of the health department. Following are some of the reasons given in the counties for not obtaining water tests.

In Carthage, four loan dockets did not contain the results of a water sample test. The county supervisor said that he notifies the county sanitarian of the need for the water test and septic tank approval prior to making the final inspection of the house concerned but the county sanitarian is reluctant to complete the paper work involved.

In Marshall County, a bacteriological analysis of the water was not on file for nine of the 12 houses of which five were not complete, but the borrowers had moved in. The county sanitation had not tested the water for these borrowers because he said the individuals would not inform him when they were ready for the tests. The county supervisor said he had relied on the sanitarian to obtain the water tests.

The county sanitarian in Sanford said he had not been requested to test the water, but he did not have the time or the personnel for the testing. He said he would furnish supplies and training for FHA personnel to collect water samples for tests.

None of the individual water systems in the Danbury unit have been tested. The county sanitarian said he had not been requested to test the water. The county supervisor does not think testing is necessary because the new State regulations for installations provide for protection from surface water and most of the wells were deep wells. He said that the county sanitarian did not have time to make these tests.

In Hertford, the county supervisor relied on the contractors to obtain the water tests. This they did not always do. In four instances, the water was not tested because the contractors had not yet called for a water test. The borrowers were already living in the houses.

The district sanitarian for Pittsboro had not tested the well water because the wells did not have a protective cover, or pump house, as required by the North Carolina Board of Water and Air Resources. He said regulations prohibited him from making a bacteriological analysis of water from wells that do not meet the

Board of Water and Air Resources requirements. The county supervisor had assumed the county sanitarian had been inspecting and taking water samples. He said that he received the Health Department approval forms from the county sanitarian. While the forms were not completed, they had been signed by the sanitarian.

Our review of district supervisor reports at the State office showed that only one district supervisor reported that a county office (Hertford) was not obtaining water tests from the health department. There was no indication that corrective action had been taken in the county. Also, our audit at Hertford showed that this condition has continued.

State Office officials said that spot-checks had been made to ensure that county offices complied with North Carolina Administration Letter 23 (424). They said the district supervisors had been charged with the responsibility to ensure that county offices complied, and while some problems had been reported, they had assumed that these were resolved.

County Offices should be reminded that the testing of water is an FHA requirement and the responsibility for ensuring that this requirement be met lies with FHA. Necessary follow-up should be made by State office personnel to insure FHA policy on bacteriological testing of water is carried out.

(C) Construction Inspections

Audit Report—Farmers Home Administration Program, in Lafayette County, With Headquarters at Lewisville, Ark., as of December 31, 1970—Report No. 412-96-T

Rural Housing Inspections and Appraisals.—5. Individual appraisals and inspections were not performed on dwellings in an FHA-financed subdivision. Commitment procedures were not being followed although the dwellings were being constructed for resale to FHA borrowers.

At the time of our review, FHA had made fourteen loans in the Price Addition to the town of Stamps, Arkansas. All dwellings in the Price Addition were constructed by Red-Val Industries, Inc., of Garland City, Arkansas. Dwellings were constructed in this addition without any FHA inspections during construction, and were sold to low income families who subsequently received FHA loans to finance the purchase. Although FHA loans were the only financing available for dwellings in this subdivision, commitment procedures set forth in FHA instructions were not being followed.

All loans in the addition were for $10,850. An appraisal and inspection were made on the first dwelling in the addition on which a loan was made. The thirteen subsequent loans were made without an appraisal and in some cases, without any construction inspections being made of the dwellings. Appraisal reports in these 13 borrowers' files consisted of copies of the original appraisal.

Mr. Rice stated that since all the dwellings in the addition were of the same design and construction, he saw no need to make separate appraisals or periodic construction inspections on each dwelling. He acknowledged that he had not inspected all the dwellings before the loans were closed.

Mr. Carl Ingram, District Supervisor, stated that he had received verbal instructions from the State Office that all FHA-financed dwellings would be appraised and inspected before loans were closed. He stated that he understood that written instructions to this effect were being issued to interested county supervisors.

Separate appraisals and inspections should be conducted on all dwellings constructed for FHA borrowers to ensure that houses are properly appraised and construction meets FHA standards.

AUDIT REPORT—AUDIT OF THE FARMERS HOME ADMINISTRATION PROGRAM IN PHILLIPS COUNTY AND PARTS OF DESHA AND MONROE COUNTIES WITH HEADQUARTERS AT HELENA, ARK., AS OF MARCH 31, 1971—REPORT NO. 412-97-T

Construction Inspections.—2. Periodic construction inspections were not being conducted in all cases. We noted ten cases in our audit sample, all involving loans to construct RH units, that failed to contain required periodic inspection reports. In six of these cases, only a final inspection was made. In four cases, a footing or "stage one" inspection was not made.

We noted various instances in which the first FHA construction inspection was made on the date of loan closure. These inspection reports showed the dwellings as much as 100 percent complete and no discrepancies were noted.

Our interviews with borrowers revealed various construction defects. These defects included such items as bathtub drains not connected, a bathroom heater installed upside down, closet doors not installed, inadequate dwelling sewer systems and inadequate surface drainage. (See Details—1.) We believe that defects and inadequacies such as these could be avoided by timely and thorough inspections. We attributed this condition to the fact that in a majority of the loans we examined, construction was in various stages of completion at the time related loans were closed and inspection started.

FHA instructions require three periodic inspections be made during RH construction.

Mr. Wilson stated that in some instances, inspections were made, but inspection reports were not prepared.

To ensure that rural housing construction meets FHA construction standards, required inspections should be conducted during construction. In cases involving loans to eligible applicants, county management should take steps as necessary to ensure that construction is not started before loans are closed.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, FRANKLIN COUNTY OFFICE, LOUISBURG, N.C. AS OF JANUARY 10, 1973—REPORT NO. 412-219-A

Construction Inspection.—6. More timely and effective inspections of houses are needed. Inspection procedures in effect were not adequate to detect all construction defects and adherence to the minimum property standards. Construction defects existed in all of the nine completed houses we visited and none of the houses met all the minimum property standards. Also, six houses in the eighteen loan dockets we reviewed had not been inspected until construction was well under way. Our visits showed some of these houses had construction defects. Further, FHA exit bulletin number 4423(424) that requires inspection during the eleventh month of a builder's warranty period, had not been implemented. (See also Details—8 for comments in other construction defects.)

The Rural Housing (RH) loans for the houses concerned represent an FHA investment of $312,790 and are shown in Exhibit A of this report.

Building Specifications.—None of the nine houses visited had moisture barriers between the top of the piers and the floor joists. Also, in four houses the porches were not vented. The house of borrower Robert L Grisson was built on a solid foundation wall and weep holes had not been provided. Moisture barrier, vented porches, and weep holes are necessary for the control of moisture condensation. The county supervisor said he has not received the training to keep currrent on minimum property standards and changes.

Timely Inspections.—FHA instruction 424.1, Paragraph IV C 3 a (1) requires that an initial inspection be made just prior to or during the placement of concrete footings or monolithic footing and floor slabs. As shown in Exhibit A, construction was from 17 to 65 percent completed before the first inspections were made. Timely and effective inspections assure that construction conforms with

plans and specifications and expedites easy correction of defects. An example of the problems caused by untimely inspections is the installation of vents on porches. Good building practices dictate that porches with concrete slab floor suspended be vented. Contractors would be reluctant, and with good reason, to vent the porches after borrowers and FHA accept the houses. The county supervisor said occasionally borrower houses are inspected and an inspection report is not prepared due to oversight.

EXHIBIT A

CONSTRUCTION INSPECTIONS—CONSTRUCTION DEFECTS

Borrower	Amount of loan	Porches vented [1]
Robert Bowden	$16,800	
Johnny C. Clifton	16,600	No.
Hevery Cruddup	15,750	
Lorenza J. Debnam	16,500	No.
Namon E. Durham	13,500	
Robert L. Grisson	14,800	No.
Kenneth E. High	16,250	
Orriles M. Rogers	15,750	
Alsidney Strickland	16,600	No.

[1] None of these houses had moisture barriers.

CONSTRUCTION INSPECTIONS NOT TIMELY MADE

Borrower	Amount of loan	Date of loan	Date of 1st inspection	Percentage of completion at 1st inspection
Eddy K. Clemons	$13,300	Apr. 13, 1971	Apr. 30, 1971	17
Isaac L. Cooper	12,300	Mar. 25, 1971	Apr. 27, 1971	35
Elmo G. Crudup	15,750	Jan. 6, 1972	Jan. 27, 1972	65
Lora G. Hamlet	[1] 12,330	do	Mar. 20, 1972	50
Gladys W. Hargrove	14,200	Feb. 22, 1972	do	35
Charles E. Jones	14,620	Mar. 25, 1971	May 19, 1971	48

[1] Funds were released prior to the 1st inspection

AUDIT REPORT—FARMERS HOME ADMINISTRATION, GRADY COUNTY OFFICE, CAIRO, GA., AS OF FEBRUARY 7, 1973—REPORT NO. 411-261-A

Construction Complaints.—4. Four of seven rural housing borrowers we visited had complaints concerning construction defects in their FHA-financed dwellings. The borrowers had little or no success in getting contractors to correct the deficiencies.

We attribute the complaints of borrowers partially to ineffective final inspections and the inability of the county office to get deficiencies corrected under the warranty. This adversely affects the value of the houses and causes discontent among borrowers that could result in a financial loss to the Government.

FHA Instruction 424.1, IV states that only upon completion of the whole contract and compliance by the contractor with all terms and conditions of the contract will the final payment be made.

Borrower Arnold D. Morgan.—This loan was made August 25, 1972, for $14,700 to purchase a lot and house. Our visit on January 22, 1973, disclosed some deficiencies that should have been corrected prior to final payment and the resulting borrower dissatisfaction with the house.

There were nine deficiencies that the borrower was most concerned about. (1) Bricks were not properly arranged at some windows. The bricks were arranged flat under some windows which could drain water into the inside walls of the house. (2) Some of the siding was not properly nailed down. (3) The foundation vents in the front of the house were at ground level permitting water to run under the house. (4) The bathroom window and back door had no screens. (5) The landscaping performed does not agree with the landscaping plat. (6) The electric broiler on the stove does not work. (7) Bricks were never cleaned by the contractor. (8) The septic tank was overflowing in the yard. (9) Linoleum was pulled up in some places and the floor was bucked up in some places.

The borrower stated that he told the contractor of some of the deficiencies several weeks before our visit, but the contractor had not corrected the deficiencies.

Borrower James C. Clay—The loan was closed September 13, 1972, for $14,-900 to obtain a house and lot. Our visit on January 22, 1973, disclosed deficiencies that should have been corrected before final payment was made.

The items of major significance were: (1) The concrete stoops for the front and back door were never installed although the dwelling plans called for them. (2) There was no access to the driveway of the house because no culvert had been installed. (3) The yard was poorly landscaped. The roadside water from both sides of the road drained in the front of the house. The water ran against the house and into the foundation vents that were at ground level.

The borrower's wife stated that she had contacted the contractor concerning the deficiencies. A notation was made in the borrower case folder on January 11, 1973, that the borrower had come to the county office concerning defects in the house. The county supervisor talked to the contractor personally concerning the deficiencies. The county supervisor also stated that the contractor said that he would correct the deficiencies, but made the notation that he was doubtful the contractor would do so.

At the time of our visit on January 22, 1973, two of the minor deficiencies had been corrected, and the remainder were left unattended. None of the deficiencies listed were corrected.

Borrower Albert J. Thomas—The RH loan was made for $14,500 on May 26, 1972, to purchase a house and lot. The borrower's wife stated that she had contacted the contractor twice to obtain iron posts that were to be installed under the front porch. The borrower was told that the posts would be installed when the contractor obtained some of the corect length. The house was completed June 18, 1972.

Borrower Elizabeth C. Combs—This loan was closed January 3, 1972, for $16,-210 to build a house. The house was completed in March 1972. The borrower stated that she had contacted the contractor repeatedly to get deficiencies corrected. These contacts with the contractor were made shortly after she moved into the house. The contractor came once and fastened down some floor covering in the utility room, but has not returned to correct the remainder of the deficiencies.

As a last resort, the borower wrote the FHA Finance Office on December 12, 1972. The letter was sent to tho State Office by the Finance Office, and a copy was sent to the county office on January 10, 1973.

The borrower was visited by the county supervisor and district supervisor, and a letter was sent to the contractor on January 19, 1973, asking for immediate corrective action on the deficiencies.

The contractor had not corrected the deficiencies at the time of our visit on February 3, 1973. Two deficiencies that should have been corrected prior to final payment were: (1) an electrical outlet in the bathroom was not installed and (2) some of the foundation vents were at ground level.

Major deficiencies which occurred after the borrower moved into the house were (1) the oak floor developed cracks, (2) the floor covering was curling up, and (3) the bathroom door would not close.

The district supervisor said that he and the county supervisor have agreed that all complaints that were not corrected by the contractor in a timely manner are going to be handled in strict accordance with FHA Instructions 444.12, Unsatisfactory Performance or Improper Action by Persons Dealing with Farmers Home Administration Rural Housing Applicants, Borrowers, and Grantees.

The county supervisor should demand that the contractor correct the deficiencies. In the future a more detailed final inspection should be made of the houses and final payments should be withheld until the contractor complies with all the terms and conditions of the contract. The county supervisor should take whatever steps are necessary to assure compliance by the contractors with provisions of their warranty.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, JEFFERSON AND WAPELLO COUNTIES, FAIRFIELD, IOWA, AS OF MARCH 2, 1973—REPORT NO. 411-188-K

Rural housing (RH) loan program

Development Inspections.—2. The supervision and inspection of RH development work were not always performed in accordance with the policies and procedures outlined in FHA Instruction 424.1. Inspections were not always made

at each stage of construction. The CS said that inspections are normally performed by the District Construction Inspector when he is in the unit. He also said that he has made some inspections himself when he was aware that construction had reached an inspection stage; however, inspections were not always made at the required stage of construction because contractors did not notify the County Office of the building progress made. The following conditions were noted during our review.

Borrower	Date of inspection report	Percent of completion	Inspections omitted
Leonard J. Dalbey	Mar. 2, 1972	64	1.
	July 20, 1972	100	
Lynn A. Lauritsen [1]	Jan. 9, 1973	100	1 and 2.
Gary W. Wolf	Mar. 24, 1972	7	2.
	Apr. 12, 1972	83	
	----------	99	
	----------	100	
Steven C. Tomas	----------	4	2.
	----------	85	
	----------	100	

[1] The running record showed that the building site was visited on Nov. 2, and Dec. 6, 1972, for inspection of the development but that construction work had bot been started.

FHA Instruction 424.1, Exhibit A, Breakdown of Dwelling Cost for Estimating Partial Payments, shows that up to 9 percent completion would include excavation, footing, foundation, columns, piers, etc. Also, that the framing would be completely enclosed when construction was 65 percent completed. Therefore, the framing could not be checked unless it was inspected between 9 and 65 percent completion.

The CS said that the Construction Inspector is assigned to the unit about 3 days each month. He said he prepared a list of dwellings that need inspection for the Construction Inspector to perform. He also said that with the rapid construction of prefabricated homes they are sometimes started and nearly completed between visits of the Construction Inspector.

FHA Instruction 424.1 IV A 3 provides for the frequency of inspection. Regular inspections by FHA personnel, including the CS, are needed to assure that development work conforms to approved plans and specifications.

All contractors should be reminded of the requirement for FHA regular inspections. They should also be requested to notify the County Office when each stage of completion is reached. Inspections of RH development work should be performed at the prescribed intervals under future programs.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, NORTH CAROLINA STATE OFFICE, RALEIGH, N.C., AS OF MAY 23, 1973—REPORT NO. 401-19-A

Construction Inspections.—3. FHA county personnel need training in performing inspections of RH construction with follow-up by State Office personnel to assure the training is effective. In 19 of the 23 county offices audited, construction defects exist in 176 of 325 houses visited. The FHA loan investment in the 176 houses is about $2,694,980. The FHA houses as constructed did not always comply with the house plans or the minimum property standards (MPS). Houses were not inspected until construction was well under way in nine counties. Our visits to 65 of 99 houses not inspected timely in these counties disclosed 45 houses with construction defects. Timely inspections could have prevented some of the defects. Further, of the counties audited, ten have misinterpreted FHA Bulletin No. 4423 (424). The county supervisors in these counties thought the bulletin applied only to builders' warranties executed after receipt of the bulletin and the State Office assumed that the reinspections were being made. We noted 88 instances where the builders' warranty had expired on houses which should have been reinspected. We visited 30 of these houses; 29 had uncorrected construction defects.

The FHA loan investment in the 88 houses was $1,290,100. Lack of thorough and effective inspections have generated borrower complaints and lessened the security value of the properties. Unless the conditions are overcome, the Agency's

goal of providing quality-built, safe, sanitary and decent housing will not be attained.

Construction Defects.—Exhibit D to this report is a listing of the 19 counties where construction defects were noted. These defects were noted in 176 of 325 houses visited. The defects include such items as leaking roofs, sagging roofs, cracked walls and ceilings, ceiling joists not properly nailed, and crooked, dropped and sagging ceilings, doors and windows not properly fitted, piers shored up with 2" x 2" strips of wood, piers not plumb, loose molding throughout the house, kitchen cabinets separating from walls, kitchen linoleum coming up, insulation falling from under house, warped floors, cracked concrete floors, and hardwood floor boards separating.

State Office Personnel said personnel shortages, the heavy workload in the county offices, and lack of training had contributed to most of these problems. They said training had not been scheduled in the past because of the shortage of funds. They said that future plans call for a series of training meetings with county office personnel on the minimum property standards, construction inspections of houses and individual and subdivision planning. They said the loose molding and kitchen cabinets separating from walls, and hardwood floor boards separating were caused by changes in moisture content which was difficult to control.

They said that the construction inspectors currently are temporary appointees for which authorization had been granted until June 1973.

Initial Inspections.—FHA instructions require an initial inspection just prior to or during the placement of concrete footing or monolithic and floor slabs. In the counties listed below the county supervisors did not have a system for monitoring the status of construction. They did not have a schedule for making systematic inspections of houses because they relied in the contractors to inform them when construction reached the stage for the initial and subsequent inspections of houses. They said sometimes the contractors neglected to call at the appropirate time, but called for inspections only when they desired partial payments on the contracts.

County unit	Number of houses built by contract method	Number of houses not inspected timely	Percentage of completion at time of 1st inspection	Number of houses visited	Number of houses with defects
Bakersville	20	19	10–90	14	12
Hertford	15	4	20–65	3	2
Kenansville	17	4	30–70	4	4
Louisburg	9	6	17–65	0	(1)
Marshall	12	12	65–80	12	7
Nashville	25	11	10–50	10	8
Sylva	9	9	3–99	9	8
Tarboro	36	28	25–99	12	1
Williamston	28	6	18–38	1	1
Total	171	99		65	43

[1] Not determined.

Training is needed on making construction inspections and on minimum property standards. The minimum property standards presumes top quality workmanship which can be accomplished only through a tight inspection program. FHA county office personnel were not always familiar with the minimum property standards, they did not adequately monitor the status of construction, timely inspections were not made, and the inspections were less than adequate.

We are aware that some of the defects reported are not so severe as to cause substandard housing and that some defects were not visible at the time of the inspections. However, we feel the inspection weaknesses pointed out and the serious nature of some defects show the need for better inspections to detect the construction defects and prevent the problems caused by the low quality construction. Uncorrected defects have caused dissatisfaction of borrowers and criticism of the Department.

A training program should be initiated for construction inspections to include MPS and the program should be attended by all State and county personnel responsible for making construction inspections. Procedures should be established for State Office personnel and district supervisors to monitor the quality of construction to assure compliance with the MPS. These procedures should include as

a minimum, periodic construction inspections by State Office staff personnel and district supervisors of homes in districts selected on a random basis. The procedures should also include a review of the construction inspection system in effect at the county offices and the timeliness of inspections made by county office personnel.

EXHIBIT D

CONSTRUCTION DEFECTS

County unit	Number of houses: Visited	Number of houses: With defects	Amount of loans (houses with defects)	County unit	Number of houses: Visited	Number of houses: With defects	Amount of loans (houses with defects)
Bakersville	14	12	$179,700	Nashville	20	17	$269,040
Carthage	10	9	148,000	Pittsboro	40	6	99,060
Danbury	11	11	165,000	Sanford	13	6	90,000
Fayetteville	17	3	52,120	Smithfield	22	9	135,000
Greenville	23	14	210,650	Snow Hill	12	7	89,030
Hertford	26	15	238,420	Sylva	18	16	242,700
Jackson	13	9	139,100	Tarboro	12	1	14,000
Kenansville	17	8	120,000	Williamston	14	12	180,610
Laurinburg	22	5	75,000				
Louisburg	9	9	142,550	Total	325	176	2,694,980
Marshall	12	7	105,000				

(D) Servicing Abandoned Property

Audit Report—Farmers Home Administration, Kansas State Office and Selected County Offices, Topeka, Kans., as of April 9, 1971—Report No. 401-13-K.

Unoccupied dwellings

6. Servicing action was needed on 16 RH loans in 4 County Office units where the borrowers were not occupying their dwellings. The State Office had not been promptly notified and/or the borrowers had not been contacted for the purpose of liquidating the account. County Supervisors for three units had exceeded their authority and granted approval to five such borrowers to lease their dwellings located on nonfarm tracts. Consequently, these loans were being used for purposes not consistent with loan objectives. Also, security property was not being adequately insured, protected, and maintained.

These loans were noted in the El Dorado, Hutchinson, Lyons, and Wellington units. County Supervisors at El Dorado, Lyons, and Wellington had granted approvals to borrowers to lease their nonfarm tract dwellings. The County and District Supervisors were of the opinion they had this authority; however, they could not provide any evidence such authority had been delegated. Some of the dwellings were deteriorating due to abuse from the weather. Others had been vacant in excess of 60 days and, therefore, were without adequate insurance. County officials advised us they had had to break into some of these homes in order to get them winterized; in some instances they had notified the local authorities and they had not in others. Most of these officials were of the opinion they needed authority to use realtors when dwellings are vacated.

The standard insurance policy in Kansas stipulates that coverage is not effective after a vacancy of more than 60 days. FHA Instructions 426.1 IV B require the County Supervisor to notify the insurance agent in writing whenever hazards are increased and ensure that any additional premium necessary is paid.

FHA Instructions 465.1 XV F require the County Supervisor to contact the borrower promptly for purposes of refinancing or reoccupying and to notify the State Director if definite agreements cannot be reached or if the borrower is not available. Paragraph XV A provides that the County Supervisor may give the borrower 60 days to accomplish immediate voluntary liquidation. Paragraph V B stipulates that only the State Director is authorized to give approval to lease dwellings on nonfarm tracts; and then only if he determines that the house was vacated for reasons beyond the borrower's control and he intends personally to occupy the dwelling within a reasonable period, usually not to exceed 2 years.

Kansas FHA Instructions 465.1 A permits redelegation of the State Director's authority to Loan Chiefs, Loan Officers and District Supervisors.

The State Office should alert all County Supervisors of the necessity for servicing all vacant dwellings promptly in accordance with the cited instructions. Also, if it becomes necessary to enter the dwellings they should be advised to have local authorities present unless the property has been conveyed to FHA.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, SPALDING, FAYETTE, PIKE COUNTY OFFICE, GRIFFIN, GA., AS OF NOVEMBER 28, 1972—REPORT NO. 411-242-A

III—DETAILS

Security servicing

Real Property Insurance.—1. The real property insurance in force on an unoccupied dwelling does not provide adequate coverage in the event of loss. This resulted because FHA personnel were not aware that the policy did not provide full coverage in the event the dwelling was unoccupied for a period exceeding 30 days. The interests of the borrower and the Government are not being afforded proper protection in the cited case.

File review of RH Borrower William R. Lynch disclosed that he had not occupied his FHA-financed dwelling for a period in excess of four months. An inspection of the dwelling disclosed that damage had occurred to window and door screens and some window panes had been broken. The county supervisor stated he was not aware that some of these conditions existed. The insurance policy provides that damages resulting from vandalism, malicious mischief or glass breakage are not reimbursable under the terms of the policy if the dwelling has been vacant in excess of 30 consecutive days immediately preceding the loss. Since this dwelling has been vacant for an extended period, the policy does not cover the damages that have occurred after the 30 day vacancy limitation cited above.

Adequate insurance coverage should be obtained in order to protect the interests of the borrower and the Government.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, ELBERTON, LINCOLN, AND WILKES COUNTY OFFICE, WASHINGTON, GA., AS OF FEBRUARY 7, 1973—REPORT NO. 411-251-A

III—DETAILS

Security servicing

Handling of Abandoned Property.—1. There has been a general laxity in handling the accounts of rural housing borrowers who have abandoned their property. Dwellings have been vacated since September 1971, with little or no effort by the county supervisor to either bring the dwellings into inventory, transfer them, or to get caretakers to occupy them. The county supervisor and his assistant were not aware of the exact number of abandoned dwellings and did not know the number that were occupied or the names of the occupants. Case files were incomplete and did not have pertinent information on dates caretakers occupied the dwellings or the names of the caretakers. Assessments have not been made on the amount of repair work that will be necessary to place the dwellings in condition to resell.

According to a local insurance agent, only eight of the nine dwellings currently abandoned are covered by insurance. He stated the insurance expires in 60 days after the policy holder vacates the house. Should FHA place another family in the house, the original policy is void and a special Fire and Extended Coverage (F&EC) policy must be written to provide coverage. In no instance has a F&EC policy been written.

Currently, about $95,700 in Government guaranteed loans are without insurance coverage. Should the houses burn or the occupants be injured, the Government could possibly be liable for damages.

The assistant county supervisor determined that nine houses were abandoned by relying on his memory. Files were not arranged to segregate the case files of the abandoned houses. Examination of the files disclosed little, if any, information regarding whether the houses were vacant or occupied, the name of the occupant, whether borrowers had been contacted, or the condition of the houses.

Details on the abandoned houses are as follows:

Borrower	Approximate loan balance	Approximate date vacated	Caretaker occupied (yes/no)
Charles Allen	$16,000	January 1973	No.
Roy Harrison	14,200	December 1972	No.
Jack I. Lyons	9,500	September 1971	No.
Joe Morgan	13,500	October 1972	No.
Henry Martin	14,000	June 1972	Yes.
Roy Parks	10,160	December 1972	Yes.
Frank Reid	9,500	October 1972	Yes.
John Thornton	14,100	do	Yes.
Victoria Ware	10,740	April 1972	Yes.
Total	111,700		

Of the nine cited borrowers, only Borrower Allen has current insurance. All of the others have expired insurance policies, even though the premiums have been paid by the borrower or vouchered. This was the opinion of a local State Farm Mutual Insurance Agent. He stated that after 60 days, the house must be occupied and the policy must be converted to a Fire and Extended Coverage policy to provide coverage. He said this was not only the policy of his company but of all companies. File folders do not show that F&EC insurance has been purchased.

The county supervisor said he was not aware of the insurance coverage problem, but would act immediately to cover the eight houses.

The file folders of the nine abandoned homes do not show that any concerted effort has been made to have the borrowers transfer the homes back to the Government. Foreclosure action has not been taken, even though the county committee has approved some homes for foreclosure.

Also, the file folders do not show the names or the dates of occupancy of five families currently occupying the homes. We learned that some of these families may have received free rent since April 1972.

Visits to the nine abandoned homes revealed most are in fair condition, but all need some repair work before they can be sold. The home of Borrower Lyons, although not damaged by vandalism, was in poor condition. The house has not been occupied since the family abandoned the property in September 1971. The house is cluttered with old furniture and wood for a heating stove. The hood over the kitchen stove has burned and the adjacent wall is charred. The bedrooms, bath, and exterior of the house need repainting, and screen doors need replacing.

The county supervisor should establish a system to control the files of abandoned dwellings in order to readily determine their status. Transactions that take place need to be recorded in the running record of the borrower's file and on management system cards. Vigorous efforts need to be taken immediately to effect insurance coverage for the eight dwellings without coverage. Continuing and timely effort needs to be taken to dispose of abandon houses either by transfer or by foreclosure.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, WILCOX AND PULASKI COUNTY OFFICE, ROCHELLE, GA., AS OF FEBRUARY 21, 1973—REPORT NO. 411-255-A

Handling liquidations

6. Effective action has not been taken to liquidate loans that are delinquent and in some cases were scheduled for liquidation. Lack of follow-up on liquidation cases when it is apparent that collection of the borrower loan accounts are hopeless, could result in financial losses to the Government.

Borrower Marvin E. Keene received a $19,780 FO Loan on May 29, 1968 and currently owes $20,736, principal and interest. The Delinquent and Problem Case Review dated October 14, 1971 showed the borrower to be delinquent by the amount of $6,193. The borrower was to pay the 1971 installment by November 1971 and get the account current by June 30, 1972 or liquidate. The borrower did make a payment of $1,000 on December 22, 1971. Another payment was made on December 19, 1972 of $1,150. The borrower is currently delinquent by the amount of $5,246.75. The county supervisor said the borrower is old and in bad health. He further said the borrower's son is working the farm.

Borrower Leonard Gibson received a $13,000 RH Loan on February 26, 1971 and currently owes $14,394, principal and interest. The Delinquent and Problem Case Review dated October 4, 1972, showed the borrower to be delinquent by

the amount of $1,646. The borrower was to get his account current by December 15, 1972 or the county supervisor was to recommend foreclosure on that date. The borrower has not made a payment since February 3, 1972. The borrower is presently delinquent by the amount of $1,689. The county supervisor said that the borrower has been unemployed for several months, but he expected to go back to work soon.

Action should be taken to get these accounts current or liquidate. Delays in liquidation when collection of delinquent accounts is in jeopardy could result in a financial loss to the Government.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, JEFFERSON COUNTY OFFICE, LOUISVILE, GA., AS OF MARCH 9, 1973—REPORT NO. 411-252-A

III—DETAILS

Security servicing

Handling of Abandoned Property.—1. There is a need to take timely action to settle the accounts of borrowers who have abandoned their property. In some instances, houses of RH borrowers have been vacant since June 1972, with little or no effort by the county supervisor (CS) to bring the houses into inventory. The CS stated he had been unable to find time to process the abandoned homes. Houses left vacant are subject to being vandalized, which causes additional repair expense.

Discussion with the CS and review of records disclosed that three houses, involving loans of $33,500, are currently abandoned and are vacant. Details of these are as follows:

Borrower Eddie Jackson: The RH loan was closed on September 28, 1971, in the amount of $12,350. On March 17, 1972, the borrower was contacted regarding a delinquncy of $368.00 on loan repayments. No further action was taken until the insurance on the property was vouchered January 26, 1973. After vouchering the insurance, the CS said he followed up on the account and was told by neighbors the family had abandoned the house. On January 10, 1973, the account balance was $12,858.41. No further action has been taken to bring the house into inventory.

Borrower Johnnie L. Hill: The RH loan was closed November 30, 1966, for $7,850.00. On July 29, 1972, the wife of the borrower contacted the county office and indicated the family was having marital problems, and wanted to assume the loan in her own name. Payments on the loan as of June 3, 1972, were behind $284.00. The CS said no follow-up was taken and he believed the family vacated the house some time in early December 1972. A note on the file folder indicated another family wanted the house.

Borrower Catherine Wilson: The RH loan was closed June 27, 1972, in the amount of $13,400.00. The CS stated the borrower never moved into the house, and has not made any payments. The last contact with the borrower was August 17, 1972, at which time she was given 10 days to move into the house. The CS said there is a good chance the borrower will voluntarily convey the house; however, no follow-up action has been taken.

To protect the Government's interest, continuing and timely effort should be made, either by transfer, voluntary conveyance, or foreclosure action, to settle the accounts of borrowers who abandon their homes.

For further information regarding the handling of inventory houses, see Details—2.

Vacant Houses in Inventory.—2. Houses that have been brought into inventory need to be disposed of timely. Currently, three houses have been in inventory from four to five months. The CS said he was concerned with the situation, but has not had time to dispose of the houses. The present value of the houses is about $28,700, and the Government is continuing to make interest payments to lenders on the loans. In addition, the houses are vacant, and this encourages vandalism.

The houses of former Borrowers Wallace L. Brown and Barbara W. Lambert were foreclosed on November 7, 1972, and the Lewis Johnson house was voluntarily conveyed on October 13, 1972. Current Government interest in the properties is: Brown—$9,549; Lambert—$6,220; and Johnson—$12,950. No caretakers have been appointed; however, the CS said he has families interested in purchasing the homes, but was unaware he could place the families in the homes prior to loan closing.

The county supervisor should dispose of the houses in inventory as soon as possible. In the meantime, caretakers should be appointed on a rent basis to provide protection of the Government's investment.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, CHARLESTON COUNTY, CHARLESTON, S.C., AS OF APRIL 23, 1973—REPORT NO. 412-246-A

Management.—4. Improvements are needed in loan making and servicing of rural housing loans. Our review of loan making and servicing of rural housing loans disclosed that two houses totaling $27,390 were in Government inventory. Also, seven houses totaling $91,410 were pending transfers. In addition, 30 houses totaling $397,170 were in some phase of foreclosure. Further, about 36 percent of the rural housing loans were behind in their scheduled payments. These conditions occurred because of pressure from builders to make loans.

The unit had a total caseload of 689 loans of which 660 were rural housing loans. Our review of three of the 39 houses in Government inventory, pending transfer, and foreclosure disclosed that Borrowers Elijah Gibbs, Joseph L. Johnson, Jerry L. Yates, and Thomas W. Young, at the time of the loan had questionable repayment ability. Even with the assistance of interest credit, these borrowers' house payments, taxes and insurance exceeded 20 percent of their family adjusted income. As a result, these borrowers were unable to meet their financial obligations and FHA had to initiate action to take the houses back. Also, according to Form FHA-389-14, Report of Direct Payment Housing Borrowers, April 30, 1973, 386 borrowers were behind in their scheduled payments. Of these, 101 borrowers were behind on their annual installment or about 15 percent. Of these 101 borrowers, seven houses were pending transfer; 30 houses were in foreclosure; and two houses were in Government inventory.

Excluding those borrowers behind on their annual installment, about 36 percent of the other borrowers were behind on their monthly payments. (See Details—1 concerning eligibility of borrowers.)

The county supervisor said that pressure from builders had been received on processing and making rural housing loans. As a result, some loans were made to borrowers with borderline repayment abilities. As a consequence, a servicing problem has resulted. He said, however, that the purpose of the rural housing program was to make loans to low to moderate income families. He added that at least 50 percent of the Section 502 funds must be used for loans to low income families. For Section 502 loans, the families who will be counted as low income are those who (1) receive interest credits and (2) do not receive interest credits but have adjusted family income of not more than $7,000. We agree with the cited purpose of the program but it is also a good business practice to make sound loans. In addition, the county supervisor told us that they had intensified servicing of all loans and had made substantial progress since he became supervisor.

Our reviews and observations disclosed that a serving problem exists in this unit. It stems basically from making loans to borrowers with border line repayment abilities. Continued emphasis should be placed on serving to correct the situation and to prevent additional loan failures.

AUDIT REPORT—FARMERS HOME ADMINISTRATION, HARDEE, DESOTO, MANATEE, AND SARASOTA COUNTY OFFICE, WAUCHULA, FLA., AS OF MAY 18, 1973—REPORT NO. 411-283-A

Inspection and Maintenance of Abandoned Real Estate.—3. During the audit we identified eight dwellings which had been given as security for RH loans, and had been abandoned. Our review of the files and inspections of the property for five of these loans disclosed that, in each case, the security was not being properly maintained to protect the FHA's interests. In one case, the dwelling was being occupied without proper authorization. The county supervisor had not provided adequate servicing of the real estate security in accordance with FHA instructions. As a result, the FHA's financial interests were in jeopardy and unrecoverable losses may have occurred.

FHA Instruction 465.1 provides that the county supervisor is responsible for seeing that the real estate security is being properly maintained and accounted for and for servicing the security in accordance with this instruction. When a

borrower fails to maintain, protect, or account for the security to the extent that the FHA's financial interest is in jeopardy, or makes unauthorized disposition or use of any security, prompt action will be taken to protect the FHA's interest. The State Director may authorize emergency maintenance and repairs to protect interests of the FHA. The county supervisor will take possession of the property and will enter into a lease or caretaker's agreement for the account of the borrower only when approved by the State Director.

The following cases were reviewed and the houses visited during the audit:

Borrower's name	Date of loan	Amount of loan	Approximate date abandoned	Problem noted
Borom, William Jr. (Hardee Co.)	June 22, 1967	$8,600	Over 1 year	Unauthorized occupancy—emergency repairs needed.[1]
Dosier, Willie E. (Manatee Co.)	Apr. 21, 1974	8,814	do	Dwelling open—extensive vandalism emergency repairs needed.[2]
McCray, Horace Jr. (Hardee Co.)	Nov. 7, 1968	8,300	March 1973	Utility room open—contained water heater.
Miley, Everett L. (Manatee Co.)	Aug. 13, 1970	12,460	February 1973.	Emergency repairs needed—broken window.
Whidden, Homer (Hardee Co.)	Dec. 20, 1970	13,000	October 1972	Dwelling open.

[1] Borom Dwelling—This house was occupied at the time of our visit. The front door facing was almost totally removed exposing the hollow door. The lawn and shrubs were overgrown. We visited the local city clerk's office to determine who was occupying the house. We were told that a local farmer was paying the utility bills and the house was occupied by a migrant family employed by the farmer.

The county supervisor said that he was aware that the house was occupied. He said that about 3 months ago he became aware that the house was open and had been vandalized. He noted that the bathroom plumbing and fixtures had been removed and were outside the house waiting to be carted off. He said he entered into a verbal agreement with the local farmer, in which he permitted use of the house. According to the county supervisor, the agreement was for the farmer to reinstall the plumbing and fixtures, make necessary repairs to the house to make it livable, and pay all utility costs during occupancy. In return, the farmer was permitted to use the house temporarily for his farm laborers. The county supervisor said that there was no written agreement or lease and that the action was taken because he thought it would protect the FHA's interests.

Our review of county office records showed that the loan was submitted to the State office for foreclosure action on May, 10, 1972. The State director concurred with foreclosure action on May 22, 1972. The case was transmitted for foreclosure to the U.S. attorney for the Middle District of Florida, Tampa, Fla., on Apr. 4, 1973.

[2] Dossier Dwelling—All the doors were unlocked and the back door was wide open. The window in the back door was broken and the screen removed. Several windows in the house were open and some were broken. The door of a linen closet was pulled off and lying on the kitchen floor. The wall heater was damaged, cabinet drawers and doors were damaged and window screens were missing. The interior of the house was filthy and all the floors were covered with rubbish. The door of the utility room, which contained the water heater, was wide open. The lawn and shrubs were overgrown. We talked with a next door neighbor who said that young people had been using the house for late night parties.

We reported the condition of the house to the assistant county supervisor and the district supervisor. They immediately inspected the property. They said that necessary measures would be taken to secure the property.

The county supervisor should establish controls over the files of abandoned dwellings to readily determine their status and schedule periodic inspections. The State director's approval should be obtained for the occupancy of the Borom house and a temporary lease agreement properly prepared, or the occupancy of the house should be terminated immediately. Continuing and timely efforts need to be taken to dispose of abandoned houses, either by transfer or by foreclosure.

(E) Conflicts of Interest

Audit Report—Farmers Home Administration, Gadsden and Liberty County Offices, Quincy, Fla., as of May 17, 1973—Report No. 411-278-A

B. Summary

A former assistant county supervisor was associated with a contractor who was building FHA financed homes. According to the records, the former employee inspected some of the contractor's homes just before accepting employment with the contractor. The former employee told us that he was a building superintendent; however, we found that he had signed a builder's warranty and a certificate of contractor's release on a house built by the contractor. If the former FHA employee is an officer in the company, such an affiliation within a year after Government employment is prohibited and could result in adverse criticism of the FHA programs.

II—RECOMMENDATIONS AND DISCUSSION WITH MANAGEMENT

A. Recommendations

For the Director, FHA State Office.—1. Determine whether a former assistant county supervisor's affiliation with a contractor is a conflict of interest as provided by the instructions, with the assistance and/or advice of the Washington office. If so, initiate proceedings as required by instructions. (See Details—1)

III—DETAILS

Employee conduct and responsibilities

1. A former assistant county supervisor was associated with a contractor who was building FHA financed homes. According to the FHA records, the former employee inspected some of the contractor's homes just before he began employment with the contractor. The former employee told us that he was a building superintendent. However, we found that he signed a builder's warranty and a certificate of contractor's release on a house built by the contractor. If the former employee is an officer of the company, or represents the company in dealings with FHA, such affiliation within a year after Government employment could be considered a conflict of interest and could result in criticism of the FHA.

FHA Instruction 207.1 Exhibit A, relating to employee responsibilities and conduct, 735–14 (a) (6) states the following prohibitions apply to both a regular employee and a special Government employee. "He may not, for one year after his Government employment has ended, represent anyone other than the United States in connection with a matter in which the United States is a party or has an interest and which was within the boundaries of his official responsibility during the last year of his Government Service."

James A. Sapp worked for FHA from June 1970 until November 1972. After he resigned from FHA, he immediately started to work for Georgia-Florida Builders, Inc., Quincy, Florida, a contractor of FHA financed homes. Just before beginning employment with the contractor, Mr. Sapp inspected the following homes built by the contractor:

Borrower	Date of inspection	Percentage of completion
Odis Green	Oct. 5, 1972	40
Archie Jackson	Sept. 18, 1972	100
Sylvester Murray	Nov. 1, 1972	100

We visited the home of Archie Jackson and found no defects and the borrower complained of none.

During our interview with Mr. Sapp, he said he was a building superintendent and that his job was to supervise and coordinate labor and material. He added that he was a hired hand and was not management, a stock holder or an officer. Mr. Sapp also said that before accepting the position he discussed the offer with the district supervisor. He added that, although he did not ask the district supervisor specifically, the district supervisor did not indicate to him that the acceptance of the offer would be a conflict of interest.

We found that Mr. Sapp signed, in January 1973, the builder's warranty and the certificate of contractor's release for the home of Albert Johnson. We understand that the State office later received an opinion from the U.S. Attorney that the warranty and certificate would be valid, even if Mr. Sapp is not an officer of the company.

The State Director should make a determination, with assistance and advice from the Washington office, as to whether Mr. Sapp's affiliation with the contractor is a conflict of interest in accordance with the cited FHA instruction. If so, the State Director should initiate action in accordance with FHA Instruction 444.12. (See Part II B above.)

AUDIT REPORT—SPECIAL REPORT ON CONDITIONS IN CAMERON COUNTY, TEX., RURAL HOUSING PROGRAM AS ADMINISTERED BY THE FARMERS HOME ADMINISTRATION, SAN BENITO, TEX., REPORT NO. 402–8–T

I—INTRODUCTION AND SUMMARY

A. Introduction

During 1971, there was considerable activity in the Rural Housing Loan Program of the Farmers Home Administration (FHA) in Cameron County, Texas. A majority of the houses were constructed in the Port Isabel area by Custom Designed Homes, Inc., Brownsville, Texas. Complaints were voiced locally by FHA borrowers about the poor quality of construction and there was general dissatisfaction with the contractor and the FHA Office in San Benito. This

condition fomented and grew until a petition by homeowners was circulated and a local television station prepared a news documentary which aired the plight of these homeowners. A suit for slander was filed by the builder against the TV station and later withdrawn and the FHA County Supervisor became a witness at preliminary hearings. Television, radio, and newspapers gave extensive coverage to this matter, much critical to FHA and USDA. An investigation was requested by the Texas FHA State Director and also by the Assistant United States Attorney in Brownsville.

An extensive investigation was conducted to determine the facts regarding charges of collusion, favoritism, and faulty construction of homes financed by FHA. This report is based on the details disclosed by this investigation (see T-401-66).

B. Summary of audit results

In our investigation of the San Benito, Texas, FHA Office, we noted certain weaknesses in the way the Rural Housing Loan Program was being administered. These included an appearance of favoritism by County Office personnel to a certain builder, the handling of "package" deals that ignored some basic controls, failure to follow instructions, and the lack of capability to properly inspect construction. As a result, resentment built up and publicity detrimental to the program occurred.

While we are addressing this report to the conditions in Cameron County, the recommendations should apply as well to any office which is confronted with a heavy work load of Rural Housing loans.

II—RECOMMENDATIONS AND DISCUSSION WITH MANAGEMENT

A. *Recommendations for the Texas FHA State director*

1. Initiate an effective program and follow-up to inform and reinforce the concept that FHA employees have a high degree of responsibility to maintain the confidence of the public. (See Details—1.)

2. Instruct personnel in the San Benito FHA Office to deal at arm's length with all contractors to prevent the appearance of favoritism and the opportunity for mishandling. (See Details—2.)

3. Require the County Supervisor to thoroughly review all of the material submitted in a package deal as to adequacy, completeness, and correctness before further processing. (See Details—3 and 5.)

4. Require "package" applicants to come to the FHA Office and review and sign each document in the presence of FHA employees. (See Details—3.)

5. Require the County Supervisor to follow FHA procedures in all phases of the packaging program, including a conference with the borrower to thoroughly acquaint him with the loan program and what he should expect from the contractor. (See Details—4.)

6. Require proper handling of Form FHA 410-5, Request for Verification of Employment, by County Office personnel. (See Details—5.)

7. Require County Office personnel to complete checks in all respects before such checks are signed or countersigned. (See Details—6.)

8. Require borrowers to sign checks only after completely filled in and in the presence of FHA personnel. (See Details—6.)

9. Require contractors to divulge to FHA for approval any inducements or changes in the plans and specifications in their agreements with the borrower. (See Details—7.)

10. Take action to suspend any contractor who offers inducement to borrowers without knowledge and consent of FHA. (See Details—7.)

11. Devise an inspection form to include specific items with responsive, informative answers as to conditions of construction. (See Details—8.)

12. Establish rigid qualifications for construction inspectors. (See Details—9.)

13. Use competent construction inspectors to train those inexperienced to raise their competence to an acceptable level. (See Details—9.)

B. *Discussion with management*

On July 10, 1972, we discussed the findings and recommendations in this report with the following officials of the Texas State FHA Office:

J. Lynn Futch, State Director,
John O. Barnes, Assistant State Director,
Arnold H. Paul, Executive Officer,
Louis W. Lee, Chief, Rural Housing Section.

The officials stated that most of the deficiencies cited in this report resulted from the County Supervisor's: (a) loss of control of the Rural Housing Program, and (b) failure to follow existing FHA instructions. They said that several changes have been made, or planned, in the personnel assigned to the Cameron County FHA Office; and that emphasis has been placed on the necessity of administering the Rural Housing Program in accordance with FHA procedures.

State Office officials stated that measures outlined herein are those that have been and are being taken by the State Office to prevent similar situations from developing in other counties. Various members of the State Office rural housing staff have been assigned responsibilities for analyzing and reviewing administration of the program in counties having large increases in the rural housing program activities.

Adidtional pertinent comments of the State Office officials are included in the applicable sections of "III—DETAILS" part of this report.

The Office of the Inspector General was represented by:

Cecil C. Perry, Assistant Regional Inspector General,
Stephen Tokoly, Supervisory Special Agent,
John H. Adams, Jr., Supervisory Auditor.

III—DETAILS

Appearance of favoritism

1. Personal association by FHA personnel with a particular contractor caused an appearance of favoritism. The County Supervisor, construction inspector, and other FHA personnel were entertained by the same contractor. Numerous witnesses mentioned this and related it to what they considered special treatment in approving loans and accepting poorly-constructed homes from this particular contractor. Eventually, this condition magnified itself until there was extensive publicity, detrimental to FHA programs, the Agency, and the Department.

An effective program and follow-up should be initiated to inform and reinforce the concept that FHA employees have a high degree of responsibility to maintain the confidence of the public.

2. The local FHA personnel used a copying machine of a contractor for official work. Contractor's employees were allowed to enter the FHA Office and obtain forms for "packaging" without help from FHA employees. The FHA Office provided complete borrower files to the contractor to make corrections or add missing forms.

Unauthorized people should not have access to the office without FHA supervision, and custody of files should be maintained by authorized personnel.

FHA employees should be instructed to deal at arm's length with all contractors to prevent the appearance of favoritism and the opportunity for mishandling.

Package deals

3. Packaging, the preparation and completion of the necessary forms by the contractor and prospective borrower, was intended to expedite and simplify the handling of the loan transaction. Our investigation revealed the following problems:

(*a*) After the contractor "packaged" the loan, the FHA personnel did not go over the information on the application and other forms to determine if each were complete and correct.

(*b*) A work sheet was used by the contractor from which pertinent forms were completed. This work sheet did not accompany the package, and mistakes in transcribing to documents could not be verified.

(*c*) The contractor had the prospective borrower sign forms in blank for the package to be filled in later. This creates the possibility of error or deliberate misrepresentations by an unscrupulous contractor.

The County Supervisor should thoroughly review all of the material submitted in the package as to adequacy, completeness, and correctness. Positive efforts should be made to verify pertinent information.

The required forms should be precompleted by the packager, but the applicant should come to the FHA Office and review and sign each document in the presence of FHA employees.

State Office officials agreed that FHA personnel should review each document with the applicant, but they did not agree there should be a requirement that the applicant's signature be affixed in the presence of FHA personnel.

Conferences with borrowers

4. Borrowers were not called into the FHA Office for preconstruction conferences as required. Many borrowers did not have a clear understanding of the loan program or the responsibility of the contractor in building the house.

The County Supervisor claimed that the conference was not necessary because other houses of the same type were in various stages of completion and the borrower could examine the same as his house.

The majority of the people who obtain Rural Housing loans are low income and relatively uneducated. They tend to regard the packaging contractor as the responsible person who will approve or disapprove their loan request. They are prone to do whatever he suggests, such as signing blank forms or "adjusting" income or other data to fit the packager's needs.

The County Supervisor should follow the FHA procedures in all phases of the packaging program, including a conference with the borrower to thoroughly acquaint him with the loan program and what he should expect from the contractor.

Verification of financial representations

5. We examined numerous loan files and noted a high percentage of delinquency. Much of this we attributed to false information on financial condition, salary, etc. If these applications had been properly examined and verified by the FHA Office, many would have been rejected because there was not sufficient financial ability.

Investigation revealed that Form FHA 410-5, Request for Verification of Employment, was handled by the contractor and the borrower after it was completed by the employer. This document was accepted by the FHA Office, disregarding the safeguards stated on the form. On the bottom of the form is the following wording:

"The above information on this form is confidential. It is to be transmitted directly to the Farmers Home Administration without passing through the hands of the applicant or the person named in item 5."

Item 5 states: "Name and Address of person or Firm making Request if other than FHA," for example, the contractor or packager.

The integrity of this document should be maintained and not accepted in violation of the stated prohibition.

Blank checks

6. Many applicants were requested or required by the contractor to sign blank checks and prefilled-in, undated checks as a convenience to keep the contractor from having to go out and contact the borrower every time a check was needed. Of the borrowers contacted in the investigation at San Benito, one denied signing a check with his purported signature and this was confirmed by an FBI handwriting expert. The signing of the blank checks removes one of the essential safeguards to the borrower in the disbursement of funds for construction.

The signature should be affixed to the checks in the presence of the FHA official who countersigns the checks.

State Office officials agreed that checks drawn on supervised bank accounts should be filled in before being signed or countersigned. They did not agree that there should be requirements that: (a) checks be filled in by FHA personnel, and (b) checks be signed by the borrower in the presence of FHA personnel.

Inducements and deviations from plans and specifications

7. The contractor agreed with prospective borrowers to pay the first year's taxes, or insurance, or to make the payments until the borrowers moved into the houses. Such inducements are detrimental to the FHA program because applicants come forth who want the "free ride" without any commitment for later obligations.

In addition, the contractor, in the actual construction of the houses, deviated from approved plans and specifications without the knowledge, consent, and approval of the borrowers and FHA.

Contractor should be suspended for offering any inducements or changes in the plans or specifications unless openly included in the agreement approved by FHA.

State Office officials agreed that side agreements between contractors and borrowers should not be permitted. They said, however, that prohibitions against inducements could not be enforced in cases where contractors choose not to divulge them to FHA. They stated that the possibility of inducements would be checked into in case the contractor's integrity was questionable. They further

stated that suspension proceedings would be instituted in accordance with applicable procedures against contractors who are known to offer improper inducements.

Inspection of construction

8. The form being used to document the inspections of the houses requires only generalizations, such as "House being built according to plans and specifications." The inspection forms contained no useful information as to the construction examined.

A form should be devised to include specific items with responsive descriptions as to any deficiencies or noted differences; and, an affirmative final inspection by the County Supervisor, construction inspector, and the borrower should be required to certify that finished products meet the agreed upon specifications and plans.

State Office officials did not agree that the inspection form should be revised. They believe that a check-list form would detract from, rather than improve, the quality of inspections being performed by using the present form in conjunction with approved plans and specifications for each dwelling. They pointed out that Form FHA 424–12 presently requires that, on final inspections, the County Supervisor and borrower certify that construction has been completed in accordance with plans and specifications.

Construction inspectors

9. We noted that the construction inspector was not proficient. When he was appointed, he had almost no pertinent experience. The occurrence of omissions, deficient construction, and poor construction were allowed, at least in part, by inexperience and lack of training.

Rigid qualifications should be established for construction inspectors. Also, comprehensive training should be instituted to bring present employees to the level of competence required or replace those employees with experienced people for inspections.

State Office officials stated that, based on his experience and background, the construction inspector in Cameron County appeared to be well qualified for the position. They attributed the deficiencies in his work, at least in part, to the County Supervisor's loss of control of the program.

IV—GENERAL COMMENTS

There has been considerable criticism of the Farmers Home Administration in recent years, primarily aimed at the Rural Housing Program. The Department of Justice, General Accounting Office, Congressmen, and news media have criticized and created poor publicity. The Office of the Inspector General conducted a large scale review of FHA rural housing activities. The findings were made available to all State Directors. The corrective actions being taken by the Administrator will alleviate many of the criticisms. However, immediate efforts are needed at the local levels to overcome the mounting criticism of the quality of housing sponsored by FHA, the appearance of favoritism, the conflicts of interest, all pointing to the integrity of a vital program of the Department.

In our analysis of the criticisms and the often unwarranted attacks on FHA and the Rural Housing Program in particular, we see a perception by many of the critics that FHA is representing the builder or contractor rather than the borrower. We think the adoption of these recommendations will do much to overcome this image in Cameron County, Texas.

In addition to Cameron County, we suggest that the State Director closely examine other locations of unusual rural housing developments to be assured that the local activities of FHA personnel do not permit the bad publicity resulting in Cameron County and that FHA personnel are following his instructions. Detailed reminders should be sent to County FHA Offices to reexamine their associations and eliminate any of the factors detailed herein to avoid such criticism.

Additional details in support of statements herein appear in the investigation report, entitled WYATT B. NESBIT, COUNTY SUPERVISOR, CAMERON COUNTY FHA OFFICE, SAN BENITO, TEXAS—ALLEGED COLLUSION AND NEGLIGENCE OF DUTY UNDER THE FHA RURAL HOUSING PROGRAM, File No. T–401–66.

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