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AUDIT REPORT

FIRST PRESTON FORECLOSURE SPECIALISTS MARKETING AND MANAGEMENT CONTRACT

BLUE BELL, PENNSYLVANIA

00-NY-229-1006

SEPTEMBER 21, 2000

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OFFICE OF AUDIT
NEW YORK/NEW JERSEY

Issue Date	September 21, 2000
Audit Case Number	00-NY-229-1006

TO: Engram A. Lloyd, Director, Homeownership Center
Philadelphia, Pennsylvania, 3AHH

Alexander C. Malloy

FROM: Alexander C. Malloy, District Inspector General for Audit, 2AGA

SUBJECT: First Preston Foreclosure Specialists
Marketing and Management Contract
Blue Bell, Pennsylvania

We completed an audit of First Preston Foreclosure Specialists (First Preston) a Management and Marketing (M&M) contractor. This report presents the results of our audit of First Preston's ability to manage and market the U.S. Department of Housing and Urban Development (HUD) single family properties. The report includes three findings with recommendations for corrective action.

Within 60 days, please provide us, for each recommendation in this report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is not considered necessary. Also, please furnish us copies of any correspondence or directives issued related to this audit. Please be advised that Handbook 2000.06 REV-3 requires management decisions to be reached on all recommendations within 6 months of report issuance. It also provides guidance regarding interim actions and the format and content of your reply.

We appreciate your cooperation during the audit, and would like to thank First Preston for its cooperation during the audit. Should you or your staff have any questions, please contact William H. Rooney, Assistant District Inspector General for Audit, on (212) 264-8000, extension 3976.

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Executive Summary

We performed an audit of First Preston to assess its performance under its Marketing and Management (M&M) Contract Number C-OP-21522. Specifically, our audit objectives were to assess First Preston's ability to manage and market properties in a manner that enables HUD to accomplish its mission. This audit is one of a series of audits the Office of Inspector General (OIG) is performing regarding the operations of M&M contractors. Each audit is part of OIG's nationwide assessment of HUD's ability to meet its program mission while outsourcing management and marketing activities.

HUD outsourced management and marketing activities

Under Secretary Andrew Cuomo, the U.S. Department of Housing and Urban Development (HUD) has undergone significant changes in response to the Secretary's "HUD 2020 Reorganization Plan." One major change is the outsourcing of HUD's management and marketing of its single family properties. Although HUD outsourced these activities, its program mission did not change. The program mission is to reduce the single family inventory in a manner that: (1) expands homeownership, (2) strengthens neighborhoods and communities, and (3) ensures a maximum return to the mortgage insurance fund.

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Contract awarded to First Preston on September 23, 1999

In March 1999, HUD awarded 7 contractors a total of 16 M&M contracts to manage its single family property inventory. One of the original contractors failed to effectively manage and market properties; as a result, HUD terminated the contractor. On September 23, 1999, HUD awarded a M&M contract to First Preston for the Philadelphia Homeownership Center (HOC) Area 3, which includes New York, New Jersey, Pennsylvania, Delaware, Washington, DC, and Virginia.

First Preston has demonstrated success in several key areas. It has instituted an electronic bidding system; reduced the number of properties in inventory; and increased the sales of properties. Despite these accomplishments, improvements are still needed.

Properties not adequately maintained or safeguarded

Physical inspections performed by the OIG, and by subcontractors of First Preston showed numerous deficiencies, evidencing inadequate maintenance and safeguarding of property assets. The unfavorable property conditions occurred because First Preston did not always repair, maintain and properly secure properties in accordance with the contract provisions. Consequently, efforts to effectively market assets for sale diminished, while health and safety hazards became more prevalent. In our opinion, this increased the risk of potential liabilities to HUD, and may have caused property values in surrounding neighborhoods to decline. Unless First Preston enacts adequate controls that ensure prompt and complete recognition of existing property deficiencies, and establishes procedures necessary to correct deficiencies identified, marketing efforts will be impeded; properties needing repair will remain in inventory as unsold; neighboring communities may be adversely affected; and shoddy property conditions will likely occur.

Properties in inventory for 12 months or longer has increased

An essential objective of the M&M contract is the selling of the properties and reducing the inventory. In the eight months since executing the M&M contract, First Preston has reduced the overall inventory by eight percent; however the number of properties held in the inventory longer than 12 months increased by 63 percent. In our opinion, this occurred because First Preston has not placed enough emphasis on the sale of properties that have been in the inventory for long periods of time. The failure to dispose of these properties results in higher holding costs; but, more importantly, such properties have a negative effect on the surrounding neighborhoods.

First Preston has not complied with all the requirements in its' contract

Furthermore, First Preston has not complied with all the requirements in its contract. Specifically, First Preston: (a) charged for ineligible costs; (b) did not performed tasks in a timely manner; (c) did not always included the required documentation in the appropriate files; and (d) did not report all problems to the Government Technical Representative (GTR). We believe these deficiencies occurred because First Preston did not implement the necessary controls to ensure that all contract provisions were met. As a result, First Preston's performance may have lead to excessive costs and properties remaining in the HUD inventory for extended periods of time.

Exit Conference

On August 22, 2000, we held an exit conference with First Preston Officials to discuss our draft findings and recommendations.

First Preston's written response is shown in Appendix B. In addition, we have included a summary of First Preston's pertinent comments after each finding.

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Abbreviations

ACL	Audit Command Language
GTR	Government Technical Representative
HOC	Homeownership Center
HUD	Department of Housing and Urban Development
M&M	Management and Marketing
OIG	Office of Inspector General
SAMS	Single Family Accounting Management System

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Introduction

HUD's Single Family Mortgage Insurance Program helps low and moderate income families become homeowners by reducing down payments and limiting lender fees. Every year, however, thousands of borrowers default on their HUD insured loans. When borrowers default, HUD encourages lenders to work with them to bring their payments current. If the lenders are unsuccessful, the borrowers' homes may be sold to third parties, voluntarily conveyed to the lenders, or surrendered to lenders through foreclosure. Once lenders obtain the properties, they generally convey title to the Secretary of HUD and submit a claim to the HUD insurance fund.

Background

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

HUD mission is to reduce property inventory

The mission of HUD's single family property disposition program is to reduce the property inventory in a manner that expands home ownership opportunities, strengthens neighborhoods and communities, and ensures a maximum return to the mortgage insurance fund.

HUD's Office of Insured Single Family Housing, Asset Management Division, is responsible for developing property disposition policies and procedures governing program administration. Each of HUD's four Homeownership Centers (HOCs) is responsible for program operations within its geographical jurisdiction. The Philadelphia HOC is responsible for overseeing First Preston's management of Area 3 properties.

First Preston awarded M & M contract on September 23, 1999

As part of a nationwide restructuring of HUD's Single Family Property Division, on March 29, 1999, HUD awarded seven contractors a total of 16 contracts to manage and market its properties nationwide. HUD awarded seven of the contracts to Intown Management Group, LLC. Two of Intown's contracts were for properties located in The Philadelphia HOC's Areas 2 and 3. Area 2 consisted of New York, New Jersey, Pennsylvania and Delaware, and

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Area 3 consisted of Washington, DC, Maryland, Virginia and West Virginia. Because of Intown's failure to effectively manage and market properties, HUD terminated all of the contracts with Intown. On September 23, 1999, HUD awarded a M&M contract to First Preston for a revised Philadelphia HOC Area 3 that now includes New York, New Jersey, Pennsylvania, Delaware, Washington, DC, and Virginia.

First Preston's main offices are located in Addison Texas, and the Regional Office for Area 3 is located at 475 Sentry Parkway, Suite 5000, Blue Bell, Pennsylvania. The President of First Preston is Ms. Nancy Richards.

Contract Objectives

The primary objectives of First Preston's contract are to ensure that: (1) properties are protected and preserved, properly managed, evaluated, and marketed in a manner which produces the highest possible return to the insurance fund; (2) average losses on sales and the average time properties remain in inventory are reduced; and, (3) the overall program and the image of properties are positive.

The contract's scope of work requires First Preston to perform all of the management and marketing duties and responsibilities formerly performed by HUD. First Preston is responsible for inspecting, appraising, securing, maintaining and selling the properties. For these services, HUD pays First Preston a fee based on a percentage of the properties' selling prices. The fee is paid in two installments, 30 percent upon the listing of the property for sale and the remainder when the property is sold. The estimated value of the contract is $35,518,270 for the period September 23, 1999, though January 31, 2001.

Prior contractor problems resulted in special contract provisions

Intown's mismanagement had created an excessive property inventory, poor property conditions, lack of adequate records, poor public relations and many other problems. Because of the unique problems in taking over the management and marketing function, after Intown's termination, several special provisions were included in First Preston's contract. A distinction was made between the properties previously assigned to Intown "transition

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properties" and new properties "newly assigned properties." Among other things the contract made concessions on time frames required for listing the properties and adjusted the management fee to 70 percent for properties previously listed by Intown. In addition, Exhibit 16 of the contract allowed First Preston to be paid on a reimbursement basis during the first 60 days of the contract, the actual costs to remove debris and defective paint, as well as actual costs to secure the property. Also, during the first 75 days of the contract, the contract allowed First Preston to be reimbursed as pass through costs for fines, interest or other penalties on transition properties

The inventory of properties at the end of September 1999, was 9,626, which represented about 19 percent of the total properties held nationwide. At May 31, 2000, the inventory of properties assigned to First Preston was 8,817, representing about 22 percent of the total nationwide properties.

Audit Objectives and Scope

The audit objectives were to determine if First Preston: (1) managed properties according to HUD policies, procedures and regulations and with the terms and conditions of its M&M contract; (2) instituted adequate controls to ensure HUD's assets are adequately protected; and (3) established operations that resulted in HUD accomplishing its mission and performance goals.

To meet our objectives, we:

- Interviewed First Preston and HOC officials;
- Reviewed 29 active property cases in two cities, Buffalo, New York and Philadelphia, Pennsylvania;
- Selected 29 active properties using the random sampling function in the Audit Command Language (ACL);
- Reviewed 15 closed cases selected using ACL's random sampling function;
- Inspected a judgmental sample of 27 properties;
- Reviewed a judgmental sample of First Preston payment vouchers;
- Examined 100 percent of vouchers between October 1, 1999 and March 31, 2000, using ACL for indications of possible duplicate payments;

- Reviewed First Preston's policies and procedures and observed its operations; and,
- Analyzed inventory and sales trends.

We assessed management controls regarding: (1) property preservation and protection, (2) billings to HUD for services, (3) property sales, (4) property appraisals, (5) sales closing documents, and (6) subcontracting.

The audit is one in a series of audits OIG performed of M&M contractors' operations. Each audit is part of OIG's nationwide assessment of HUD's ability to meet its program mission and goals while outsourcing its management and marketing activities.

Audit Period

We performed our field work from April 2000 through August 2000. The audit covered the period between September 23, 1999 and May 31, 2000. We updated our report to reflect current actions, where applicable. We conducted our audit in accordance with generally accepted government auditing standards.

A copy of this report was sent to First Preston.

Properties Not Adequately Maintained or Safeguarded

Physical inspections performed by the OIG, and by subcontractors of First Preston, showed numerous deficiencies evidencing inadequate maintenance and safeguarding of property assets. The unfavorable property conditions exist because First Preston did not always repair, maintain or properly secure properties in accordance with contract provisions. Consequently, efforts to effectively market assets for sale have been diminished while health and safety hazards have become more prevalent. Thus, this has increased the risk of potential liabilities to HUD, and may have caused property values in surrounding neighborhoods to decline.

Criteria

The M&M contract between HUD and First Preston contains requirements relative to issues of maintenance and security of the properties. Section C-2, paragraph V.5 defines one of the contractor's tasks to routinely inspect and take all actions necessary to preserve, protect and maintain each property in a reasonable condition at all times. Further, Section C-3, paragraph VI of the contract stipulates that the contractor shall be responsible for safeguarding all government property. The contractor shall be held liable for damages to government property due to causes such as vandalism, neglect, negligence of employees and subcontractors, failure to secure property or other misconduct by the contractor.

Scope

Our audit included a review of First Preston's management and marketing operations using a sample of 29 properties located in Philadelphia, Pennsylvania and Buffalo, New York. To determine the quality and accuracy of inspections performed by First Preston's subcontractors, and to verify current property conditions, we performed physical inspections of the 27 properties in the sample. In addition, we performed exterior inspections of six additional properties in Buffalo and two in Philadelphia to assess the impact of the properties on the surrounding neighborhood. The inspections focused on conditions associated with property maintenance, safeguarding, and health and safety matters. We compared the results of our inspections to the latest inspections that were performed by First Preston's subcontractors.

Numerous deficiencies noted during OIG inspections

Inspections Results

The HOC's monthly assessment reports of First Preston's performance have continually stated that property maintenance was at an unacceptable level of performance. In its letter of May 31, 2000, the HOC stated that for the month of April, of the 1,510 inspections performed, 59 percent (889) were unacceptable. Our inspections corroborated the existence of property maintenance problems. While overall results varied broadly, our inspections showed that all 27 properties, were deficient in at least one, but often several, of the 22 relevant categories examined (See Table Below).

Property Deficiency	First Preston	OIG
Foundation Cracks	0	7
Exterior Appearance	1	3
Kitchen and Bath	0	21
Heating	0	3
Plumbing	0	5
Electrical	0	5
Roof Leaks	5	10
Water Damage	1	6
Vandalism	1	6
Needed Repairs	3	10
Defective Interior Paint	9	21
Interior Appearance	0	3
Door Key Did Not Work	0	3
Lawn Not Cut	10	14
Debris in Yard	6	6
Poor Roof Condition	2	6
Signs Not Posted	3	19
Unsecured Doors	2	2
Windows Not Boarded	7	22
Windows Not Secured	1	13
Exterior Hazards	2	5
Defective Paint	8	15

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Properties were in poor condition and contained health and safety hazards

Examples of poor property conditions

Several properties inspected were in poor condition and contained alarming health and safety hazards. Among other things, our inspectors disclosed that a shotgun was under the porch of one property; a decaying rat was in the basement of another, and an entire window was laying on the ground outside a third property. Moreover, some properties have been broken into and vandalized; some were laden with debris, and/or were in need of vital repair. Some of the more notable property deficiencies are identified within the pictures of Appendix A to this report.

Differences were noted between OIG and subcontractors' inspections

Subcontractors' inspections not consistence with OIG results

Significant differences were noted between the results of our inspections and those recently conducted by First Preston's subcontractors. Yet, it would be reasonable to expect the observations to be similar since the OIG inspections were performed, in most instances, within two weeks or less of the latest documented subcontractor inspection. Notwithstanding, for nearly all 22 areas inspected, the subcontractor classified significantly fewer properties as deficient than the OIG. The following is a graphical illustration that compares the number of deficient properties, for nine pertinent inspection categories, as identified by both First Preston's subcontractors and OIG appraisers.

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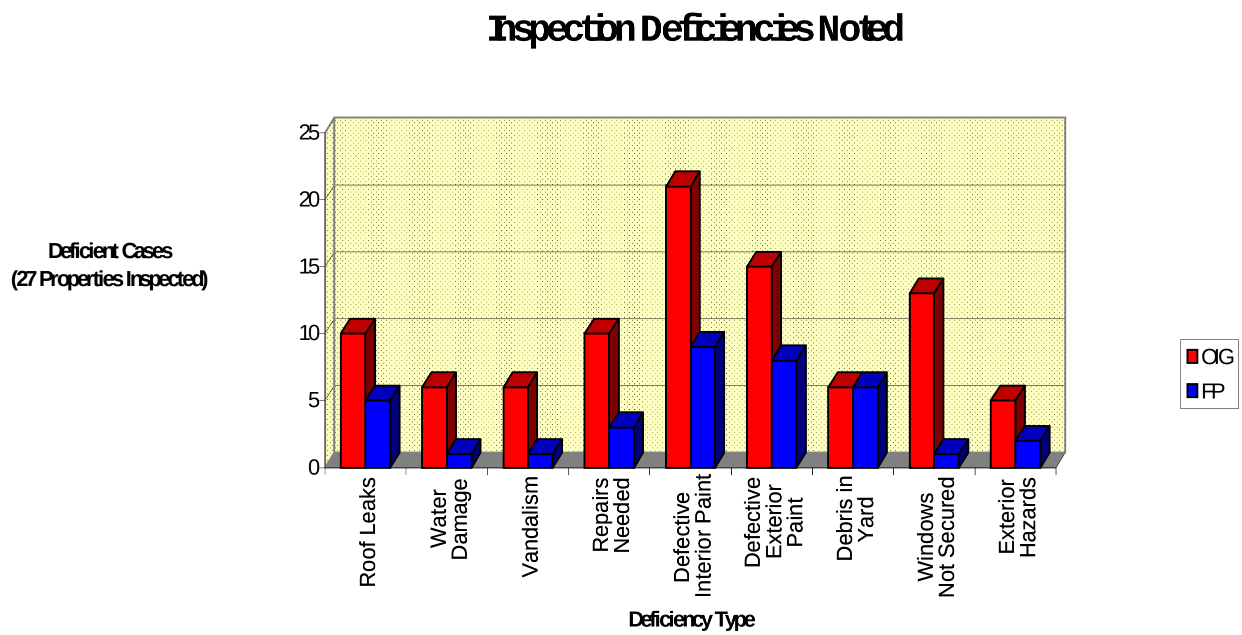

Subcontractor inspections incomplete

<u>Subcontractor inspections appear to be incomplete</u>

As illustrated, OIG inspections consistently classified more properties as deficient than did First Preston's subcontractors. In particular, subcontractors' inspections appear incomplete relative to detecting property deficiencies such as: defective paint, water damage, vandalism, needed repairs, and, inadequate security. These results indicate that subcontractors' inspections may be less than adequate and may most likely contain errors and/or omissions.

We believe the poor maintenance and security of the properties that we inspected is the result of First Preston's lack of adequate controls over its subcontractors. Without proper controls to verify and promote the accuracy of subcontractors' performance, First Preston cannot be ensured that inspections will identify all existing deficiencies, all completed repairs or whether all properties are properly secured. The poor condition of the properties negatively effects the sale of the properties; may

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allow health and safety situations to go uncorrected; can increase potential liabilities to HUD; and possibly decrease the value of surrounding homes and neighborhood.

First Preston has not performed requirements concerning lead-based paint timely

Inefficient processing of lead based paint requirements

Apart from the above, First Preston has been less than expedient or efficient in its efforts to market certain properties located in Philadelphia, Pennsylvania.

Exhibit 15 of the M & M contract contains special provisions based on a court decree mandating that lead-based paint be abated in all properties sold within Philadelphia that were built before 1978. Specifically, it provides that upon acquisition of pre-1978 HUD owned homes, the M&M Contractor shall, on a weekly basis, furnish to the City of Philadelphia, Department of Public Health a written task order listing properties requiring initial inspections for lead-based paint. The Exhibit further states that if Health Department employees cannot access a property to perform the requested inspection or re-inspection, the M&M Contractor shall be charged a “lock out” fee of $60 for each occurrence.

Discussions with Philadelphia HOC staff, and a review of pertinent documentation showed that First Preston often did not request an initial lead-based paint inspection until several weeks subsequent to the date of property acquisition. In addition, as evidenced by numerous instances where HUD incurred costs for lock out fees, First Preston has not always assured access to properties subsequent to its request for an inspection.

In addition to adversely effecting the marketing of Philadelphia properties, First Preston’s delay in requesting lead-based paint inspections and not assuring access to properties may have allowed a serious health and safety condition to continue unabated.

Contractor actions required

Unless First Preston enacts adequate controls to ensure prompt and complete recognition of existing property deficiencies, and until it establishes procedures necessary to correct the deficiencies identified, marketing efforts will be

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impeded, properties needing repairs will remain in the inventory as unsold, neighboring communities may be adversely affected, and shoddy property conditions such as those previously described will likely occur.

Auditee Comments

First Preston disagrees with our conclusions. Its comments provide that the OIG inspections and the HOC's monthly assessments do not take into consideration the inherent risk verses contractor compliance. First Preston considers there to be serious conflicts of interest because several of HUD's Special Property Inspectors are disqualified M & M contract bidders and are operating under terms that are inconsistent with First Preston's contract.

First Preston comments also provide that its inspectors do not look at needed repairs the way the OIG does. According to its comments First Preston will not replace siding, paint and carpet, etc.; therefore, First Preston's inspectors will not write up these items during routine inspections.

Regarding, our first recommendation First Preston indicated that it will work with HUD to readdress its requirements. Regarding the second recommendation, concerning lead-based paint, First Preston, agreed that the problem existed early on during its contract; however, First Preston claims that it is now in compliance with its contract.

OIG Evaluation of Auditee Comments

Regarding inherent risks, First Preston has a contract with HUD that requires First Preston to adequately maintain and safeguard the properties in accordance with its contract. When we performed the inspections, we used an OIG Appraiser. Our inspections revealed that First Preston was not adequately maintaining or safeguarding the properties in accordance with the requirements of its contract. We performed our inspections in accordance with the contract which requires First Preston to routinely inspect and take

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all actions necessary to preserve, protect and maintain each property in a presentable condition at all times.

Regarding the lead-based paint issue, we recommend that the HOC ensure that First Preston is in compliance with the requirements.

Recommendations

We recommend that you require First Preston to:

1A. Establish procedures that: ensure all significant property deficiencies are identified; monitor the accuracy of subcontractor property inspections; and, provide assurance that the needed repairs are completed promptly.

1B. Ensure that the requirements of Exhibit 15 of the M&M contract, regarding lead-based paint are met.

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Number of Properties in Inventory for Twelve Months or Longer Increased

An essential objective of the M&M contract is to sell HUD owned properties and thereby reduce the inventory of HUD owned properties. In the eight months since executing the M&M contract, First Preston has reduced the overall inventory by eight percent; however, the number of properties held in the inventory longer than 12 months has increased by 63 percent. In our opinion, this occurred because First Preston has not placed enough emphasis on the sale of properties that have been in the inventory for long periods of time. The failure to dispose of these properties results in higher holding costs, but more importantly such properties have a negative effect on the surrounding neighborhoods.

Criteria

The M&M contract as executed on September 23, 1999, lists six primary objectives in Section C-2 paragraph I. Two of those objectives are to ensure: (1) that HUD owned properties are protected and preserved, properly managed, evaluated, and marketed in a manner which produces the highest possible return to HUD's mortgage insurance fund, and (2) that average losses on sales and the average time properties remain in inventory are reduced.

Scope

We reviewed the inventory, sales and profit and loss data from HUD's Single Family Accounting Management System (SAMS). Our audit included a review of the Acquired Properties Monthly Summaries reports and the Cash Management Profit and Loss reports for October 1999 to May 2000. In addition, we reviewed First Preston's monthly Executive Reports since the execution of its contract on September 23, 1999.

Properties 12 months and over increased by 63 percent

Inventory of older properties has increased

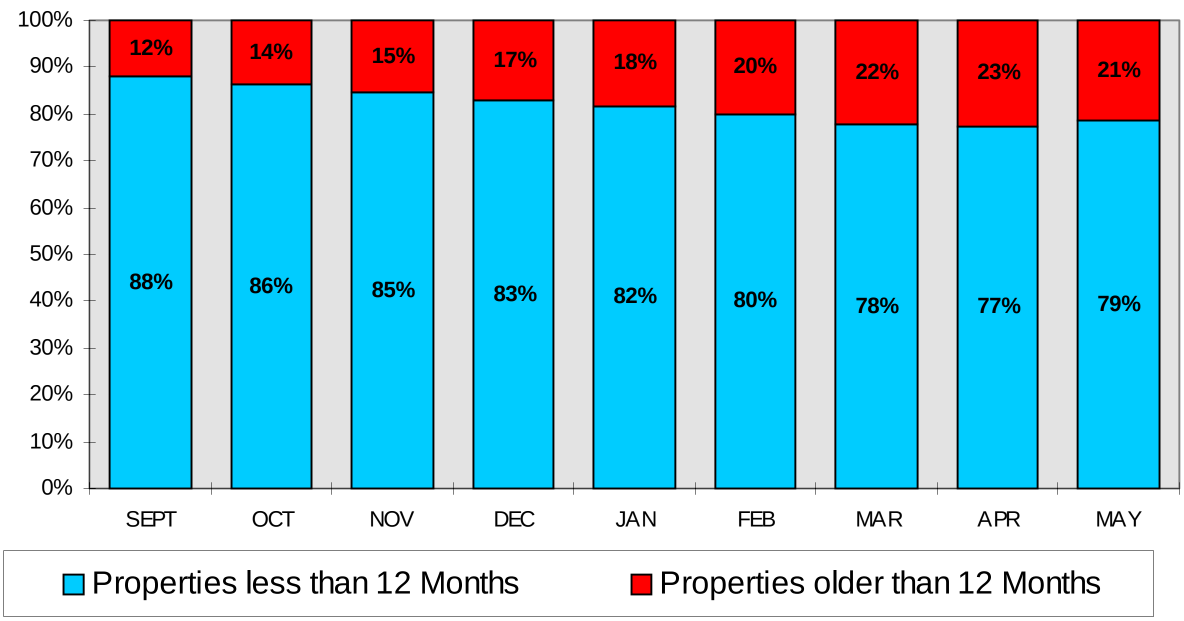
During the period that First Preston had the M&M contract, Area 3 showed an 8 percent decrease in the number of properties in the inventory. At the end of September 1999, the inventory of HUD properties was 9,626, and as of May 31, 2000, the inventory was 8,817. While properties in the inventory over 6 months decreased by 12 percent, properties that have remained in the inventory for 12 months or longer have increased by 63 percent from 1,150 to 1,876.

End Of Month	SEPT	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY
Total Inventory	9,626	9,903	10,175	10,227	10,060	9,903	9,583	9,240	8,817
Properties > 12 Mo.	1,150	1,375	1,555	1,733	1,855	2,001	2,119	2,089	1,876

<u>Steady increase in the percent of properties 12 months and older</u>

Properties that were in the inventory 12 months or longer accounted for 12 percent of the total inventory at the end of September 1999, and had increased to 21 percent at the end of May 2000. According to the Andersen Consulting Industry Benchmarking and Best Practices Report the real estate industry standard is 2 to 3 percent.

AGE OF PROPERTIES BY PERCENT



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Older properties have a higher holding cost and greater probability of deterioration

Increased likelihood of deterioration and vandalism

The failure to timely dispose of properties results in higher holding costs and increases the likelihood that the property will deteriorate or be vandalized. Not only does this reduce the marketability of the property, but the deteriorating properties have a negative effect on the surrounding neighborhoods and the value of nearby properties. Because the M&M contract principally concentrated on selling properties quickly, we believe that First Preston has not placed enough emphasis on the sale of properties that have been in the inventory for long periods of time.

Revenue losses have increased significant

$9,529,517 in lost revenue

HUD measures revenue losses based on the differences between average sales price and appraised value, the HUD goal is to sell properties at 98 percent of appraised value. During the period of time that First Preston has been under contract to perform the management and marketing function, there has been a steady decrease in the sales price as a percent of the appraised value and an increase in the loss of revenue. The following schedule shows that sales prices decreased to 90 percent of the appraised value in May 2000; and that there has been $9,529,517 in lost revenues since October 1999.

MONTH	APPRAISED VALUE	ACTUAL SALE PRICE	% OF APPRAISED VALUE	98% GOAL AMOUNT	DIFFERENCE	SALES VOLUME	REVENUE GAIN/ (LOSS)
Oct-99	$61,985	$62,233	100%	$60,745	$1,488	667	$992,496
Nov-99	$66,237	$66,463	100%	$64,912	$1,551	681	$1,056,231
Dec-99	$62,503	$61,963	99%	$61,253	$710	929	$659,590
Jan-00	$59,462	$58,127	98%	$58,273	-$146	1,140	($166,440)
Feb-00	$61,699	$60,051	97%	$60,465	-$414	1,192	($493,488)
Mar-00	$59,073	$56,943	96%	$57,892	-$949	1,427	($1,354,223)
Apr-00	$57,738	$53,981	93%	$56,583	-$2,602	1,293	($3,364,386)
May-00	$58,782	$52,703	90%	$57,606	-$4,903	1,399	($6,859,297)
							($9,529,517)

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The Good Neighbor Program may have contributed to the increase in the loss of revenue

The large increase in the loss of revenue in May could have, in part resulted from HUD's implementation of the Good Neighbor Program that began on May 1, 2000. The program was designed to sell properties that are 6 months or older to the local governments for $1.00. The intent of the program is to reduce the inventory of older properties. However, the sale of older properties for $1.00 will increase the loss of revenue and significantly impede HUD from meeting its goal of selling properties at an average of 98 percent of appraised value. While the Good Neighbor Program may have contributed to the increase in the loss of revenue in May, the overall trend since October 1999, has been a decrease in the sales price compared to the appraised value.

The lack of a significant reduction in the inventory is due to First Preston's failure to sell older properties in the inventory. In our opinion, this results from First Preston failure to allocate sufficient resources to the marketing of the older properties. As a result, loss revenue to HUD has increased and the average sales price has decreased to significantly below HUD's goal of a 98 percent average return.

Auditee Comments

First Preston disagreed with our conclusion and found the finding to be deceptive and misleading. First Preston's comments provided that the reference to an industry standard of 2 to 3 percent for properties in the inventory longer than 12 months is inapplicable to HUD's situation. The comments further provide that the industry standard does not apply because it does not take into consideration such items that are beyond First Preston's control, for example, lead-based paint abatement, bad cases held off market, and the properties held off market for purchase by the City of Buffalo.

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First Preston disagrees with our opinion that it has not placed enough emphasis on sale of the properties that have been in the inventory for long periods of time. Its comments provide that where the audit reports a loss revenue of $9.5 million based on percentage of sales compared to appraised value, First Preston can argue a real increase in revenue of over $83 million due to the increase in HUD's average sales price. First Preston agreed that the Good Neighbor Program and other special interest programs has caused an increase in revenue loss that has made it difficult to obtain the stated goal of selling properties at an average of 98 percent of appraised value. First Preston does not interpret the 98 percent goal as a contract requirement.

OIG Evaluation of Auditee Comments

Our review disclosed that for Area 3, properties in the inventory over 12 months increased by 63 percent since First Preston was awarded the M & M contract. As for the industry standard, we used the standard because it is accepted in the industry. As for the lead-based paint properties and properties held off market, we recognize that these properties have contributed to the fact that properties over 12 months in the inventory increased significantly. These are the type properties that in our opinion, First Preston has not placed enough emphasis on removing from the inventory. As mentioned in our recommendation, First Preston needs to work with the HOC to develop incentives to sell these properties.

In addition, one of HUD's performance indicators is to sell properties at 98 percent of the appraised value. First Preston does not interpret the 98 percent goal as a requirement of the contract. For this reason we made the recommendation that the HOC evaluate this goal and make applicable adjustments.

Recommendations

We recommend that you:

2A. Work with First Preston to increase the emphasis on the sale of older properties and/or

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develop incentives to encourage the sale of older properties.

2B. Evaluate HUD programs such as the Good Neighbor Program to determine their impact on the goal of selling properties at an average of 98 percent of appraised value. Based on that evaluation make adjustments to either the goal or the programs so they are not in conflict.

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First Preston Needs to Comply with all the Provisions of its Contract

First Preston has not complied with all the requirements in its contract. Specifically, First Preston (a) has charged for ineligible costs; (b) has not performed tasks in a timely manner; (c) has not always included the required documentation in the appropriate files; and (d) has not reported all problems to the Government Technical Representative (GTR). We attribute the cause of these deficiencies to First Preston's failure to implement the necessary controls to ensure that all contract provisions are met. As a result, First Preston's performance may have lead to excessive costs and properties remaining in the HUD inventory for an extended periods of time.

Criteria

Section B, paragraph I of the M&M contract requires First Preston to provide services to successfully manage single family properties owned by or in the custody of HUD, to successfully market those single family properties, and to successfully oversee the sales closing activity, including proper accounting for HUD's sales proceeds.

First Preston charged ineligible costs

Ineligible pass through costs

Section C, exhibit 16, paragraph 3 of the contract provides that only for the initial transitional properties,[1] First Preston could be paid costs (pass through costs) for such items as debris removal, securing the property, and defective paint removal. However, our review disclosed that First Preston charged HUD for debris removal etc., for properties newly assigned to it. The HOC reviewed requests for reimbursements and determined that $212,436.63 was not allowable. This review performed by the HOC was, in part, precipitated by the fact that an employee of First Preston, who was responsible for the maintenance of the properties in the Buffalo, New York area, was arrested for financial extortion and kickbacks.

First Preston responded to the HOC stating that requests for reimbursement of costs for such items as debris removal etc., were submitted to HUD in error. Officials of First

[1] Properties assigned to First Preston by HUD at the start of First Preston's contract.

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Preston claimed they performed a reconciliation that identified $238,959 as ineligible requests that were inadvertently submitted and received. Thus, First Preston reimbursed the funds to HUD.

It is apparent that the controls implemented by First Preston were unable to ensure that requests for reimbursement from HUD were only for eligible expenditures. As such, First Preston needs to institute management controls that will ensure that requests for reimbursement from HUD are for eligible costs.

Project files did not contain invoices or GTR approvals

Our review noted additional instances of questionable controls at one of First Preston's Field Offices. This Field Office was unable to locate copies of invoices for various completed work and had not requested the necessary GTR approval for certain costs. Further, the Field Office's work orders were not numbered. As a result, First Preston's controls could not be relied upon to ensure that only requests for eligible costs were submitted to HUD.

Possible duplicate charges

Our review disclosed another situation involving First Preston's controls, which pertains to pass through costs that were forwarded to HUD for reimbursement. Using an audit software package, (Audit Command Language), we reviewed all pass through costs forwarded by First Preston to HUD for the period October 1, 1999, through March 31, 2000. We identified 479 items that may be duplicate payments. Section C-4, paragraph III. B, of the contract provides that reimbursement by HUD for pass through costs may not be requested until First Preston pay for the service or item. We reviewed a sample of these requests at one of First Preston's Field Offices and at the HOC. Our review disclosed that some records were not available at neither the First Preston Field Office nor the HOC. However, a member of First Preston's staff told us that the records should be available at First Preston's Texas Office. Because we could not verify if duplicate costs exist, we

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originally questioned $32,549.45 of pass through costs as duplicate costs[2].

At our exit conference, officials of First Preston stated that of the $32,549.45 of questioned duplicate costs, $20,196.95 had been reimbursed to HUD, and that the remaining balance of $12,352.50 was for invoices that are not duplicative. Upon review, we verified that the $20,196.95 was reimbursed to HUD. First Preston repaid $6,551.20 of the $20,196.95 directly as a result of our audit inquires. More importantly, duplicate costs occurred and we have recommended that First Preston needs to institute management controls to prevent duplicate costs from occurring.

First Preston did not meet contract time thresholds

First Preston is required to meet certain time thresholds to ensure that properties are listed and sold within a reasonable time period. The timely listing and sale of properties reduces holding costs, and provides for a greater monetary return to the insurance fund. Our review found several instances in which First Preston was not meeting contract time thresholds.

Inspection were not performed within 24 hours

For the newly assigned properties, First Preston was to obtain an inspection within 24 hours per Section C-2, paragraph V. B. 3A, of its contract. Our sample included 15 newly assigned properties. For 11 of these properties, the inspections were not completed within 24 hours. However, four of the 11 were a week or more late with one being 43 days late.

Appraisals were not performed within 10 business days

Also, Section C-2, paragraph V. B. 9, of the contract requires First Preston to obtain an appraisal of a property within 10 business days of being assigned to First Preston. For 12 of the 15 properties in our sample, the appraisals were not received within the 10 day criteria. In fact, eight were five or more business days late with one being 51 business days late.

Disposition programs were not approved within 3 business days

Section C-3, paragraph II, requires First Preston to comply with HUD Handbook 4310.5 REV-2. Section 6-17 of the

[2] We arrived at this amount by questioning the second reimbursement by HUD for a service or item previously reimbursed to First Preston by HUD. The details of the 479 items were provided to First Preston.

Handbook requires the review and approval of a disposition program within three business days of receipt of the appraisal. There were seven cases from a possibility of 20 cases in our sample in which the disposition program was not approved within the required time frame. One of the disposition programs was approved 32 business days late.

Title evidence was not approved timely

Section C, exhibit 11-1 of the contract requires First Preston to review and approve or reject title evidence of a property within 10 calendar days of receipt from the mortgagee. First Preston took an excess of 10 days to approve the title evidence in six of a possible 13 cases in our sample. Failure to perform within required time frames results in possible increased interest payments to the mortgagees which results in a greater expense to HUD.

<u>The files did not always contains the required documentation</u>

Section C-3, paragraph XI. of First Preston's contract provides that: First Preston will ensure that hard copies of any and all required documentation under the contract be maintained in the appropriate property or subject matter file. Our review of the property files indicated that many items could not be located in the files. Further, we were unable to determine from the files whether First Preston had been completing various required tasks, since the information was not documented in the file. Our review indicated that First Preston was not always documenting the reconciliations of sales information, reviews of closing documents, wire transfer receipts, actions taken on held off market properties, HUD 27011 reviews, and title evidence.

Reconciliations were not adequately documented

Section C, exhibit 8-7 C, of the contract requires First Preston to reconcile the sales information with the sales proceeds. Section 11-19 D of HUD Handbook 4310.5 REV-2 explains that no case will remain unreconciled longer than 30 days past the closing without an explanation. First Preston did not reconcile the sales proceeds for two of 15 cases within the required time frame. For the two cases, the lack of reconciliations became apparent when we requested reconciliation information from First Preston.

Thus, the sales proceeds for one property were reconciled 111 days late. We believe that this situation was precipitated by the fact that First Preston has not adequately documented the sales reconciliation in its files. For eight of the 15 cases in our sample there were inadequate evidence that cases were reconciled.

Lack of evidence that Settlement Statement form HUD-1 was reviewed

First Preston did not document that it performed the form HUD-1, Settlement Statement, review as required in Section C, exhibit 8-8 of the contract. The review assures the appropriateness of charges to HUD. A First Preston closing official claimed that they are reviewing the HUD-1's. However, First Preston is not documenting that the reviews are being performed. In addition, First Preston is not reviewing the closing documents prior to closing. Section C, exhibit 8-4 B requires that First Preston must ensure the accuracy of all closing documents and that all costs being charged to HUD are appropriate. Members of First Preston's staff stated that they do not review the documents prior to closing because the closing agents are not required to submit pre-closing packages to First Preston. Without this review, inappropriate charges to HUD could occur, which First Preston would not be aware of, until several days after the closing.

Wire transfer receipts were missing from the files

First Preston is not obtaining adequate evidence that sales proceeds have been properly wired to Treasury. Section C, exhibit 8-7 B, of the contract stipulates that First Preston will ensure that wire transfer receipts indicate that the proper funds were wired to Treasury. For all 15 cases in our sample, we could not locate the wire transfer receipt in the files. First Preston staff maintained that the SAMS screens indicated when the funds were transferred. However, First Preston's contract requires First Preston to obtain the wire transfer receipts.

First Preston is not adequately monitoring HOM properties

First Preston explained that the properties in our sample are maintained as held off market (HOM) for two primary reasons; they were either aged inventory that has not had any bids for a lengthy period of time, or properties whose files, had missing or incorrect information. Our review indicated that First Preston is not adequately monitoring the properties that are HOM. For four of 10 properties that we reviewed, First Preston had not taken adequate steps to resolve missing document problems. As such, these properties remained HOM when they could have been re-listed and possibly sold.

Files do not contain evidence of form HUD-27011 review

Section C, exhibit 12 requires First Preston to review the Mortgagee Claim form HUD-27011. For 17 of 21 cases, which First Preston should have reviewed the HUD-27011, we could not locate any evidence that First Preston met this requirement. First Preston staff claimed that the entering of the information into SAMS was their evidence that Part A of the HUD-27011 was reviewed. The Chief Operating Officer told us that First Preston has created a form to be completed by staff to show that staff reviewed Parts B, C, and D of the HUD-27011. However, we could not locate any of these forms for the properties in our sample to verify this review.

First Preston is not adequately monitoring title evidence receipt

Mortgagees are required to submit evidence of a good and marketable title within forty-five (45) days after the date a deed to the Secretary of HUD is filed for record. This is outlined in Section C, exhibit 11 of First Preston's contract. Further, First Preston is responsible for reviewing and approving all extension requests for conveying title, submission of title evidence, submission of fiscal data, and for filing supplemental claims. There were seven cases in our sample in which the title evidence was not received within 45 days, and there was no evidence in the files of any requests for extensions. We believe that First Preston needs to closely monitor the timely receipt of title evidence.

First Preston has not notify the GTR of problems

The contract requires First Preston to notify the GTR when certain situations occur. Our review disclosed that First Preston is not properly notifying the GTR in regards to mortgagee neglect and deficiencies pertaining to closing agents.

First Preston is not formally notifying the GTR of mortgagee neglect

After a property's initial inspection, Section C, exhibit 11-19 requires First Preston to notify the GTR, if the inspection discloses that the property was damaged due to mortgagee neglect. There were six cases in our sample in which mortgagee neglect was identified during the initial inspection. In all of those cases, First Preston did not formally notify the GTR of the neglect. First Preston claimed that it stopped reporting mortgagee neglect to the HOC because the HOC was not allowing the costs of repairing the mortgagee neglect. We believe that it is still the responsibility of First Preston to notify the GTR regardless of the previous actions taken by the HOC.

Initial inspection did not identify apparent mortgagee neglect

Furthermore, our review disclosed that three initial inspections contained items that would constitute mortgagee neglect. Items identified in these inspections included excessive debris and holes in the roof that caused additional damage. The First Preston Inspectors, in all three cases, did not identify the properties as having a mortgagee neglect condition. We believe that First Preston needs to closely monitor the initial inspections to ensure that all instances of mortgagee neglect are reported.

First Preston is not notifying GTR of closing agent problems

Section C, exhibit 8-7 of the contract requires First Preston to notify the GTR in those instances where the closing agent failed to comply with the wire transfer procedures specified in its contract. Also, the GTR should be notified when the closing agent failed to submit the final sales closing package within the time specified in the closing agent's contract. The purpose of this requirement is to ensure that the closing agent is assessed the proper liquidated damages for any late delivery of wire transfers.

We found that for six of 15 properties reviewed, the closing agents did not wire the sales proceeds to HUD in a timely manner. However, First Preston did not formally notify the GTR when instances such as these occurred.

Also, we found that for three of the same 15 properties, First Preston did not enter HUD-1 data into SAMS in a timely manner. The only explanation provided by First Preston was that sometimes closing information came in late from the closing agents. But, First Preston staff was unable to provide documentation indicating such situations. Furthermore, there was no evidence in the files indicating that if the closing information was late that First Preston notified the GTR. We believe that First Preston needs to track the dates when pertinent documents are received and notify the GTR if such information is late.

Summary

In summary, we believe that First Preston has not implemented the necessary management controls to ensure that all contract provisions are followed.

Auditee Comments

First Preston comments indicate that because there was an inability to obtain SAMS information during the initial takeover, and because of the volume of properties, it was not possible to delineate between the takeover properties and newly assigned cases. This caused calendar issues and reimbursements that were inadvertently submitted and received by First Preston. First Preston's contract compliance accounting team conducted a quality control review of all pass-through items in March 2000 and identified $238,959 that was refunded to HUD.

Concerning files not containing invoices and GTR approvals, First Preston stated that the OIG review was performed in a field office; and that a field office file does not have a complete case file. First Preston's files are integrated into the case file upon closing. The case files are maintained in the Blue Bell, Pennsylvania, Office in accordance with its Quality Control Plan. Further, in an effort to eliminate the risk of duplicate payments, all original invoices with GTR approval are sent to the Corporate Accounting Department in Addison, Texas.

First Preston stated that of the $32,549.45 of questioned pass through costs $20,196.95 was reimbursed to HUD between March 23, 2000 and August 21, 2000. Also, First Preston indicated that the remaining $12,352.50 was for invoices that are not duplicative.

First Preston explained how it is currently operating and described its new procedures.

OIG Evaluation of Auditee Comments

We recognize that First Preston has reimbursed HUD the $238,959 of ineligible costs that it improperly requested

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and received. Our concern is that requests for ineligible costs occurred. Therefore, we recommended that the HOC ensure that First Preston has adequate management controls to prevent this from occurring again.

Our review of two First Preston Field Offices in our sample revealed that the controls at these Field Offices could not be relied upon to ensure that only requests for eligible costs were submitted to HUD. We believe that as a minimum First Preston Field Offices should maintain copies of numbered work orders, invoices for completed work, and any necessary GTR approvals. We raised this issue and made an appropriate recommendation to the HOC for its consideration.

Regarding the questioned costs, we verified that $20,196.95 was reimbursed to HUD. Regarding the $12,352.50 that First Preston states are not duplicate costs, we have recommended that the HOC determine whether First Preston is correct. More importantly, our reason for raising the issue is to show that duplicate costs occurred and that the HOC must ensure that First Preston has adequate management controls to prevent duplicate costs submitted to HUD for reimbursement.

Regarding First Preston's current procedures, we made various recommendations to the HOC to ensure that First Preston's contractual time thresholds are met, that files are adequately documented and that the GTR is notified when applicable.

Recommendations

We recommend that your Office require First Preston to:

3A. Ensure that it institutes management controls that will ensure that requests for reimbursement from HUD are for eligible costs.

3B. Review the remaining questionable pass through costs to determine whether there are any duplicate payments and that each charge has an original invoice and supporting documentation. If additional duplicates are found, First Preston should be required to reimburse HUD.

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3C. Maintain complete project files in its Field Offices. At a minimum, those files should include work orders, invoices, and GTR approvals when necessary.

3D. Ensure that all contract requirements are performed within the required time frames, including the following requirements:

- Properties inspected within 24 hours of assignment.
- Appraisals are received within 10 business days.
- Disposition programs are approved within 3 business days.
- Title evidence approved within 10 calendar days.

3E. Document in each property file that a reconciliation of the sales information with the sales proceeds has been performed.

3F. Develop a checklist to indicate what is to be reviewed on the form HUD-1 and include a copy of the completed checklist in the property file.

3G. Ensure that wire transfer receipts are obtained from the closing agents and are maintained in the property file.

3H. Establish and implement procedures that ensure that all properties listed as HOM are legitimate. If the properties are HOM due to missing documents, First Preston must take the appropriate efforts to obtain the missing documents and document the tracking of these efforts in the files.

3I. Document in the property file the items reviewed on form HUD-27011, Parts A, B, C, D.

3J. Monitor the receipt of title evidence to ensure that a title is submitted to First Preston within the applicable time frame.

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3K. Establish procedures that clearly identify what constitute mortgagee neglect, and which neglects should be reported on the initial inspection. Formally notify the GTR of those properties where mortgagee neglect has been identified.

3L. Formally notify the GTR of deficiencies which the closing agent did not performed in accordance with the its contract.

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Management Controls

In planning and performing our audit, we obtained an understanding of the management controls that were relevant to our audit. Management is responsible for establishing effective management controls. Management controls, in the broadest sense, include the plan of organization, methods and procedures adopted by management to ensure its goals are met. Management controls include the processes for planning, organizing, directing and controlling program operations. They include the systems for measuring, reporting and monitoring program performance.

Relevant Management Controls

Relevant Management Controls

We determined that the following management controls were relevant to our audit objective:

- Program operations - Polices and procedures for ensuring that HUD owned properties are protected and preserved, properly managed, evaluated, and marketed in a manner which produces the highest possible return to HUD's mortgage insurance fund.

- Validity and Reliability of Data - Administrative controls for ensuring the validity and reliability of the data entered into the Single Family Accounting Management System (SAMS).

- Compliance with Laws and Regulations - Procedures for ensuring that First Preston complies with all contract requirements.

- Safeguarding Resources - Policies and procedures for ensuring that there are adequate controls over processing and payments for services and controls for ensuring the disposition of properties that have been in the inventory for over 12 months.

We assessed all of the relevant controls identified above. The scope of our assessment is identified in the Introduction Section of this report and in the respective findings.

It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing and controlling program operations will meet an organization's objectives.

Based on our review, we believe that significant weaknesses exist in the following management controls. These weaknesses are described in the findings section of this report.

- First Preston did not adequately maintain or safeguard HUD properties. Finding 1 (Program Operations)

- First Preston did not comply with all requirements of the contract. Finding 3 (Compliance with Laws and Regulations) (Program Operations).

- First Preston was unable to ensure that requests for reimbursements from HUD were only for eligible expenditures. Finding 3, (Safeguarding Resources). First Preston did not place enough emphasis on the sale of properties that have been in the inventory for long periods of time. Finding 2, (Safeguarding Resources).

Follow Up On Prior Audits

This was the first OIG audit of the HOC's Area 3 contract.

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Property Condition Examples

	DRIVE-BY INSPECTION		
OIG Inspection:	06-01-00	Location:	Buffalo, NY
Condition:	Property appearance adversely impacts surrounding neighborhood.		

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Acquired:	01-14-00	Case No:	372-166691
OIG Inspection:	06-01-00	Location:	Buffalo, NY

Condition: Shotgun under deck is a serious health and safety hazard.

Acquired:	09-23-99	Case No:	441-309878
OIG Inspection:	06-06-00	Location:	Philadelphia, PA

Condition: Window on street shows inadequate safeguarding of assets.

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Acquired:	08-13-99	Case No:	372-265070
OIG Inspection:	06-01-00	Location:	Buffalo, NY

Condition: Mass of wiring is an electrical hazard.

Acquired:	12-11-99	Case No:	441-444362
OIG Inspection:	06-08-00	Location:	Philadelphia, PA

Condition: Roof leaks have caused significant ceiling damage

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Auditee Comments

First Preston

August 28, 2000

Mr. Alexander C. Malloy
District Inspector General for Audit
U.S. Department of Housing and Urban Development
New York/New Jersey
26 Federal Plaza, Room 3430
New York, NY 10278-0068

Subject: OIG Audit (Draft) Response

Dear Mr. Malloy:

First Preston Foreclosure Specialists, Inc., is in receipt of your draft audit report dated July 28, 2000. This report reviews aspects of our Philadelphia regional Marketing and Management Contract operation for the U.S. Department of Housing and Urban Development (HUD), and we appreciate the opportunity to provide a response. We are also grateful for the occasion to meet with yourself and senior members of your staff on August 22, 2000 to discuss this report in detail. During the audit, your team was very professional and courteous to all of our employees. The atmosphere surrounding the various interrelations between your team and First Preston was open and direct, which is essential to the overall success of this program.

Before responding to specific issues detailed in your report, please allow us to recap the historical condition of this portfolio and the progress we have made to date.

Takeover Anomalies

Opening Day

At the onset of the audit, a Senior OIG Auditor mentioned that he felt it was too early in our contract tenure to adequately review performance. On September 23, 1999, we became the successor to a failed contractor. First Preston had 21 days from HUD's signing of the contingency contract and 1 day from HUD's notice to proceed to begin operating under this contract. We hired in excess of 200 employees and subcontractors to help us meet this challenge. Subcontractors were not eager to engage in our employ due to the unpaid invoices owed to them [illegible] previous contractor.

T.O.C.

[illegible]te Services 5040 Addison Circle Suite 400 Addison, Texas 75001 Phone: 972.788.1100 Fax: 972.419.5415

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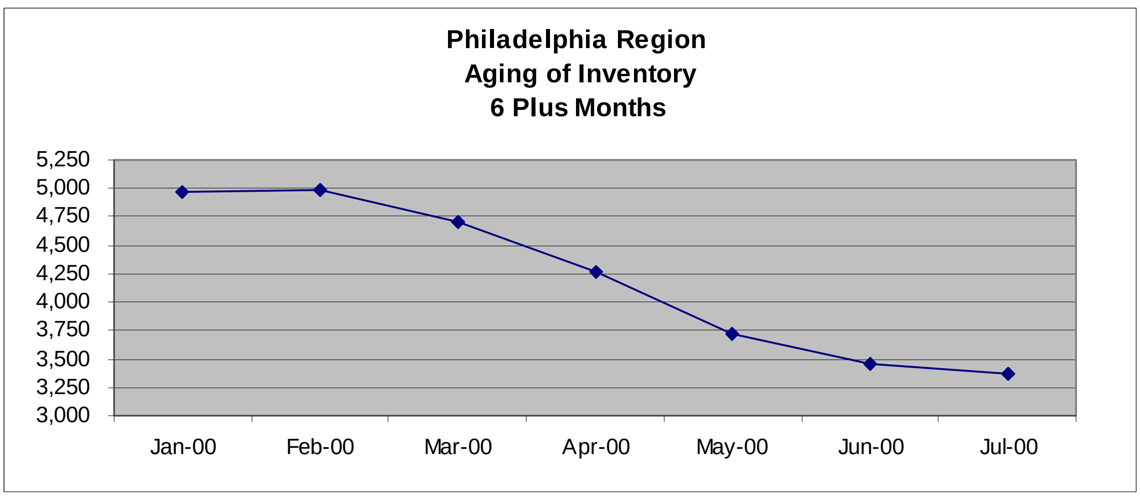
Disarray of Files

On September 24, 1999, approximately 60,000 case files and numerous boxes of loose paper that needed to be filed were delivered to First Preston to reconcile. It appeared the former contractor had six case files for each property. We worked with a File Transfer Protocol (FTP) report that was provided by HUD, which was an extraction of the First Preston assigned properties contained in HUD's SAMS system, requiring the manual removal of duplicate entries. This report provided limited information for reconciliation purposes.

Aged Inventory

First Preston continues to reduce the quantity of assets that remain in inventory over six months. In September 1999, the number of properties in inventory over six months, according to HUD's MEAP report (SAMS Report MEAPSS00), was 4,219, or 44% of HUD-owned inventory. Today, there are less than 3,500 properties that have been held by HUD more than six months. This represents a reduction of over 22%, under the constraint of the requirement for higher acceptable bid thresholds and without the use of marketing incentives that were typical prior to privatization. The statements made in your report referring to the 12-month inventory will be addressed on pages 6 - 8 of this response.



(Information provided by HUD MEAPSS01 report)

Title Evidence

The other M&M contractors opened their offices and began processing title evidence they had just received from the Mortgagees. First Preston's Philadelphia region inherited over 5,000 title evidences from the previous contractor that had not been approved or rejected. As you can imagine, reconciling these along with the current flow of new title evidence was a monumental

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task. The OIG's report should take this into consideration when determining whether or not we are performing the review process within 10 calendar days of receipt.

Customer Dissatisfaction

The lack of production during the eight months prior to our contract left a negative impact on the communities involved in the HUD marketing program. For these months, brokers, sales agents, closing attorneys, etc., had witnessed a tremendous drop in the number of available properties. This meant several disgruntled members of the industry had to be courted back to the program by First Preston's staff. The number of customer complaints at the onset of this contract was overwhelming. Ten thousand (10,000) calls per week were fielded by our customer service representatives. Much of our time and emphasis was dedicated to this endeavor.

This chart illustrates the number of properties processed through the system, therefore, the number of cases the industry experienced relative to sales, closings, title policies, etc.

Contractor	Takeover Inventory	Total Sales	Ending Inventory	Total Time Inventory Managed
Previous Contractor	5,669	< 1,500	9,854	8 months
First Preston	9,854	> 12,000	8,442	10 months

First Preston Successes

Inventory Reduction

Prior to our contract in September 1999, HUD's inventory for the Philadelphia 3 area was 9,854. As of July 2000, HUD's inventory for this same region was 8,332. This represents a 15% reduction in the total number of properties held in inventory since the start of our involvement in this region. This significant decrease is due to First Preston's overall plan of action within the scope of the contract and HUD's regulations, and our efforts of hiring and training a sufficient number of real estate industry professionals dedicated to the success of this privatized marketing and management concept.

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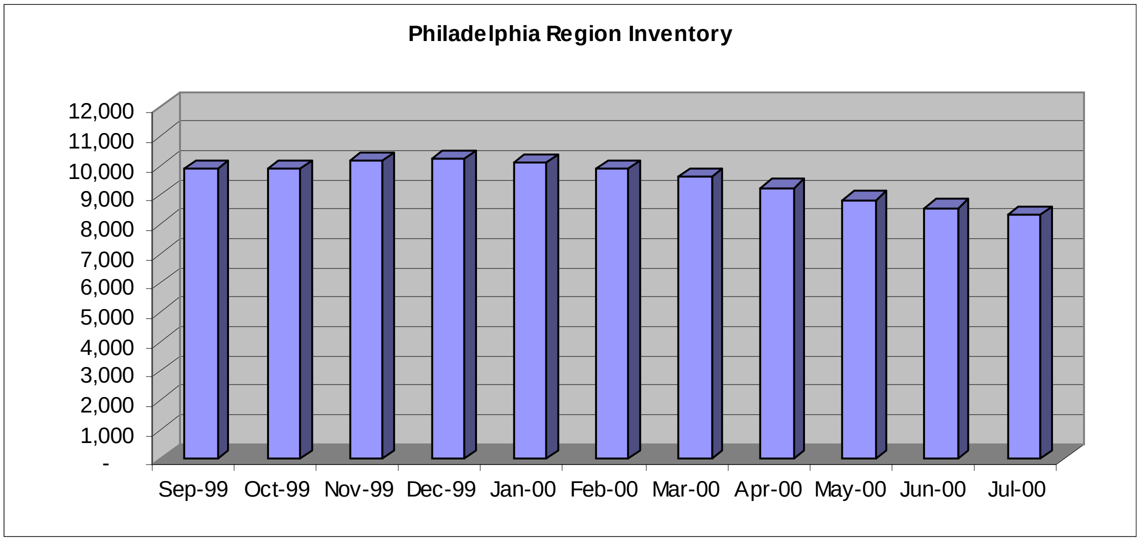

(Information provided by HUD MEAPSS01 report)

Reduced Turnover Rate – Returns $18.4 Million to HUD Annually

One of the major factors leading up to such a dramatic reduction of inventory can be found in the fact that First Preston successfully lowered the turnover rate of properties by 18%. We compared the turnover rate experienced by HUD prior to the M&M program, since the turnover rate during the time of our predecessor was skewed heavily due to the lack of closings. A reduction of this size represents a savings to the government of $18.4 million dollars per year, or $92.4 million over the life of our contract. We calculate this savings by multiplying current inventory by the turnover rate reduction and holding per diem cost, then we annualize this figure (8,442 X 46 days X $28/day X 1.7 periods/year = $18,484,603). [Note: The $28 per day figure is HUD's annually calculated and reported per diem holding cost per property.]

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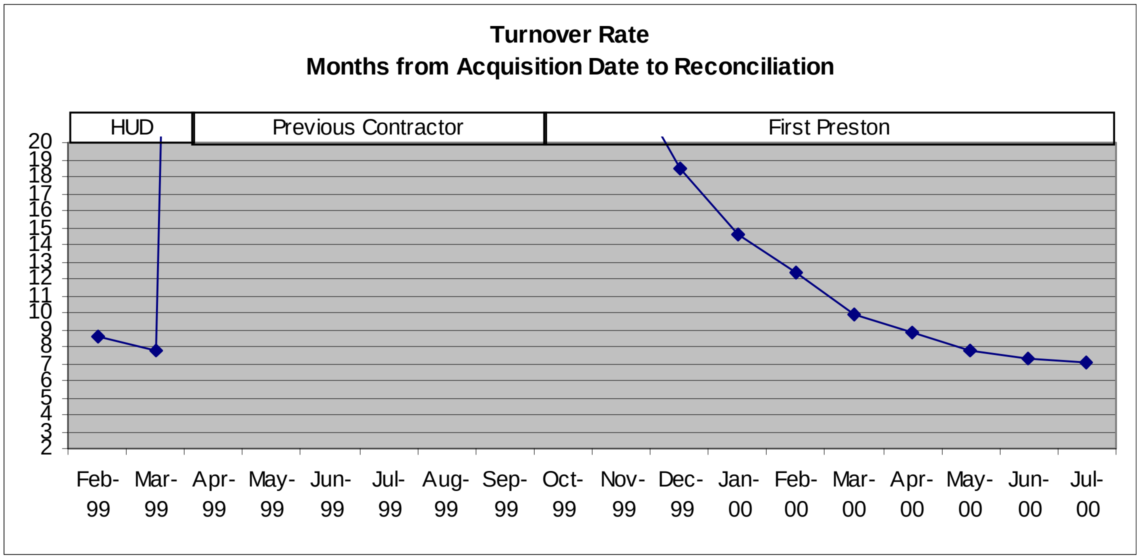
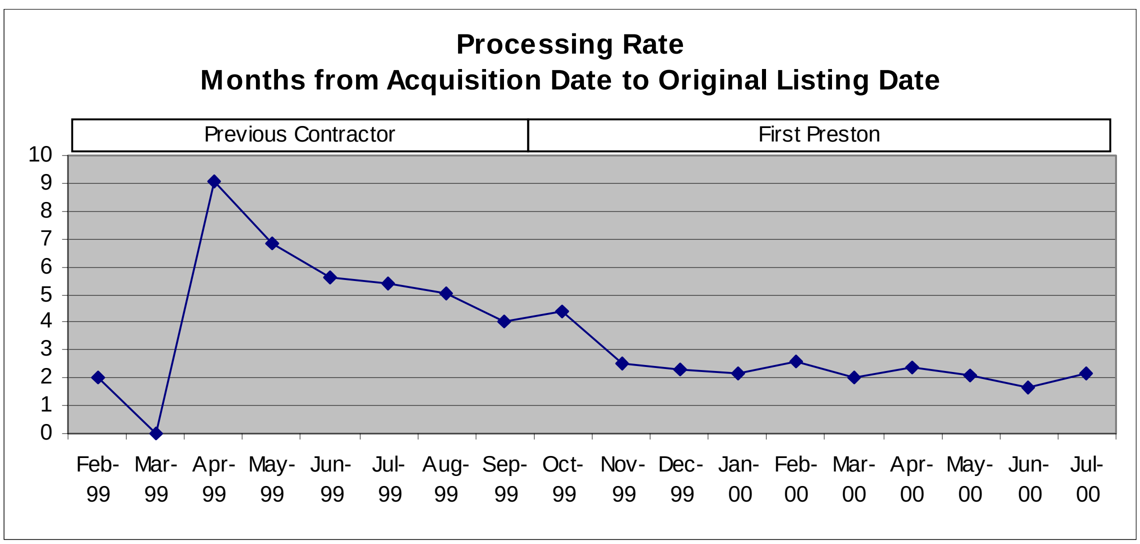


(Information provided by HUD MEAPSS01 report)

Processing Time

According to HUD's MEAP report, processing times were reduced from 9.09 to 2.13 months when comparing the period prior to First Preston's takeover with our current results. This represents the number of days it takes from acquiring an asset to listing, which represents a 77% greater success rate.



(Information provided by HUD MEAPSS01 report)

Higher List Prices – Returns $83.3 Million to HUD

In monitoring First Preston's progress, we also measure sales proceeds in relationship to past performance. We are currently experiencing a 14% increase in average sales price over the sales

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price experienced prior to the M&M contracts. This achievement resulted in an increased net to HUD of 16%, and has returned over 12,000 homes to private homeownership. First Preston's success at selling this inventory has returned $83.3 million in revenue to the FHA Fund over the amount realized prior to the program.

(Information provided by HUD's SAMS helpdesk)

Findings

<u>Finding 1: Number of Properties in Inventory for 12 Months or Longer has Increased</u>

<u>Properties 12 months and over have increased by 61 percent</u>

For the purpose of reporting on First Preston performance, we determine this finding to be deceptive and misleading. Page 2 of the auditor's report references an industry standard of 2 to 3 percent according to Andersen Consulting Industry Benchmarking and Best Practices Report, which is inapplicable to HUD's foreclosures by comparison. Although HUD's reporting figures will substantiate the percentage quoted by the OIG, your report fails to expand on reasons. The following bullets illustrate reasons for the number of cases exceeding 12 months in inventory, all of which are beyond the control of First Preston:

A. At the time of the audit over 800 properties required Lead-Based Paint abatement in the city of Philadelphia. HUD, not First Preston, controls the process of abatement. Currently, First Preston is acquiring and selling these properties at a much faster pace than HUD is capable of locating subcontractors to perform the abatement causing this inventory to increase substantially.

B. Over 500 bad cases were in Step 3 Held-Off-Market. These cases have been in HUD's inventory for well over a year and do not represent a cost to the government, although per diem charges are allocated to these case numbers.

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C. Approximately 100 aged properties were held off market for purchase by the city of Buffalo.
D. The number of properties in inventory over 12 months doubled from the time the predecessor's contract ended and our contract began. In other words, if the IG had performed this audit on the first day of our contract, the finding would have read: "The number of properties held in the inventory longer than 12 months has increased by 83%."
E. Further price reductions beyond the scope of our contract require GTR approval. None of the cases marketed longer than 135 days were granted a further price reduction until February, 2000, when we received a directive from HUD Headquarters in Washington D.C.

Your letter states "In our opinion, this occurred because First Preston has not placed enough emphasis on the sale of properties in the inventory for long periods of time." We totally disagree with this opinion, due to the fact that HUD has stipulated how properties are marketed during subsequent listing periods and First Preston must follow the thresholds set forth in our contract. Furthermore, First Preston has conducted over one hundred training seminars throughout the country, with attendances in excess of 60,000 brokers. No other M&M contractor can match this marketing and training effort. These seminars were heavily concentrated in the Philadelphia 3 Region during the first few months of our contract.

Steady increase in the percent of properties 12 months and older

Clearly, when First Preston took over management of the Philadelphia 3 region, cases exceeding 12 months in inventory were growing at a rate of 100-200 properties per month, with exception of the first month of our contract when these cases grew by 522. Today, this same inventory is decreasing at a rate of 100-200 properties per month. So, in fact, First Preston is decreasing the number of marketable properties that have been in inventory for 12 months or longer, as the following graph illustrates.

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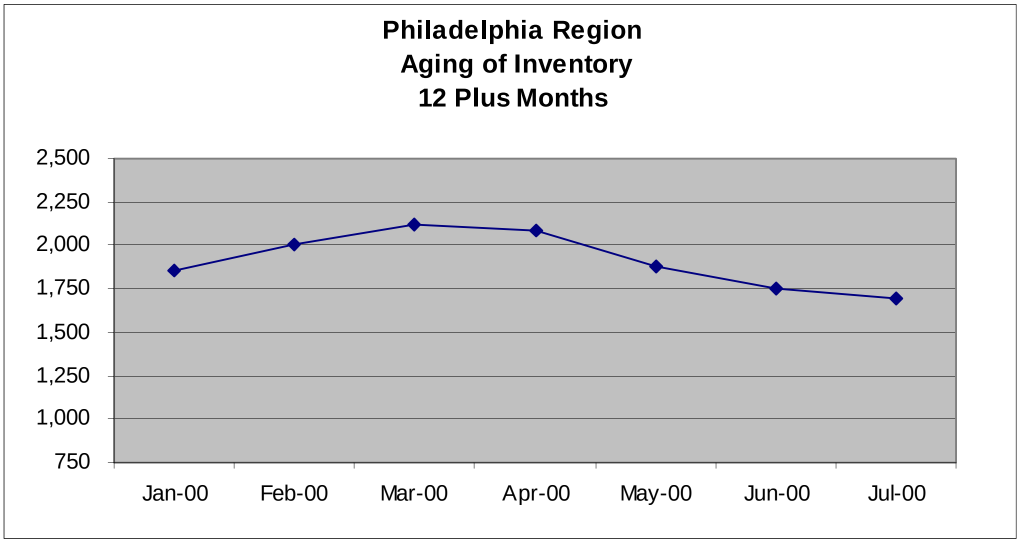

(Information provided by HUD MEAPSS01 report)

The Andersen Consulting Industry Benchmarking and Best Practices Report states that the real estate industry standard of aged inventory greater than 12 months is 2 to 3 percent, but does not take into consideration bad cases, lead-based paint abatement, lack of approval for price reductions, and a starting inventory where 12 percent already exceeded 12 months since acquisition. Therefore, comparisons of First Preston's performance to the Andersen Consulting Industry Benchmarking and Best Practices Report are misleading.

<u>Older properties have a high hold cost and greater probability of deterioration</u>

First Preston agrees with this statement, however, the 500 bad cases have no direct costs and HUD controls the lead-based paint abatement costs and holding time. As demonstrated in the previous paragraph, First Preston has been successful in reducing the twelve-month inventory with the exception of the bad cases and the lead paint abatement properties. The length of hold time related to these older properties is a concern of First Preston and a considerable financial burden to our firm under this contract. The costs of maintaining these properties for extended periods are borne by First Preston. This frustration is evidenced by 425 properties in Step 8 awaiting abatement measures of which First Preston has no control.

Prior to the M&M contracts, HUD provided an addendum to the purchasers of properties requiring lead-based paint abatement in the city of Philadelphia. This addendum allowed the purchaser to place $1,500 in escrow, close on the property in the normal closing period, and then abate the paint prior to move-in. When HUD changed this program, even though the courts ruled it was allowed, the increased costs of holding these properties began. We have respectfully requested that HUD evaluate this abatement process and take immediate corrective action to reverse the backlog of inventory awaiting service.

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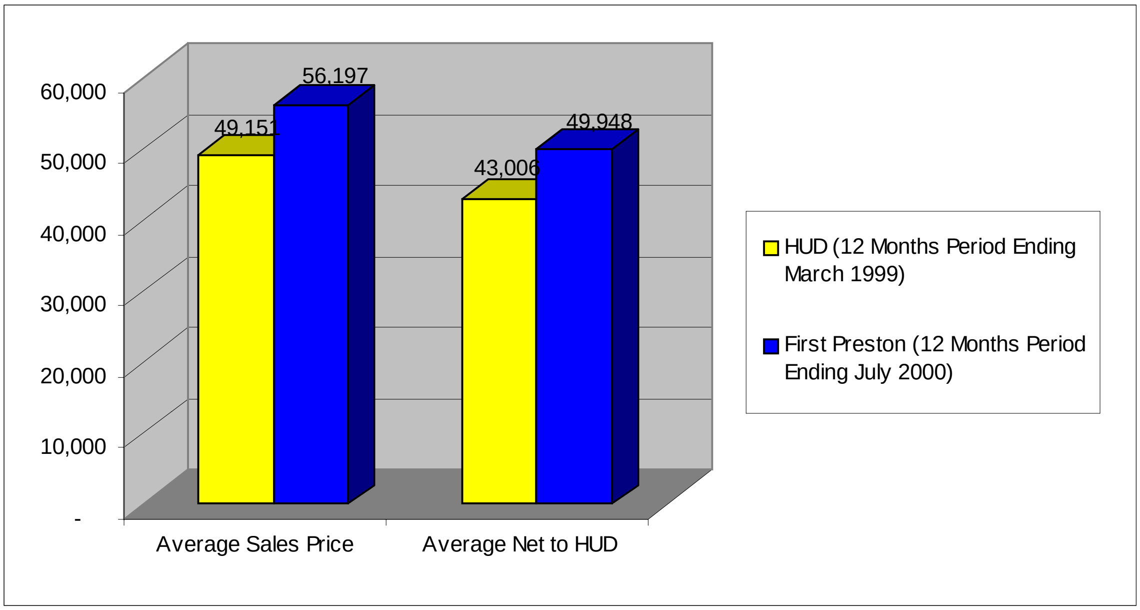
Revenue loss has increased significantly

In the twelve months prior to the M&M program (for the period ending March 1999), HUD's average sales price was $49,151, with an average net proceeds of $43,006. Today, under First Preston's management the twelve-month average through July 2000, for HUD's average sales price is $56,197 with a net of $49,948. Where the OIG audit reports a revenue loss of $9.5 million based on the percentage of sales price compared to appraised value, First Preston can argue a real increase in revenue of over $83 million.



(Information provided by HUD's SAMS helpdesk)

The Good Neighbor Program may have caused some of the increase in revenue loss

We agree with the auditors that the Good Neighbor Program has caused an increase in revenue loss. However, we would like to expand by stating HUD's special interest sales programs including Officer Next Door, Teacher Next Door, Good Neighbor Program and Non-Profit sales, make it difficult to attain the stated goal of selling properties at an average of 98 percent of appraised value. These special interest programs and the 98% laudable-goal are mutually inconsistent, or otherwise self-contradictory, and are issues concerning HUD policy that are inappropriate measures of First Preston's performance.

Another major cause that skews the measurement of our performance relative to the 98% goal, is the ITMG legacy inventory which hadn't moved significantly for eight months. Although, the time ITMG had the contract can certainly be considered "under the M&M program," it should not reflect as poor performance on the part of First Preston.

Recommendations

We recommend that you:

1A. Work with First Preston to increase the emphasis on the sale of older properties and/or develop incentives to encourage the sale of older properties.

1B. Evaluate HUD programs such as the Good Neighbor Program to determine their impact on the goal of selling properties at an average of 98 percent of appraised value. Based on that evaluation make adjustments to either the goal or the programs so they are not in conflict.

Contractor response:

1A. First Preston welcomes HUD's approval of the use of sales incentives such as those used by HUD prior to the M&M program. Also, we respectfully request HUD to remove all bad cases and revert to the lead-based paint escrow program it previously used.

1B. We do not interpret this goal as a contract requirement, so First Preston should not be held to this performance criteria. Contradictory goals should not be the vehicle to penalize the contractor, therefore, we request the evaluation criteria be changed to reflect actual performance, i.e., increases in net sales proceeds to HUD.

Finding 2: Properties Not Adequately Maintained or Safeguarded

Numerous deficiencies noted during OIG inspections

The OIG inspections and the HOC's monthly assessments do not take into consideration inherent risk verses contractor compliance. First Preston remains concerned, and considers there to be serious conflicts of interest in the fact that several of HUD's Special Property Inspectors are disqualified M&M contract bidders and are operating under terms that are inconsistent with our contract. The fact that the contracts between HUD's inspectors and First Preston are mutually inconsistent sets out a false measurement of our performance. We should not be rated "unacceptable" based on standards we are not required to meet.

17 out of the 22 categories in the audit report suggest the way a property looks, or the inherent risk of vandalism or traffic in and out of the properties. If a vandal breaks a window, First Preston is required to repair the window within 24 hours of discovery. However, when the OIG or HUD's Special Property Inspectors find the broken window, First Preston receives an unacceptable performance rating. Due to the large number of properties in the Philadelphia region located in blighted urban neighborhoods, and based on the parameters HUD uses when inspecting, our performance will never be addressed appropriately. This audit and other's performed on HUD's behalf should reflect First Preston's performance in accordance with the contract, and should not equate our standards to that of the inherent risk of vandals, etc. Section C of the contract requires routine inspections and the repair of situations that represent safety hazards within 24 hours. Our inability to stop vandalism is not a failure under this contract, and we continue routine inspections and the issuing of work orders to correct these issues as required.

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Furthermore, First Preston is committed to the communities that HUD serves and is receptive to modifications or revisions to our contract that would allow us to better serve these communities.

Properties were in poor condition and contained health and safety hazards

Again, the OIG inspections revealed the ongoing inherent risk of vandalism, etc. The shotgun, decaying rat and window lying on the ground are merely conditions that existed at the time of the OIG inspection, and were not necessarily present upon our last inspection. In fact, First Preston re-inspected and never found the shotgun shown in the OIG's pictures attached to the report. Simply, someone used the space under a vacant house as a temporary hiding place for a weapon.

In reference to the OIG's statement: "Moreover, some properties have been broken into and vandalized, were laden with debris, and/or were in need of vital repair" in no way is a direct reflection of our performance under this contract. Again, we are required to cure some of these type issues upon discovery and this contract does not intend nor require a cosmetic repair program. Also, it should be noted that the OIG chose properties in two of the most vandal-ridden areas of our region.

The first two properties in the Appendix indicate stripped siding, boarded windows and a broken window. We agree that these conditions adversely impact surrounding neighborhoods. However, when we discover broken windows, we repair by boarding or replacing within 24 hours. The mass of wires and ceiling damage reflect conditions of the properties that are unsightly, yet in and of themselves do not represent safety hazards, and under our contract require no action.

First Preston and the M&M contractor cannot be held accountable for vandalism in high crime areas. However, we are accountable to preserve and protect the properties in the communities that we serve. It is to that end, we have expanded all oversight and have updated our quality control plan.

Differences were noted between OIG and subcontractor inspections

The rationale that First Preston's inspector's inspections differ so widely from those of the OIG is likely for two reasons. First, our inspector indicates a snapshot of a property at the time of the inspection. If the windows are secure, no debris is present, a prior roof leak is inactive and vandalism has not occurred, the inspection will reflect such. Second, our inspectors do not look at repairs needed the way the OIG possibly would. We know that we will not replace siding, un-board windows, paint and carpet, etc., therefore, our inspectors will likely not write these items up on routine inspections. Mainly, routine inspections will denote attention needed due to lack of maintenance, vandalism, acts of God, broker/buyer traffic, etc. Again, the OIG inspected properties in seriously low-value areas that endure heavily vandalism. In fact, much of the expense for maintenance over our entire portfolio is as a direct result of vandalism.

Subcontractor inspections appear to be incomplete

The OIG mentions subcontractor inspections appear incomplete relative to detecting property deficiencies such as: defective paint; water damage; vandalism; needed repairs; and, inadequate security. First Preston has spent considerable time over the last three to four months re-training our inspectors to conform to all requirements of our contract. Our inspectors are trained to understand that defective paint is scraping, pealing or chipping paint on the exterior or interior of properties built prior to 1978. Furthermore, First Preston is only required to remove this defective paint prior to the closing of the property. Without examples of these cases, it is difficult to provide a comprehensive response. With respect to water damage, if we have cured the cause it would not be reported again due to the likelihood of duplicated efforts. Vandalism, needed repairs and inadequate security suggest a condition present at the time of the OIG inspections that might not have been present upon our last inspection. Again, without examples of these cases, it is difficult to provide a reasonable response.

In an ongoing effort to better train our inspectors and improve property conditions, we instituted a weekly regional conference call between the Regional Property Director and all Property Management Centers. The purpose of this call is to highlight deficiencies denoted on our own property condition inspections and to discuss the upcoming properties to be listed. Also, in July 2000, we conducted a region-wide property maintenance meeting with all of our Property Management Centers attending, to further train and stress the requirements of the contract. All forms for inspection were reiterated and the Regional Property Director further explained to all Property Managers the requirements of each property inspection.

Routine inspections are performed per the contract and reviewed by the appropriate staff daily. Data is input into the database as a measure of accountability. Work Orders are sent out for any corrective action as determined in the routine inspections.

An additional level of quality control has been developed by our Corporate Office. A corporate oversight division has been created to review contract compliance and procedures. The staff is geographically located to cover all areas and perform property inspections on 10% of the inventory, selected randomly as required by our Quality Control Plan. Findings are submitted to corporate oversight coordinators, who are responsible to document and request written responses from the field offices. See the attached oversight chart.

First Preston has not performed requirements concerning lead based paint timely

The OIG is obviously referring to the handling of the Philadelphia properties requiring lead-based paint abatement at the onset of this contract. We regret that our actions within the first few weeks of contract commencement were less than we would have desired. In order to satisfactorily perform in tandem with HUD's newly implemented procedures for procurement and abatement, First Preston formed a team to focus specifically on the process. Our issues were further complicated within the first sixty days of the contract when a lock we were using required a "thinner" master key than those being used prior. We have explained and corrected this issue with HUD and the City earlier this year, and since then we have not received any complaints.

Although our team is current with all procedures in the process that we control, and lockouts do not present a problem, we are still concerned that HUD's abatement contractors cannot keep pace with the acquisitions and sales of First Preston on these properties. We have requested the HOC to readdress their decision on how to process lead abatement and anxiously await their decision.

Contractor actions required

First Preston internally performs property inspections and file reviews every 60 days at the Property Management Centers. These are random and began in the second quarter of this year. As a result of these audits, we have redistributed portfolios and restructured local offices.

We created a corporate oversight division to further review First Preston's portfolio for compliance, timeliness and attention to maintenance issues. This adds an additional 10% of the properties reviewed. Vendors and inspectors will be held accountable for lack of performance. Any subcontractors not performing to our standards will be placed on probation and closely monitored. During such time they are subject to termination. Inspectors are well trained and will continue to receive additional training throughout the year.

An additional level of oversight is provided by the BLB. BLB's perform an inspection within 24 hours of listing. Any property maintenance issues are sent to the Property Director and Contract Manager for immediate processing. This will reduce the likelihood that any properties listed have been vandalized.

Recommendations

We recommend that you:

A. Establish procedures that: ensure all significant property deficiencies are identified; monitor the accuracy of subcontractor property inspections; and, provide assurance that the needed repairs are completed promptly.

Contractor response:

We will work with HUD on these recommendations and urge the HOC to readdress its requirement to rate our performance unacceptable when its subcontractor denotes the risks inherent with owning properties in highly vandalized neighborhoods. Our performance should be rated as a strict compliance with our contract. We are prepared to honor the required inspections, maintenance and repairs of our contract, and are happy to do more if the Statement of Work and contract is modified. Placing the level of expectations of the OIG or Special Property Inspectors on First Preston, without the consideration of inherent risks involved, is entirely unreasonable nor contractually required.

We recommend that you:

B. Adopt controls, applicable to the requirements of Exhibit 15 of the M&M contract, ensuring lead-based paint inspectors access to applicable properties, and that minimize the time elapsed from date of property acquisition to the date initial lead-based paint inspections are requested.

Contractor response:

Due to the delay in time from when this finding was an issue, we believe HUD would agree that we are acting in accordance with Exhibit 15 and the problems we experienced early on in the contract no longer exists.

Finding 3: First Preston is Not Always Performing in Accordance with the Contract Provisions

This section references that First Preston (a) charged for ineligible costs, (b) has not performed its tasks in a timely manner, (c) has not always included the required documentation in the appropriate files, and (d) has not reported all problems to the Government Technical Representative (GTR). We will fashion our response in the same order as noted above.

Ineligible pass-through costs

Given that First Preston took over this contract in a contingent position within twenty-one (21) days, we were working without the benefit of a master list other than the FTP and did not have Internet connectivity. To date, First Preston was never supplied a comprehensive takeover inventory list. From September 24, 1999 until October 10, 1999, we only received FTP reports of the properties. The properties were assigned to our field property management offices off of the FTP report that during 1999 did not include the acquisition date. Further the connectivity of the field offices took about sixty days (due to delay in getting lines from the phone companies) to complete in order to fully automate those offices.

With the inability to obtain SAMS information in the initial takeover and the volume of properties that were acquired without services, it was not possible to delineate clearly between the takeover properties and newly assigned cases. This caused calendar issues and reimbursements that were inadvertently submitted and received by First Preston. Our contract compliance accounting team conducted a quality control review of all pass-through items in early March 2000 and identified $238,959.00 that was refunded to HUD.

On March 17, 2000, First Preston contacted the Philadelphia HOC Director to discuss the findings our quality control group had found in batches of invoices that had been processed. At this time, we requested that he direct his staff to return all batches of invoices in his office back to First Preston for an additional review. This telephone conversation was followed by an email confirming the conversation.

Additionally, telephone messages were left with the GTR's and the Deputy Director seeking return of the bills and a meeting to discuss our findings. The HOC staff did not respond to multiple requests for meetings regarding these issues. On March 23, 2000, First Preston submitted six checks totaling $238,959.00 to the HUD lockbox with the required SAMS 1100 detailing the case numbers to apply payments. These checks cleared First Preston's bank on March 27, 2000.

On March 31, 2000, Mr. Michael Perretta, then acting REO Director of the Philadelphia HOC, sent a letter requesting reimbursement of $212,436.63. This letter did not include any detail of the amount. On April 13, 2000, First Preston responded to Mr. Perretta in writing detailing the reimbursement that had already been submitted and cleared prior to the date of his letter. We denoted our attempts to establish a meeting to discuss these issues and again no meeting was established. We also advised Mr. Perretta that First Preston had submitted in excess of the amount requested and since we did not have a detail that we would be happy to discuss any variances with our submission. Shortly thereafter, Mr. Perretta left HUD.

In conclusion, First Preston maintains that this is a false finding. We have enclosed copies of the cancelled checks for the reimbursements that will verify HUD has been in receipt of the funds since March 27, 2000. Further, additional controls have been in place since the quality control audit in March to ensure that requests for reimbursements from HUD are in compliance.

Project files did not contain invoices or GTR approvals

This finding does not represent a review of all file documents. This review was performed in a field office, and a field office file does not represent a complete case file. These files are integrated into the case file upon closing. The case files are maintained in the Blue Bell, PA office in accordance with our GTR approved Quality Control Plan. Further, in an effort to eliminate the risk of duplicate payments, all original invoices with GTR approval attached is sent to the Corporate Accounting Department in Addison, TX. These invoices are attached to a check copy maintained in the corporate office and a copy is attached to the HUD transmittal that is submitted for reimbursement. The review did not occur at the appropriate location to ensure that all documentation was included such as work orders and GTR approvals.

Possible duplicate charges

We are in receipt of the list of reimbursements under scrutiny totaling $32,549.45 from the OIG staff. The following details the reconciliation of those charges:

Items reimbursed to HUD from 3/23/00 to 8/21/00	$20,196.95	
Invoices that are not duplicates		$12,352.50
Total amount detailed		$32,549.45

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A number of the items listed as possible duplicate charges are for services with similar dollar amounts or with similar post codes. A review of the individual invoices identifies separate services and/or service dates. Additionally, a large number of the items noted were for lock changes. At the takeover of this contract, First Preston acquired all the approved locking mechanisms available from the manufacturer. Since a high percentage of the properties had not been secured and sufficient lock stock was not available, First Preston had to put temporary locks on inventory to secure it. Within the initial thirty days, all temporary locks were converted to permanent locks in order to allow maximum access to the brokerage community. This was an inherent risk due to the manner in which this contract was awarded.

Our Contract Compliance Accounting team reviews the transmittals for compliance with the contract, documentation in accordance with those requirements and compares the detail to information in SAMS to ensure that invoices are not submitted more than once. This team has been instrumental in identifying items that need reimbursement to HUD out of the original takeover submissions. Additionally, this team reviews all transmittals prior to submission to HUD to ensure compliance. This team was established in early 2000 as a result of the increased volume of transmittals prepared by First Preston due to the Philadelphia 3 contract.

First Preston did not meet contract time thresholds

At the time of the takeover by First Preston, the inventory had grown from 5,669 properties in March 1999, to 9,854 properties. This eight-month period under the previous contractor had caused the processing time to increase to a high of 9.09 months. Currently, the processing rate is at 2.13 months, which is a 77% decrease in the time from acquisition date to original listing. Further, First Preston has decreased the turnover rate by 18% compared to HUD's rate at the start of the M&M program. While this review may identify instances where the timeframes were not met, the overall performance of First Preston indicates substantial compliance with these requirements that has significantly reduced holding costs. Thus, there has been a greater monetary return to the insurance fund.

Inspections were not performed within 24 hours

The Contract Manager along with the Property Director receives a log sheet of all initial assignments. Weekly the Property Management Centers are to verify that all inspections are performed within 24 hours of assignment. This database is used to verify that the inspection was completed to First Preston's and HUD's specifications. First Preston is also in the process of expanding and upgrading our internal reporting system to provide a more detailed tracking system.

An additional quality control checkpoint has been implemented by First Preston's Corporate Office. A corporate oversight division has been created to review compliance and contract procedures. The staff is geographically located to cover all areas and perform property

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inspections on 10% of the inventory, selected randomly as required by the contract. Findings are submitted to corporate oversight coordinators who are responsible to document and require written responses from the field offices. See attached organizational chart.

Appraisals were not performed within 10 business days

First Preston has expanded our roster of appraisers and retained new FHA appraisers who understand the requirements of appraisal reform. Simultaneously with the takeover of this inventory came the implementation of the new requirements of appraisal reform that on a short-term basis created confusion among FHA appraisers. Appraisers were required to obtain certifications and the FHA roster was continuously changing. Through education and certification we have aligned ourselves with competent appraisers that are capable of meeting the required timeframes. This improvement is already evidenced by the substantial reduction of Step 1's over the last several months. Currently, our Step 1 portfolio represents less than three weeks of inventory.

Disposition programs were not approved within 3 business days

First Preston, with the knowledge of the HOC, is listing properties on a weekly basis. This removes the need to perform the disposition as required by the HUD handbook. Under the guidelines of the handbook, HUD previously listed properties more often. However, from a marketing standpoint, the weekly listing program is more user friendly to the public and the brokerage community which is served by a routine listing day. This routine, predictable day fosters greater competition in bidding.

Title evidence was not approved timely

At the takeover of the contract by First Preston, there were over 5,000 cases with titles that were not approved. Currently, First Preston is current on approvals of all title evidence received for new acquisitions and have obtained over 69% of the initial 5,000 outstanding titles evidence. First Preston also has 344 cases that are sold and reconciled without title approval. We have sent multiple requests to lenders requesting the title packages. In cases where title has transferred to new owners, it is very difficult for lenders to go back and obtain title evidence. We have been working with the GTR on a resolution on the remaining outstanding title and the action which can be taken to obtain the evidence.

Reconciliation's were not adequately documented

The reconciliation of the sales information is documented within the HUD-1 Checklist as discussed below. In addition, the closing staff reviews the unmatched sales proceeds and unreconciled sales closings daily for items that need attention. We are diligent in contacting closing agents for necessary items and preparing SAMS transmittals to correct any errors or payments required. The closing staff sends daily emails to the GTR (or their designee) on any transactions that cannot be corrected in-house or to identify any closing agent issues.

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Lack of evidence that Settlement Statement form HUD-1 was reviewed

In an effort to address the concerns that our files lacked evidence on the review of the HUD-1, First Preston has established a HUD-1 Checklist which details the information which is reviewed and is signed by the appropriate personnel. This checklist details thirty-four (34) items that are reviewed on each HUD-1 statement in accordance with the contract. The use of this checklist has been in place for the past several months.

None of the contracts of HUD's closing agents in Philadelphia area 3 require pre-closing HUD-1's be sent to the M&M contractor. First Preston recently met with the Philadelphia HOC representatives asking them to modify the closing agent contract to require pre-closing packages. Effective October 1, 2000, the Philadelphia HOC Contracting office will require the closing agent to submit a pre-closing HUD-1 to the M&M Contractor. This will provide First Preston the ability to correct problems on the HUD-1 prior to closing. Additionally, we will require our Contract Managers to provide a weekly notification letter to the GTR listing all cases that close without First Preston's review of the pre-closing HUD-1. This letter will detail the case number, date of closing and the closing agent. We anticipate that the GTR will address these concerns with the appropriate closing agent.

Wire transfer receipts were missing from the files

Prior to the M&M contract, acknowledgement of wire transfers were submitted by many of the closing agents to the HOC in response to this requirement. Evidence of the Step 10 sweep confirmed the validity of the wire transfer acknowledgement. Our closing staff has notified the closing agents that the acknowledgments are not acceptable and wire transfer receipts must be submitted. We will notify our GTR daily of non-compliance by the closing agent.

First Preston is not adequately monitoring Held Off Market (HOM) properties

At the takeover of the contract, there were over 800 properties in Step 3. A large number of these properties did not have case files. First Preston has worked diligently to resolve these issues. During meetings with the HOC in October and November, First Preston was advised to place these assets in a Step 3 and the HOC would review and assist us in resolving. In January 2000, a ninety-day quality control audit was performed by First Preston. This audit was provided to the OIG staff. This report detailed the status of the Step 3 properties by HOM code and requested assistance from the HOC. Over the course of the contract, some of the original Step 3's have been confirmed as HUD properties and moved to listing. The vast majority of cases are still pending HUD's removal. To assist HUD with this process, First Preston has hired a Troubled Asset Coordinator who is working with municipalities and taxing authorities to determine ownership. Although, this is beyond the scope of our contract, we find this imperative to resolve the final disposition of bad cases. First Preston can only advise of the status and cannot remove these cases. This action must be performed by the HOC.

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Files do not contain evidence of form HUD-27011 review

First Preston reviews each 27011A it receives from Mortgagees to ensure accurate information is input into SAMS. We do not have a formal form for this review, but check marks on the form and precise input will set new cases up in SAMS, at which point we print the CMC1 screen and various screens from SFIS. We verify the address, by cross checking the 27011A with the attached title policy or deed. Legal descriptions on these two documents will inform us if a condo unit must be added to the street address.

We do have a comprehensive check list for the review of the 27011B,C&D forms, and perform this review on all properties prior to conducting a final close-out of a file. Any discrepancy in reporting by the Mortgagee is forwarded to our GTR with proper documentation. This is evidenced whereby thousands of the completed review check list can be found in Step 10 files located in our off-site storage. We recently heard from the HOC that Mortgagees were offset over $10,000 due to improper claims concerning review of these B,C&D forms in a single month.

First Preston is not adequately monitoring title evidence receipt

First Preston's title department monitors the title evidence due report from SAMS on a daily basis. Letters are drafted and mailed on evidence that is overdue. In some instances, repeated efforts to obtain evidence have failed and First Preston is currently working with the HOC to address the issues of Step 10's without title approval. See title evidence not approved timely paragraph above.

First Preston is not formally notifying the GTR of mortgagee neglect

First Preston has invested significantly in an upgrade to our internal reporting systems and will include a Mortgagee Neglect report that can be provided by lender, HOC area or case number. This report will allow our firm in conjunction with the GTR's to identify the serious offending lenders and take appropriate corrective action. The completion and implementation of this upgrade is anticipated by the calendar year-end of 2000. In the interim, our offices will continue to submit mortgagee neglect reports weekly via an Excel spreadsheet to the corporate office where the information is downloaded to an Access database for comparative purposes.

Upon receipt of a new property, our staff is assigning the property to the appropriate property management firm for inspection and securing. Along with the initial assignment, we provide the CMC1 screen and any Property Preservation and Protection (P&P) requests (and approvals) for this asset. The property management inspector must provide an initial inspection and confirm that all approved P&P work is complete and acceptable. If mortgagee neglect is identified upon the initial inspection, our Acquisition staff is contacting the lender for copies of their inspections for comparative purposes. This contact is documented in writing (fax, letter or email) and placed in the file. Our regional staff will continue to utilize the B, C and D checklist to identify any claims made by lenders that are not acceptable. While this checklist has been used for many months, we have not identified this as an additional Quality Control checkpoint. This review enables the staff to deny any items that have not been completed.

First Preston provided updated inspector and property manager training in August 2000 regarding the property preservation and protection guidelines. This training will reinforce previous sessions and will solely focus on the mortgagee neglect reporting.

Initial Inspection did not identify apparent mortgagee neglect

See the response above regarding mortgagee neglect reporting.

First Preston is not notifying GTR of Closing Agent problems

First Preston's closing staff reviews the unmatched sales proceeds and unreconciled sales closings daily for items that need attention. We are diligent in contacting closing agents for necessary items and preparing SAMS transmittals to correct any errors or payments required. The closing staff sends daily emails to the GTR (or their designee) on any transactions that cannot be corrected in-house or to identify any closing agent issues. Additionally, the corporate accounting staff prepares a weekly report on both unmatched sales proceeds and unreconciled sales closings for the Contract Administrator. The accounting staff details the efforts of both accounting and the closing staff and identifies any action needed by the Contract Administrator. These reviews have occurred throughout the term of the contract and will continue as established. Also, First Preston has met with HUD staff on numerous occasions to report closing agent problems. A Special Report, containing our in-house 90-day Quality Assurance Audit (dated January 10, 2000), and detailing serious issues with two of HUD's closing agents, was delivered to HUD and the OIG. One of the closing agents, after our reporting of information to the HOC, was terminated by HUD. The other, will not have their present contract renewed.

Effective October 1, 2000, the Philadelphia HOC Contracting office will require the closing agent to submit a pre-closing HUD-1 to the M&M Contractor. This will provide First Preston the ability to correct problems on the HUD-1 prior to closing. Additionally, we will require our Contract Managers to provide a weekly notification letter to the GTR listing all cases that close without First Preston's review of the pre-closing HUD-1. This letter will detail the case number, date of closing and the closing agent. We anticipate that the GTR will address these concerns with the appropriate closing agent.

In closing, First Preston has worked diligently and tirelessly to accommodate any and all concerns expressed through monthly HOC assessments, Cox reviews, and OIG audits. In each case, First Preston has responded timely and proactively to reports and recommendations. Today, our critical paths (SAMS Report "Cases Exceeding Time in Current Step") in each region are at an all-time high success rate. Our inventory continues to reduce. Our sales prices remain stronger than months preceding the M&M contracts, despite new discounted programs of OND/TND and Dollar Homes. Our processes in terms of turnover rate, processing rate, and closing rate have never been stronger and in many cases, are superior to those under previous HUD management. We have employed consultants with the highest name recognition in the industry to upgrade asset-tracking systems and expand accounting systems, specifically tailored to HUD requirements. We have incorporated an oversight team of five oversight managers supervising seventeen field inspectors that are in place and working diligently monitoring all field maintenance. We have trained several thousand brokers in all six states. In short, First Preston has never wavered from its passion for the success of this program or its commitment to HUD and the communities it serves.

Again, we thank you for the opportunity to respond and please let me know if we can be of further assistance.

Sincerely,

Larry E. Basinger
Chief Operating Officer

Attachments

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The Honorable Fred Thompson
Chairman
Committee on Governmental Affairs
340 Dirksen Senate Office Building
United States Senate
Washington, DC 20510-6250

Director, Housing & Community Development Issue Area,
United States General Accounting Office
441 G Street, NW, Room 2474
Washington, DC
(Attention: Judy England-Joseph)

Ms. Cindy Fogleman
Subcommittee on General Oversight & Investigations
O'Neill House Office Building, Room 212
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T.O.C.

Exit