

April 1996

PROPERTY DISPOSITION

HUD's Illinois State Office Incurred Unnecessary Management Expenses



B-270938

April 22, 1996

The Honorable Henry G. Cisneros
The Secretary of Housing and
Urban Development

Dear Mr. Secretary:

We recently reported on the costs that the Department of Housing and Urban Development (HUD) has incurred in acquiring, managing, and selling foreclosed single-family properties.¹ Although HUD cannot control all of the costs of acquiring or selling properties, it can avoid or minimize some of the costs of managing them. For properties sold in fiscal years 1992 through 1994, these management costs totaled about \$691 million, or 5 percent of the overall costs of HUD's Single-Family Property Disposition (SFPD) program.

This report presents information on unnecessary management expenses being incurred by HUD's Illinois State Office (formerly the Chicago Field Office) in its property disposition program. We are alerting you to these expenses because of the opportunity to reduce them in the future and because other HUD field offices may be incurring similar management expenses.

Results in Brief

During our review of HUD's Single-Family Property Disposition Program in the Illinois State Office, we noted two practices that unnecessarily increase HUD's management costs. First, that office continues to pay for water and sewer services for vacant properties that are held for months in inventory before they are sold. We estimate that for the 138 properties held in inventory for at least 6 months as of August 1994, the office unnecessarily paid water and sewer bills on 60 properties, at an expense of about \$22,000. Second, the Illinois State Office did not pay property taxes on time, which resulted in HUD's unnecessarily incurring a \$62,000 expense to recover two properties lost for unpaid delinquent property taxes, penalties, and interest expense (tax liens). Furthermore, the expense incurred to recover these properties was substantially higher than the amount the office would have paid had it acted sooner.

¹Property Disposition: Information on HUD's Acquisition and Disposition of Single-Family Properties (GAO/RCED-95-144FS, July 24, 1995).

Background

HUD has issued guidelines to its field offices for managing and selling properties in its inventory. These guidelines² require that when a Federal Housing Administration lender forecloses on a loan and HUD takes possession of a property that the field office contract with an experienced real estate asset manager (REAM) to manage it. Although HUD's guidelines for managing properties require field offices to meet certain standards, they state that variations in requirements among field offices may be necessary as regional climates and other conditions differ. HUD's Illinois State Office requires its REAMS to notify all local utilities in writing to cancel water and sewer services when HUD takes possession of properties. According to field office officials, this requirement is intended primarily to avoid utility payments on vacant properties and to avoid excessive costs from broken pipes and water damage during periods of freezing temperatures.

HUD's guidelines also require field offices to evaluate unpaid property taxes and other liens, such as homeowners associations' fees, and to promptly pay unpaid property taxes to avoid fines, penalties, and assessments. These requirements were established to protect HUD's interest in its properties and avoid tax sales by taxing authorities to satisfy tax liens.

In Illinois, if taxes on a HUD property remain unpaid for more than a year, the local taxing authority has the right to sell that property to recoup the tax liens. The price paid at a tax sale for a HUD property is usually significantly below fair-market value. However, HUD retains the right to redeem the property within 2 years from the date of the tax sale for the purchase price paid at the tax sale plus accrued interest. If HUD does not redeem the property within 2 years, the tax sale purchaser can apply for a tax deed to obtain title after giving notice to the delinquent taxpayer. When the title is transferred to the tax sale purchaser, HUD must then negotiate a price with the purchaser if it chooses to recover the title. This price is usually substantially higher than the cost of the unpaid tax liens and accrued interest.

The Illinois State Office is primarily responsible for managing and selling the properties that HUD acquires in Illinois, most of which are concentrated in the Chicago metropolitan area. Through its contracts with and oversight of REAMS, the field office is responsible for efficiently managing the properties under its jurisdiction and for ensuring the appropriateness and accuracy of the costs incurred to protect and preserve them. These

²See HUD's Property Disposition Handbook—One to Four Family Properties, Rev-2 (Apr. 1994).

responsibilities require adequate internal controls to prevent fraud, waste, and abuse in the SFPD program.

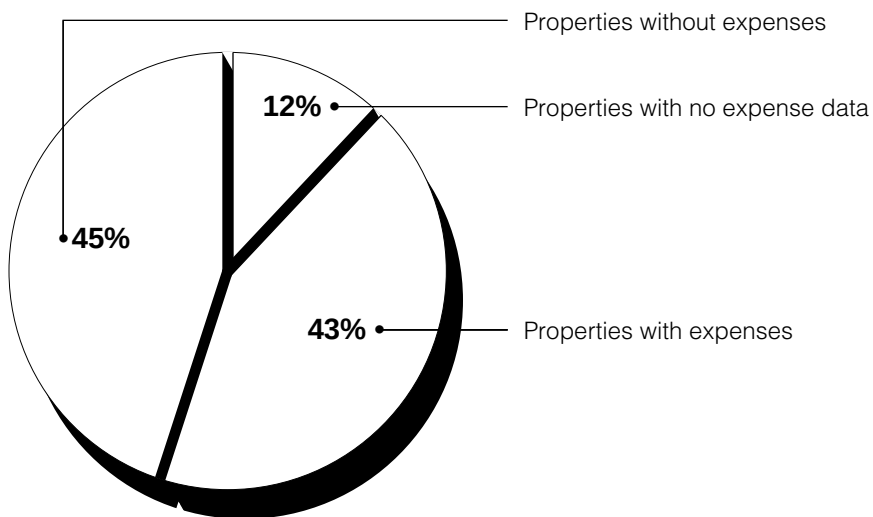
HUD's Illinois State Office Paid for Water and Sewer Services on Vacant Properties

Despite the Illinois State Office's requirement to cancel water and sewer services when taking possession of a property, the office continued to pay such expenses for many properties. As figure 1 shows, we estimate that for 43 percent (or 60) of the 138 properties held in inventory for 6 months or longer as of August 1994, the field office incurred water and sewer expenses. The field office spent a total of about \$22,000 in water and sewer expenses for these properties, or an average of \$367 per property.³ We also estimate that for 45 percent (or 62) of these properties, the field office incurred no water and sewer expenses; cost data were unavailable for the remaining 16 properties.⁴

³For this analysis, we randomly selected 60 properties from the universe of 138 properties that were held in inventory for at least 6 months as of August 1994. (The similarity between the number of properties in our sample and our estimate of the number of properties in the universe with expenses is coincidental.) At the 95-percent confidence level, we estimate that between 45 and 75 properties had costs that ranged in total between \$15,000 and \$29,000.

⁴We based our analysis on billing information provided by local utilities. We noted instances in which HUD had incurred water and sewer costs on some properties, but because data were not available to permit us to distinguish between costs that were incurred before and after HUD took possession of the properties, we did not include these amounts in our analysis. However, our estimate of the amount HUD paid in unnecessary water and sewer expenses includes penalties that were based on unpaid billings accumulated before the Department acquired the properties.

Figure 1: Estimated Percent of Vacant Properties With Water and Sewer Expenses (Properties Held in Inventory 6 Months or Longer as of August 1994)



The Illinois State Office paid water and sewer bills on vacant properties because REAMS either did not (1) notify the appropriate utilities to turn off the services when HUD took possession of the properties or (2) follow up to ensure that these services were discontinued. Moreover, our review of property files and discussions with officials indicated that the field office did not monitor the extent to which REAMS had notified the appropriate utilities to discontinue water and sewer services on vacant properties. In Chicago, where a substantial portion of the Illinois State Office's inventory is located, properties not equipped with water meters are billed a flat rate biannually for unmetered water and sewer services. Consequently, even if the water supply to a property is turned off at the curb, the city continues to bill for water and sewer services unless it is notified in writing to discontinue the services. To illustrate, in 1994 the Illinois State Office was billed and paid \$465 for water and sewer services on a vacant property that remained unsold after 20 months in the inventory.

We discussed the payment of utility expenses on vacant properties with officials at the Illinois State Office and HUD headquarters. Field office officials told us that the REAMS should have notified the appropriate utilities to discontinue water and sewer services and done the necessary follow-up to guarantee that such action did occur. They also said that they could not provide a valid reason for why these services would need to

remain in operation on vacant properties. Officials at HUD headquarters told us that property management activities were generally handled at the field office level.

Unpaid Tax Liens Resulted in Lost Properties

HUD's Illinois State Office lost the title to three properties in its inventory because it did not (1) pay the tax liens that had been placed on the properties and (2) act promptly to recover the properties within the required 2-year period. The office later paid \$62,000⁵ to recover two of the three properties. The office did not pursue recovering the third property, thus avoiding further expenses, because it had been scheduled for demolition.

The field office lost these properties despite HUD's requirement for the prompt payment of tax liens. Moreover, even when local taxing authorities notified the office that these properties had been sold for unpaid taxes and that redemption was required within 2 years of the tax sale, the office did not recover the properties within the time frame allowed. Consequently, the field office subsequently paid substantially higher prices to recover two of the three properties from the new owners because it forfeited the right to recover them for an amount equal to only the back taxes and accrued interest.

Specifically, we found that when the field office took no action to recover one property within the required 2 years, the taxing authority transferred the property title to the tax sale purchaser. About 2 years later, after having sold the property when it had lost the title to it, the field office paid \$42,000 to recover the property. The office paid that amount instead of only the \$1,190 in back taxes plus accrued interest (up to a maximum of 18 percent every 6 months) that it could have paid if it had acted in time.

The second lost property was sold at a tax sale for unpaid taxes, estimated at under \$600. Unaware that a tax sale purchaser acquired the title to the property following the 2-year redemption period, HUD's Illinois State Office sold the property to other purchasers. To recover the property, the field office paid the tax sale purchaser \$20,000, roughly \$14,000 more than it would have paid before the redemption period expired.

⁵The total does not include (1) the holding costs HUD incurred for the two properties, (2) attorneys' fees, (3) court recording fees, and (4) costs for various administrative services because field office personnel could not locate these data in HUD's new automated Single-Family Accounting Management System (SAMS) II.

The field office did not recover the third property within the 2-year redemption period, or pursue doing so afterwards, even though it had spent about \$54,000⁶ to acquire the property. According to the field office officials responsible for the area where the property is located, no efforts were made to recover the property because the property had been scheduled for demolition. The Illinois State Office, however, needlessly spent additional money on this property 1 month after the redemption period had expired and HUD had no ownership in the property by paying \$500 for back taxes and penalties for the property.

According to officials at HUD's Illinois State Office, inadequate links between the automated systems for handling HUD's loan management and property management programs were a primary cause of losing properties. They indicated that under HUD's current automated systems, tax liabilities are difficult to monitor for all HUD field offices when properties with delinquent taxes are transferred from a loan management program to the SFPD program.

The Illinois State Office has taken steps to remedy the problem through a contract for tax services to be awarded in the near future. The contractor will be responsible for (1) preparing a magnetic tape for the office's payment of annual real estate taxes, (2) researching and identifying delinquent taxes, and (3) redeeming properties to avoid tax sales.

Officials at HUD headquarters believe on the basis of their experience that the problem with tax liens and lost properties that we observed in Illinois is not systemic across all HUD field offices. According to the SFPD Director, HUD headquarters will work with the field offices that encountered this problem to institute corrective action and alert other HUD field offices to this situation.

Conclusions

HUD's Illinois State Office's incurred thousands of dollars in unnecessary expenses for water and sewer services, as well as for tax penalties, lost properties, and increased costs to recover properties from the new owners. Nationwide, HUD could be wasting significant amounts of money.

⁶Under law, when HUD acquires a property that has gone through foreclosure, the agency reimburses the lender for the unpaid principal balance of the loan, covers a portion of the costs associated with the foreclosure, and makes interest payments to compensate the lender for the interest lost after the borrower defaulted on the loan.

We support the Illinois State Office's efforts to better track unpaid taxes. We believe this will help the office avoid having future tax liens and losing properties.

Recommendations

We recommend that the Secretary of HUD direct the Assistant Secretary for Housing to (1) require that the Illinois State Office ensure that REAMS discontinue water and sewer services when HUD takes possession of properties and (2) advise other HUD field offices of this situation to reduce the likelihood that this problem can occur elsewhere.

Agency Comments

We provided a draft of this report for comment to the HUD Director for Housing, who also serves as the Commissioner of the Federal Housing Administration. We met with officials at HUD headquarters, including the Director of Single-Family Property Disposition, Office of Insured Single-Family Housing, to obtain their comments on the draft.

The officials agreed with the report's findings, conclusions, and recommendations. The SFPD Director said that she will issue a Department-wide memorandum to inform field offices about the unnecessary costs that HUD incurs when it pays water and sewer bills on vacant properties. The memorandum would also alert field offices to the issue of properties lost because of unpaid property taxes. The HUD officials also suggested several technical revisions, and we have incorporated these comments into our final report as appropriate.

Scope and Methodology

To determine the extent to which HUD paid for water and sewer services on vacant properties that were held in its inventory, we randomly selected 60 of the 138 properties that the Illinois State Office had held in its inventory for 6 months or longer as of August 1994.

To obtain the total dollar amount billed for each of the properties in our sample, we contacted the various municipalities and utility companies that billed HUD for these services. We also reviewed HUD's SFPD handbook and discussed with field office officials their procedures for handling water and sewer services for vacant properties. We discussed this matter with the field office's Director of the SFPD program and its Chief and Assistant Chief of the Single-Family Housing Division.

In examining properties the Illinois State Office lost because of unpaid tax liens, we reviewed available records and information obtained from HUD's automated tracking systems. Furthermore, we interviewed the field office's Director of Single-Family Housing and Chief of the SFPD program to obtain the rationale for the field office's nonpayment of delinquent property taxes and failure to recover properties within the statutory 2-year redemption period.

We performed our work in accordance with generally accepted government auditing standards from May 1994 through December 1995. However, we did not independently verify the accuracy of the utility bills for water and sewer services or HUD's records of the total costs to recover properties lost through tax sales.

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement of the actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Reform and Oversight Operations not later than 60 days after the date of this letter and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this letter.

Major contributors to this report are listed in appendix I. Please contact me at (202) 512-5167 if you or your staff have any questions or want additional information.

Sincerely yours,

A handwritten signature in cursive script, reading "Judy A. England-Joseph". The signature is written in black ink and is positioned above the printed name.

Judy A. England-Joseph
Director, Housing and
Community Development Issues

Major Contributors to This Report

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