



Issue Date September 15, 2000
Audit Case Number 00-AT-222-1009

TO: Charles E. Gardner, Director, Homeownership Center, 4AHH

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

SUBJECT: Southeast Alliance of Foreclosure Specialists, LLC.

We completed an audit of Southeast Alliance of Foreclosure Specialists, LLC., a Management and Marketing (M&M) contractor. This report presents the results of our audit of Southeast Alliance's ability to manage and market FHA's single family properties. Southeast Alliance's comments to the two findings and associated recommendations are included as Appendix A with excerpts and the Office of Inspector General's (OIG) response incorporated into the Findings and Recommendations section of the report.

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 a planned completion date; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued as a result of the audit. Note 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 provided a copy of this report to Southeast Alliance.

We appreciate your cooperation during the audit. We would also like to thank Southeast Alliance for its cooperation during the audit and commend the professionalism of its management and staff. Should you or your staff have any questions, please contact me at (404) 331-3369, or Gerald Kirkland, Assistant District Inspector General for Audit, at (865) 545-4368.

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Executive Summary

Under Secretary Andrew Cuomo, HUD has undergone significant changes in response to the Secretary's "HUD 2020 Reorganization Plan." One major change is the outsourcing of FHA's management and marketing of its single family properties. In March 1999, FHA awarded 7 companies a total of 16 Management and Marketing (M&M) contracts to manage its single family property inventory.

Although FHA outsourced these activities, its program mission did not change. The program mission is to reduce this inventory in a manner that:

“(1) expands homeownership, (2) strengthens neighborhoods and communities, and (3) ensures a maximum return to the mortgage insurance fund.”

This report presents the results of our assessment of Southeast Alliance of Foreclosure Specialists, LLC., a M&M contractor, and its ability to manage and market properties in a manner that enables FHA to accomplish its mission.

The contractor demonstrated success in three key areas. The contractor reduced both the number of properties in inventory and the number of properties in inventory over 6 months. It also reduced the average losses from property sales. Despite these accomplishments, improvements are still needed. The contractor demonstrated the willingness to improve its operations.

Our audit confirmed what FHA repeatedly reported in its monthly performance assessment reports. As discussed in Finding 1, the contractor did not maintain properties as required. The contractor did not perform timely initial property inspections, did not always identify serious property defects, did not conduct routine inspections as required, and did not correct hazardous conditions within mandatory 24 hours. The poor property conditions decrease marketability; increase FHA's holding costs; have negative effects on surrounding communities; reflect poorly on the Department's image; and in some cases, threaten the health and safety of neighbors and potential buyers.

Also, as discussed in Finding 2, the contractor did not comply with other contract requirements. For example, the contractor did not review HUD-1 Settlement Statements, did not obtain timely property appraisals, and billed FHA for unauthorized expenses and ineligible expenses. The noncompliance could significantly increase the risk of loss to the insurance fund.

We recommend you:

- Require the contractor to ensure property inspectors are adequately trained;
- Require the contractor to develop and implement procedures to perform timely initial and routine inspections;

- Require the contractor to promptly correct hazardous conditions and make necessary repairs to preserve and protect properties;
- Closely monitor the contractor's compliance with maintenance requirements and take necessary actions to ensure requirements are met; and
- Ensure the contractor implements other controls to ensure contract requirements are met.

Southeast Alliance response to the draft report

We provided the draft report to Southeast Alliance on July 28, 2000. Southeast Alliance provided written comments to the draft report on August 9, 2000, which are summarized within each finding and included in their entirety as Appendix A. We also discussed the draft report with Southeast Alliance officials on August 14, 2000. Although they disagreed with some specific deficiencies identified in our property inspections, they generally agreed that improvements are needed. They generally agreed with the recommendations and have implemented, or plan to implement, procedures to address the recommendations. We considered the comments in preparing our final report.

Table of Contents

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

Executive Summary	iii
-------------------	-----

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

Findings

1	The Contractor Did Not Properly Maintain Properties	5
---	-----------------------------------------------------	---

2	The Contractor Violated Contract Requirements	15
---	-----------------------------------------------	----

Follow-Up on Prior Audits	19
---------------------------	----

Appendices

A	Southeast Alliance Comments	21
---	-----------------------------	----

B	Distributions	33
---	---------------	----

Abbreviations

FHA	Federal Housing Administration
HOC	Homeownership Center
HUD	U.S. Department of Housing and Urban Development
M&M	Management and Marketing
OIG	Office of Inspector General
REO	Real Estate Owned

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Introduction

Background

FHA's Single Family Mortgage Insurance Program helps low and moderate income families become homeowners by reducing downpayments and limiting lender fees. Every year, however, thousands of borrowers default on their FHA-insured loans. When they default, FHA encourages lenders to work with them to bring their payments current. When they cannot do this, their 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 in exchange for payment of their insurance claim.

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

FHA disposes of properties through its Property Disposition Program. FHA's mission is to reduce the property inventory in a manner that expands homeownership opportunities, strengthens neighborhoods and communities and ensures a maximum return to the insurance fund.

FHA's Asset Management Division, is responsible for developing property disposition policies and procedures governing program administration. Each of FHA's four homeownership centers (HOCs) is responsible for program operations within its geographical jurisdiction.

In March 1997, as part of HUD's continuing reinvention efforts, FHA issued its 2020 Field Consolidation Plan for Single Family Housing. In March 1999, FHA put the final phase of its reorganization efforts into effect. It awarded 7 companies a total of 16 M&M contracts to manage and market its properties nationwide.

FHA awarded the contract for the Atlanta HOC Area-3 to Southeast Alliance. The 5-year contract has an estimated value of \$79 million. Area-3 consists of properties located in Florida and Puerto Rico.

The primary contract objectives are to ensure: (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 is positive.

Southeast Alliance is a limited liability company that was formed by and between First Preston Management, Inc., and Just Valuation, Inc., in response to the request for proposal to manage and market FHA single family properties. Just Valuation, Inc., has the majority membership interest and Mr. Ron L. Nation is its president. Southeast Alliance's main office is located in Norcross, Georgia.

During the audit period, the contractor was responsible for managing and marketing an average inventory of over 3,600 properties. This represents about 8 percent of the national inventory. As of May 31, 2000, FHA had paid the contractor about \$22.5 million for its services.

On March 31, 2000, we issued Audit Related Memorandum 00-AT-123-0803 which identified weaknesses in the contractor's operations. The memorandum was based on survey results from our nationwide assessment of the performance and success of the M&M contracting initiative. The purpose of the memorandum was to give FHA an opportunity to address deficiencies prior to issuance of the final audit report. The weaknesses identified were: decreased revenues, decreased sales to owner occupants, properties not maintained according to requirements, untimely property inspections, and other violations of contract requirements.

In your response to the memorandum you disagreed with our assessment regarding decreased revenues and sales to owner occupants. You agreed with our assessment that the other areas needed improvement.

Contractor operations improved in some areas since issuance of the memorandum.

Audit objectives and scope

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

To meet our objectives, we:

- Interviewed Southeast Alliance and HOC officials;
- Reviewed monthly Performance Assessment Reports and related correspondence;
- Reviewed a judgmental sample of 20 active and 15 closed property cases files;
- Inspected a judgmental sample of 23 properties;
- Reviewed a judgmental sample of contractor payment vouchers;

- Reviewed the contractor's policies and procedures and observed its operations; and
- Analyzed inventory and sales trends¹.

We assessed management controls over: (1) property preservation and protection; (2) billings to FHA for services; (3) property sales; (4) property appraisals; (5) review of sales closing documents; and (6) subcontracting.

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

Our audit was performed from February through May 2000 and generally covered the activities from contract inception on March 29, 1999, through May 31, 2000. We expanded our scope to other periods as necessary to accomplish the audit objectives.

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

¹ We excluded April and May 1999 from our analysis because data during those initial months of the contract are not representative of overall contractor performance.

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The Contractor Did Not Properly Maintain Properties

The contractor did not maintain properties according to contract requirements. The contractor did not: (1) perform timely initial property inspections; (2) ensure property inspectors accurately reported property conditions; (3) perform routine property inspections; (4) correct hazardous conditions; or (5) make repairs or perform routine maintenance to preserve and protect properties. This occurred because the contractor did not have adequate controls to ensure requirements were met. The poor property conditions decreased marketability; increased FHA's holding costs; negatively affected surrounding communities; reflected poorly on the Department's image; and in some cases, threatened the health and safety of neighbors and potential buyers.

Contract requirements to secure and maintain properties

Section C-2 of the M&M contract requires the contractor to: perform an initial inspection of newly acquired properties within 24 hours of assignment; secure properties to prevent unauthorized entry; protect properties from damage from the elements; remove and properly dispose of all interior and exterior debris; maintain the lawn and shrubbery; properly secure pools and spas; correct any condition that presents a health or safety hazard to the public within 24 hours of discovery; and patch roof leaks or other factors which may cause deterioration of condition of the property.

The contractor did not perform timely property inspections

Our review of property files for 16 newly acquired properties found the contractor did not inspect 14 of the properties within 24 hours of assignment. Delays ranged from 1 to 20 days.

Properties which are not inspected and secured timely are subject to further deterioration and vandalism and potential reduced return to the insurance fund. Deteriorated and vandalized properties also have negative effects on the surrounding community and reflect poorly on the Department.

Finding 1

The contractor did not perform adequate property inspections

The contractor's property inspections did not identify serious property deficiencies. In December 1999, we inspected 23 acquired properties in central Florida to determine if the contractor properly reported property conditions and properly maintained the properties. We compared our inspection results to the most recent contractor inspection reports. For 12 of the 23 properties sampled, the contractor's reports did not disclose many property deficiencies even though the conditions were easily identifiable. The deficiencies included, for example, broken glass in windows, vandalized HVAC units, an unsecured gate, and interior and exterior debris.

The contractor generally agreed with our assessment and took immediate steps to correct deficiencies noted in our inspections. Although the contractor was aware of requirements, it contended that initially its inspectors were not properly trained to identify and report property conditions.

Although the contractor knew its inspectors were not properly trained, it did not take timely action to provide training. The contractor provided training in January 2000, 4 months after HUD's Atlanta, GA Contracting Division issued a "Letter of Concern" to the contractor because of the poor property conditions.

The contractor must ensure its inspectors are properly trained to identify and report property deficiencies. Otherwise, the contractor may not be aware of conditions which need correction, including potential health and safety hazards.

Following are examples of conditions the contractor's inspectors did not report.



FHA Case Number 094-184531

Orlando, Florida

OIG Inspection December 14, 1999
Broken glass presents a safety hazard.



FHA Case Number 094-358716

Orlando, Florida

OIG Inspection December 14, 1999
Exterior debris and a vandalized HVAC unit.

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Lack of routine inspections

The contractor is required by its contract to perform routine property inspections. The contractor's procedures are to inspect properties every 14 days. Forty percent of the properties we inspected did not show evidence of routine inspections. For example, the property located at 7728 Fernbrook Way, Winter Park, Florida, was inspected only one half the required number of times from July 29, 1999, through December 14, 1999. When we performed our inspection on December 15, 1999, we noted the contractor had not visited the property since November 2, 1999. FHA's monthly performance assessments also identified deficiencies in the contractor's routine inspections.

Routine inspections are essential to alert the contractor to property conditions that may need immediate attention. Failure to perform the inspections increases the risk of property damage.

Hazardous property conditions

The contractor did not correct health and safety hazards within 24 hours as required. We found hazardous conditions, such as missing balusters from a balcony, a porch held up by a broken tree limb, and an improperly covered swimming pool. It appeared these conditions had existed for some time.



FHA Case Number 094-214300

Sanford, Florida

OIG Inspection December 14, 1999
Tree limbs holding up the porch roof.

On December 15, 1999, we inspected the property located at 2992 Chantilly Avenue, Winter Park, Florida. A swimming pool on the property was not properly covered and needed to be drained. Also, the fence around the pool was heavily damaged allowing easy access to the pool. There was nothing to prevent children from entering the pool area and falling into the pool.

The contractor's November 23, 1999, inspection report showed the pool was unsecured and needed to be drained. The report did not identify the damaged fence. Since the conditions still existed at the time of our inspection, 22 days later, the contractor clearly had not complied with the contract requirement.

The contractor must identify and correct all health and safety hazards within 24 hours to reduce the risk of harm to the public and liability.

History of
maintenance problems

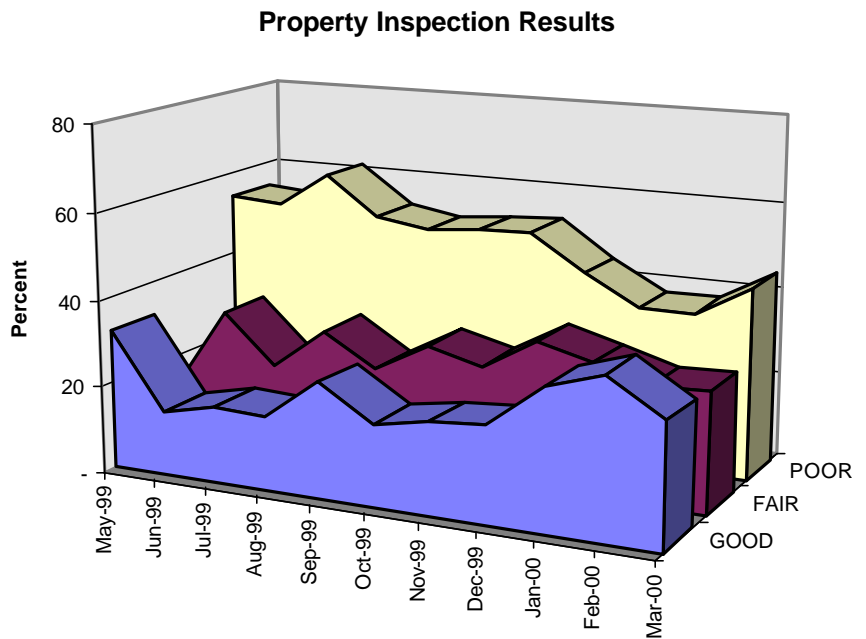
FHA's monthly assessment reports repeatedly showed the contractor was not complying with property maintenance requirements. A September 1999 Letter of Concern stated in part, "This letter is to express our serious concerns with the inadequate progress of Southeast Alliance of Foreclosure Specialists in maintaining properties in presentable conditions at all times. We have brought this to your attention repeatedly in our monthly Performance Assessments, without satisfactory improvement. Although you have offered a variety of explanations for the conditions of specific properties, the pattern of findings continues to be far below our expectations."

Our property inspections confirmed what FHA reported in its assessment reports. Seventeen of the 23 properties, 74 percent, we inspected were in "poor" condition. In addition to hazardous conditions, we found the contractor did not make needed repairs or perform routine maintenance to preserve and protect properties. We found deteriorated stucco on the exterior of one property that allowed water damage to the interior, excessive yard growth, interior and exterior debris and various other conditions.

The following table provides examples of our inspection results.

<u>Deficiency</u>	<u>Percent Noncompliant</u>
Interior or Exterior Debris	52
Health and Safety Hazards	39
Roof Leaks	30
Vandalism	26
Lawn Not Maintained	12

The following chart shows the results of FHA’s monthly performance assessment reports. The percentage of properties found to be in “poor” condition from May 1999 through March 2000 ranged from a high of about 62 percent in July 1999 to a low of about 37 percent in February 2000.



The chart also indicates the contractor’s performance improved substantially from December 1999 through February 2000. However, we believe additional improvements are needed.

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The following pictures show examples of the contractor's failure to perform needed repairs and routine maintenance.



FHA Case Number 094-331712

Orlando, Florida

OIG Inspection December 15, 1999

Damaged stucco allowed water damage to interior walls.



FHA Case Number 094-272346

Apopka, Florida

OIG Inspection December 13, 1999

Overgrown grass, shrubs, and trees.

Southeast Alliance
comments

The contractor disagreed with some of the specific deficiencies identified in our property inspections and provided explanations for the conditions. However, it agreed that its property maintenance procedures need improvement. The contractor generally agreed with the recommendations and has, or plans to implement procedures to address the recommendations. It held additional training for its property inspectors and other personnel and will continue intense training. It also implemented additional procedures to ensure properties are inspected timely and implemented an oversight division to review compliance and contract procedures.

OIG response to
comments

We commend the contractor's efforts to improve its maintenance procedures. We reviewed the contractor's explanations for the property conditions and do not believe the explanations justify the conditions we identified. For example, the contractor stated some conditions were due to recent vandalism. However, the property files and our visual observations of property conditions did not support the statements. Thus, we did not revise the finding.

Recommendations

We recommend

- 1A. Require the contractor to ensure property inspectors are adequately trained to perform inspections and accurately report conditions.
- 1B. Require the contractor to develop and implement procedures to perform timely initial and routine inspections.
- 1C. Require the contractor to promptly correct hazardous conditions and make necessary repairs to preserve and protect properties.
- 1D. Closely monitor the contractor's compliance with maintenance requirements and take necessary actions to ensure requirements are met.

The Contractor Violated Contract Requirements

The contractor violated several contract requirements. This occurred because the contractor's internal controls were not adequate. The noncompliance could significantly increase the risk of loss to the insurance fund. Specifically, the contractor:

- Did not review HUD-1 Settlement Statements;
- Did not obtain timely property appraisals;
- Billed FHA for unauthorized expenses and ineligible expenses; and
- Did not follow prescribed procedures for submitting vouchers for payment.

The contractor did not review HUD-1 settlement statements.

Section 8 of the contract requires the contractor to review the form HUD-1, Settlement Statement, to ensure only eligible expenses are charged to FHA and to ensure the form is accurately completed. The contract provides specific instructions for reviewing the form.

None of the 15 closed case files we reviewed showed evidence the contractor reviewed the form HUD-1. The contractor stated it did not review the forms because it was the closing agents' responsibility. Following our discussions, the contractor attempted to require the closing agents to submit the closing package for review prior to closing. The closing agents did not comply with the request because it would delay loan closings. The contract specifically requires the contractor to review, correct and certify the closing documents within 5 days after receipt. In order to perform the required review, it must be performed after the loan closing.

Although our review did not identify significant discrepancies, the risk to FHA and the insurance fund is increased because of the contractor's failure to perform the reviews. Considering the contractor sold an average of about 660 homes a month during the audit period, the risk could be significant.

The contractor did not obtain property appraisals timely.

The contractor did not obtain property appraisals timely. Contract section C-2 requires the contractor to obtain an appraisal within 10 business days of assignment. Our review of 17 applicable cases showed the contractor did not meet the 10-day requirement for 10 cases. The delays ranged from 1 to 26 days.

Unauthorized and
ineligible expenses

The contractor cannot list properties for sale without an appraisal. Delayed listings may result in delayed sales, thus increasing holding costs and reducing the return to the insurance fund.

The contractor charged FHA for unauthorized termite inspection expenses and ineligible late fees and costs associated with property liens. These expenses were incurred after the respective properties were assigned to the contractor. Under certain conditions, FHA will reimburse the contractor for termite inspection fees. However, the contractor must obtain prior approval from FHA's responsible Government Technical Representative prior to incurring the cost. The contract specifies that costs for late fees and property liens incurred after assignment are to be borne by the contractor.

We reviewed a judgmental sample of charges on the contractor's March and April 2000 vouchers. We found the contractor improperly billed FHA \$875 for initial termite inspections. The contractor did not obtain prior approval for the costs. According to the contractor, FHA had not paid the \$875. We did not verify whether FHA made the payment.

The contractor also charged for late fees (administrative collection fees) associated with homeowner association monthly property maintenance fees. The late fees occurred because the contractor failed to timely pay the fees. Thus, these costs should be borne by the contractor.

In some cases, vouchers included both FHA and contractor costs. Rather than pro-rating the costs, the contractor billed FHA for the entire costs. Other ineligible costs included filing fees and interest resulting from a property lien.

Although the unauthorized and ineligible expenses identified in our sample were minimal, this demonstrates a systemic control weakness that allowed the contractor to either knowingly or inadvertently charge ineligible costs to FHA.

The contractor submitted multiple vouchers each month

Section G of the contract requires the contractor to submit a single monthly voucher for payment of pass-through expenses. However, the contractor continued to submit multiple vouchers for pass-through expenses each month. For example, in October 1999 the contractor submitted 16 separate vouchers. This requires additional FHA staff resources to review the vouchers, thus increasing costs.

Southeast Alliance comments

The contractor stated that termite inspection costs on uninsured properties are eligible for reimbursement provided proper approval is provided by the Government Technical Representative. The contractor provided documentation to support that such costs are eligible. However, the contractor did not obtain approval for \$875 of termite inspection costs. FHA did not pay the \$875. Also, the contractor is working with Atlanta HOC towards a solution regarding the review of HUD-1, Settlement Statements, and has implemented a checklist for reviewing the forms. The contractor has provided appraisal training seminars and has retained new appraisers. It does not believe it is realistic to submit pass-through vouchers once a month and suggested a contract modification to permit weekly or daily submittals.

OIG response to comments

We made appropriate changes to the finding and recommendations regarding termite inspection costs and revised the recommendation regarding submission of vouchers.

Recommendations

We recommend that you ensure the contractor:

- 2A. Properly reviews HUD-1, Settlement Statements.
- 2B. Obtains property appraisals within prescribed time limits.
- 2C. Ensure all pass-through expenses are eligible and properly approved.
- 2D. Submit monthly vouchers for pass-through expenses unless FHA agrees to revised submission procedures.

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Follow-Up on Prior Audits

This is the first OIG audit of Southeast Alliance of Foreclosure Specialists. No financial statement or other audit reports have been issued pertaining to its operations.

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Southeast Alliance Comments



August 9, 2000

Ms. Nancy H. Cooper
District Inspector General for Audit
Southeast/Caribbean
U. S. Department of Housing & Urban Development
75 Spring St., SW, Room 330
Atlanta, GA 30303-3388

Subject: IG Audit (Draft) Response

Dear Ms. Cooper:

Southeast Alliance of Foreclosure Specialists, LLC (SAFS) is in receipt of your draft audit report dated July 28, 2000. This report reviewed our Atlanta 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 were also grateful for the occasion to meet with Mr. Charles Pagano of your staff on August 14, 2000 to discuss this report in detail. At that meeting, it was reiterated that SAFS demonstrated success in three key areas and overall was performing operations in an acceptable and professional manner. We enjoyed the comment by Mr. Pagano, referencing SAFS as one of the best M&M contractors in the country. The atmosphere of the meeting exuded a bonded partnership, demonstrated by all parties, which we believe is essential to the overall success of this program.

In view of our status as an SBA Section 8(a) firm, we are sending a copy of our response to our Business Opportunity Specialist at SBA.

Before responding specifically to the findings in the draft report, I would like to point out some of the successes afforded to HUD by this M&M contractor during the last sixteen months.

Inventory Reduction

Prior to our contract in March 1999, HUD's inventory for the Atlanta 3 area was 3,772. As of August 2000, HUD's inventory for this same region was 2,992. This represents a 21% reduction in the total number of properties held in inventory since the start of the program. We believe this significant decrease is due to SAFS overall knowledge of the contract and HUD's regulations, and our efforts in hiring and training a sufficient number of real estate industry professionals dedicated to the success of this privatized marketing

and management concept. At the same time SAFS was successful at reducing HUD's inventory, new acquisitions increased by 3.5%.

Reduced Holding Time – Returns \$13.7 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 SAFS successfully lessened the holding time that a property remains in our care by 31%. A reduction of this size represents a savings to the government of \$13.7 million dollars per year, or \$68.5 million over the life of our contract. We calculate this savings by multiplying current inventory by the holding time reduction and holding per diem cost, then we annualize this figure (2,992 X 68 days X \$28/day X 2.41 periods/year = \$13,729,210).

Aged Inventory

SAFS continues to reduce the quantity of assets that remain in inventory over six-months. In March 1999, the number of properties in inventory over six-months, according to HUD's MEAP report, was 1,924, or 51% of HUD-owned inventory. Today, there are 611 properties that have been held by HUD more than six-months, or 20% of the total portfolio. This represents a reduction of 32%, under the constraint of the requirement for higher acceptable bid thresholds and without the use of marketing incentives that were typical prior to privatization.

Processing Time

According to HUD's MEAP report, processing times were reduced from 3.8 to 1.38 months when comparing the period prior to SAFS takeover with our current results. This represents the number of days it takes from acquiring to listing an asset, which is a 64% greater success rate.

Higher List Prices – Returns \$28.2 Million to HUD

In monitoring SAFS progress we also measure sales proceeds in relationship to past performance. We are currently experiencing a 2.2 % increase in average sales price over the sales price experienced prior to our contract. This achievement resulted in a increased net to HUD of 5.7%, and returned 9,666 homes to private home ownership. SAFS' overwhelming success at selling this inventory has returned \$28.2 million in revenue to the FHA Fund over the amount realized prior to the program.

Executive Summary

In this section of the report, you acknowledged that SAFS “reduced the average losses from property sales”. However, further on you stated “From June 1, 1999 to May 31, 2000, total losses from contract sales were almost \$170 million. Had the contractor properly maintained properties and complied with the other contract requirements, losses may have been less.” The OIG report never explains the basis for the \$170 million loss, or the providence of our reduction of average losses from property sales. It is our understanding that losses are calculated based on HUD’s acquisition cost, the cost paid to the mortgagee in conjunction with the 27011 claim, subtracted from the net proceeds of the eventual sale. The only part of this equation that is affected by the performance of SAFS is the net proceeds portion, which as stated above, increased dramatically under our term as contractor. Any costs associated with SAFS maintaining the properties or performing other contract requirements were borne by SAFS, and would not have contributed to this \$170 million loss.

It is always important to bear in mind that SAFS’ accomplishments are not only measured numerically (by reductions in inventory time or net realization to HUD) but also by the ease with which the industry is able to cope with the entire process of re-selling FHA properties. Overwhelming success in the program should be noticed in that over a 1,000 new brokers took part in the sales of HUD homes over the last twelve months.

Since the inception of our contract we have continually incorporated new procedures, corporate oversight teams and conducted numerous training sessions to resolve the issue of property condition. SAFS is committed under its zero-tolerance initiative to improve in this very important area. Over the period from December 1999 to date, SAFS as stated in your report “improved substantially”. We monitor our performance weekly; we initiated an updated quality control plan and continue to stand committed to make any changes or adjustments to existing policy if a deficiency is observed.

SAFS conducted training seminars with all of our appraisers earlier this year. SAFS trained on accuracy, compliance and timeliness. Turnaround time has improved dramatically. This improvement is reflected in SAMS as we have less than a two-week inventory on hand in Step 1. Anything failing critical path is monitored daily and resolved timely. This trend will continue as our list of appraisers is expanded to accommodate the volume of work.

We are always striving to improve as an M & M contractor. As stated in your report SAFS has improved in key areas and we also believe additional improvement is necessary. We thank you for the opportunity to respond and will use the information

contained in the report to concentrate in specific areas where we determine improvement is warranted.

Finding 1- Contractor Did Not Properly Maintain Properties

As your report details, property conditions have improved from December 1999 to March 2000. Our current reporting further indicates that property conditions continue to improve. In as much as the initial start up was difficult for all those involved, we feel hiring new and additional staff and training all personnel responsible for property condition has produced positive results.

Our response to your findings on individual properties, which were reported after your on-site inspections, is as follows:

094-184537 6118 Ardenwood Court, Orlando, FL

Deficiency found: Broken glass in boarded window
Date of IG's inspection 12-13-99

This was a newly acquired property and the IG witnessed Mortgagee neglect. This should not be determined a finding, yet inherent risk, as acquiring a property not properly managed by the Mortgagee does not mean that SAFS is out of compliance with the contract. The IG and HUD should further consider that certain inherent risks are associated with costs that are borne by the contractor. The work order was issued on 12/13 and the glass was removed on 12/14. SAFS has a procedure to report Mortgagee neglect detailing the dollar amount, lender and type of neglect. This information was reported timely to HUD.

094-358716 1251 Woodman Way, Orlando, FL

Deficiency found: Exterior debris and A/C vandalized
Date of IG's Inspection 12-14-99

Previous inspections indicated this area has a high probability of vandalism. Our bi-monthly inspection revealed the same finding as the IG report. Again, the IG witnessed an inherent risk, not our failure to comply with the contract. Upon our discovery of the same item, a work order was issued and the file was properly documented. Furthermore, as part of our outreach commitment, SAFS has expanded contact with communities where HUD has home ownership. Our Lead Inspectors visit the neighborhoods within six-business days of acquisition and hand out information packets to surrounding homes. These packets explain that the property is a HUD home and requests that the neighborhood assist us and themselves to report any vandalism or other illegal activity. This program is similar to a neighborhood crime watch. We will continue to monitor the success of the program and make changes as we see appropriate.

094-342701 7728 Fernbrook Way

Deficiency found: Lack of Routine Inspections

Our records indicate that inspections were indeed performed after the date of 11/02/99 and prior to the IG's inspection. There is often a gap when the post closing files are merged between Property Management Center and the regional office following a successful closing. SAFS created a corporate oversight division earlier this year to address intense oversight and corrective training issues. Performance tracking and evaluation on a regular basis of the property management field in together with an upgrade of our internal reporting system will address any deficiencies in this area. The completion and implementation of this upgrade is anticipated by calendar year-end 2000.

094-214300 817 Catalina Dr., Sanford, FL

Deficiency found: Tree Limbs holding up back porch
Date of IG's Inspection: 12-14-99

Pictures were taken of this finding on 12/15/99 to request demolition of the structure and a work order was issued after the bid process. The demolition has been completed. The safety hazard identified by the OIG was timely reported to HUD by SAFS. No contractual deficiency occurred. Our goal is to insure that all initial and routine services are performed timely and completely upon discovery. We have subsequently re-trained inspectors and personnel at the Property Management Centers to monitor for such incidents and to address them immediately.

094-266076 2992 Chantilly Avenue, Winter Park

Deficiency found: Swimming pool was not properly covered.

Inspections indicated pool was properly boarded on 12/14/99. Further inspections indicate on 12/15/99 that the residence was vandalized, gate was broken requiring replacement of a section of fence and one section of pool cover (wire mesh). Our inspection indicated no exterior security issues. The work order was immediately processed. A November 23, 1999 inspection indicated the pool was secured. As stated earlier in the inspections the pool was boarded. The inspector did call for the draining of the pool, which is not a local code requirement. Again, this finding represents the inherent risk of vandalism, not our failure to comply with the contract.

094-331712 2844 Waymeyer Dr., Orlando, FL

Deficiency found: Damaged stucco allowed water damage to interior walls
Date of IG's inspection 12-15-99

According to the Inspector who accompanied the IG during this inspection, the findings were correct. The Inspector did not report the severity of the stucco condition; work order was issued on 12/16/99 to seal area. Expanded education and re-training in this area by the regional office contributed to SAFS improvement in recognizing areas requiring attention.

094-272346 290 Summerset Dr., Apopka, FL

Deficiency found: Overgrown grass, shrubs, and trees

Date of IG's Inspection 12-13-99

Prior inspections to 12/13/99 indicated that the property had locks changed. Inspectors are instructed not to enter properties that were previously under contract and appearances reveal property may have closed. They are instructed to contact our office to determine the actual status of property. The property was under contract to a non-profit by the name of World Outreach. SAFS has often found that purchasers under contract change out the locks believing this will prevent vandalism or unwanted entry, even though this activity is in violation of HUD's regulations. We are called out when this happens to replace the locks and place the purchaser and buyer on notice.

World Outreach failed to close and we ultimately cancelled the contact. The IG's visit was during the time that our Property Management Center was determining the status. Because HUD's closing agents do not report property settlements immediately upon closing, it is often difficult to determine the proper status of a property. The Atlanta HOC is currently considering modifying the escrow agents contract to report closings to SAFS on a daily basis. Currently HUD's closing contractors have to report to closings SAFS three days after a property's settlement. This has resulted in confusion as to whether a home requires a routine inspection or not. World Outreach, on a separate matter, has been removed from the HUD system through limited denial of participation (LDP).

IG RECOMMENDATIONS FOR FINDING 1

We recommend you:

- 1A. Require the contractor to ensure property inspectors are adequately trained to perform inspections and accurately report conditions.

Contractor's Response:

SAFS concurs with IG's recommendation and as stated in the report and implemented further property inspector training sessions in 1999. In addition, SAFS re-trained property inspectors, regional and local personnel and Property Management Centers during the 2nd quarter of 2000. SAFS requires that all new hires and inspectors attend a training session prior to sending into the field. Atlanta HOC attended our June training seminar. By incorporating the Atlanta HOC into the seminar, we were able to resolve many of the questions in the field. SAFS will continue this intense training in the future.

We recommend you:

- 1B. Require the contractor to develop and implement procedures to perform timely initial and routine inspections.

Contractor's Response:

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. SAFS hired Lead Inspectors at each office to perform a follow-up inspection on the sixth day following an initial inspection. The Lead Inspector will inspect and rate the initial clean-out for completeness to HUD specifications. The same database will be used to verify that the inspection was completed to SAFS' and HUD's specifications. SAFS is also in the process of expanding and upgrading our internal reporting system to provide a more detailed tracking system.

Routine inspections will be performed per the contract and reviewed by appropriate staff daily. Data will be input into the database as a measure of accountability. Work orders will be sent out for any corrective action as determined in the bi-monthly inspections.

An additional level of quality control has been developed by our 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 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.

We recommend you:

- 1C. Promptly correct hazardous conditions and make necessary repairs to preserve and protect properties.

Contractors Response:

As stated in the previous recommendation, initial property inspections will be performed within 24 hours. Close monitoring by the Property Management Center, Property Director and the Contract Manager will result in a more timely responses to any hazards or P & P issues. The initial inspection will be reviewed daily and any conditions requiring attention will be completed within 24 hours.

We recommend you:

- 1D. Closely monitor the contractor's compliance with maintenance requirements and take necessary actions to ensure requirements are met.

Contractors Response:

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

As stated in our response to recommendation 1B, we created a corporate oversight division to further review SAFS portfolio for compliance, timeliness and attention to maintenance issues. This adds an additional 10% of properties reviewed.

Vendors and inspectors will be held accountable for lack of performance. Any vendors not performing up 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 during 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 the Contract Manager for immediate processing. This will reduce the likelihood that any properties listed have been vandalized.

FINDING 2: The Contractor Violated Contract Requirement

Deficiency found: Ineligible Expenses

Per a memo from HUD dated September 15, 1999, SAFS is eligible for reimbursement of termite inspection costs on properties listed uninsured. SAFS reviewed transmittal number SFF A3 00 00352 and determined that \$875 dollars of the \$1,575 did not have the proper GTR approval. All future requests for termite inspection reimbursement must have regional authorization. The disposition strategy will be verified at that time.

Deficiency found: The Contractor Did Not Review HUD-1 Settlement Statements

As stated earlier, HUD's escrow agents feel it is impossible for SAFS to approve HUD 1's prior to closing. Logistically, escrow agents make changes to HUD 1's right up to the time of settlement. The Atlanta HOC is working towards a solution regarding this matter. As an interim resolution, SAFS implemented a HUD 1 Checklist detailing 34 items that are reviewed on each HUD 1 and signed off by appropriate personnel. While this review

meets the terms of our contract, with HUD's assistance, we will strive to perform a comprehensive review of the closing document prior to settlement.

Deficiency found: The Contractor Did Not Obtain Property Appraisals Timely

SAFS has performed appraisal-training seminars in June 1999 and in June 2000. SAFS has also retained new appraisers who are trained prior to being added to the roster. This effort has resulted in an inventory of less than two (2) weeks since acquisition and appraisals meeting the 10-day time frame.

Deficiency found: The Contractor Submitted Multiple Vouchers Each Month

Just to clarify the IG's understanding of this process, HUD requires that no more than fifty line items be listed per voucher. Therefore, since hundreds of taxes, utilities and other GTR approved expenses are transmitted to HUD each month, it is unlikely to process these on a single voucher. Invoices are processed daily due to volume. It is unrealistic to process a month's worth of billings in one day. SAFS makes every effort to forward invoicing once per month. In our exit conference it was agreed by the IG's Office that a modification might be warranted due to the volume that SAFS and HUD have to process. This would also assist HUD in their review of these documents.

IG RECOMMENDATIONS FOR FINDING 1

We recommend you:

- 2 A. Ensure the contractor implements procedures to: (1) charge only eligible pass-through costs to FHA; (2) perform required post closing reviews of HUD-1 Settlement Statements; (3) obtain property appraisals within prescribed time limits; and (4) submit only one voucher per month for pass-through expenses.

Contractors Response:

1. We hired additional staff to our accounting department internally as well as in corporate to review all transmittals. Staff has been trained to monitor transmittals for contract compliance.
2. SAFS has implemented a 34-point checklist while reviewing HUD-1's Settlement Statements post closing.
3. SAFS has provided appraisal training and has expanded their roster resulting in a 10-day turnaround.
4. SAFS submits one invoice per month but would like to see a modification to the contract to possibly weekly or daily submittals due to volume. Further, HUD is not able to meet the contractual timeframes for payment when one voucher is submitted. Additionally, SOZA will only allow 50

line items per transmittal so multiple vouchers are necessary to receive payment.

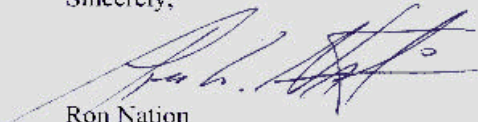
We recommend you:

2 B. Require the contractor to repay \$1,575 for ineligible termite inspection costs.

Contractors Response:

Per a memo from HUD dated September 15, 1999, SAFS is eligible for reimbursement of termite inspection costs on properties listed uninsured. Furthermore, a review of the transmittal indicates SAFS has never received funds as stated by the OIG. We respectfully request that HUD review this transmittal in depth, and forward the proper payment to SAFS for those inspection costs with GTR approval.

Sincerely,



Ron Nation
Southeast Alliance of Foreclosure Specialists, LLC
222 South Westmonte Drive, Suite 206
Altamonte Springs, Florida 32714

Attachments

- I. Corporate Oversight Division Organizational Chart
- II. Termite inspection with GTR approval

Laurie Lewis

From: Joan E. Berry [Joan_E_Berry@HUD.GOV]
Sent: Wednesday, September 15, 1999 9:01 AM
To: llewis@firstpreston.com; mhardiman@firstpreston.com
Cc: Boris C. Whiteside
Subject: Termites

Per Boris, properties should be treated upon discovery of active termites. Do not wait for a request from a lender to complete loan process. On an uninsured property the cost of inspection will be a pass-through-cost. If you have a question, please let me know.

Joan

----- Forwarded by Joan E. Berry/HOC/ATL/HUD on 09/15/99
09:50 AM-----

"Laurie Lewis" <LLewis@FirstPreston.com> on 09/09/99 02:34:26 PM

To: Joan E. Berry/HOC/ATL/HUD
cc:
Subject: Termites

I would like to clarify a conversation between Mike Hardiman and Boris. It was stated that if we have a property that the inspector indicates that we have live termites, that we have the authority to have the property treated and handle this as a pass through item to HUD. Could you please clarify this as I have a property with a contract that is uninsured and our inspector indicates active termites?

Thanks!
Laurie

Distribution

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Chief of Staff, S (Room 10000)
Special Assistant to the Deputy Secretary for Project Management, SD (Room 10100)
Acting Assistant Secretary for Administration, S (Room 10110)
Assistant Secretary for Congressional and Intergovernmental Relations, J (Room 10120)
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(Room 10139)
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Government National Mortgage Association, T (Room 6100)
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Director, Office of Multifamily Assistance Restructuring, Y, 1280 Maryland Avenue, SW, Suite
4000

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Director, Homeownership Center, 4AHH
Audit Liaison Officer, 3AFI
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Public Affairs Officer, G (Room 8256)
Director, Housing and Community Development Issue Area, U.S. GAO, 441 G Street N.W.,
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The Honorable Joseph Lieberman, Ranking Member, Committee on Governmental Affairs,
United States Senate, Washington DC 20510-6250
The Honorable Dan Burton, Chairman, Committee on Government Reform,
United States House of Representatives, Washington DC 20515-6143
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