



U. S. Department of Housing and Urban Development

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OFFICE OF INSPECTOR GENERAL
Office of Audit

April 22, 1999

Audit Memoranda
No. 99-NY-219-1803

MEMORANDUM FOR: Ira G. Peppercorn, General Deputy Assistant Secretary for
Housing-Federal Housing Commissioner, Chairman,
Mortgagee Review Board

FROM: Alexander C. Malloy, District Inspector General for Audit,
New York/New Jersey

SUBJECT: Greystone Servicing Corporation

We have completed a review of the matters submitted to the Office of Inspector General (OIG) by Ira G. Peppercorn, Chairman of the Mortgagee Review Board in a memorandum dated October 13, 1998. The matters pertain to possible violations of the U.S. Department of Housing and Urban Development/Federal Housing Administration (HUD/FHA) regulations by Greystone Servicing Corporation (FHA ID No. 73723-0000-5). The violations were reported to the Mortgagee Review Board as a result of a March 1997, review performed by HUD's Quality Assurance Division.

Briefly, the Mortgagee Review Board requested that the Inspector General review the violations reported to them by HUD and to determine whether HUD/FHA suffered any losses as a result of the violations. The Board did not take any actions regarding the violations because staff believed that the violations may not have been documented well enough to support action by the Board.

In order to evaluate the accuracy and reasonableness of the reported violations, we obtained and examined the documentation maintained by HUD to support its March 1997 review of Greystone Servicing Corporation. We then contrasted HUD's determinations with the documentation and responses provided by Greystone in its defense.

We performed on-site work in January 1999, at Greystone's Servicing Office in Warrenton, Virginia. During the site work, we interviewed pertinent Greystone personnel and solicited documentation and explanations for any follow-up items developed during our review. In addition, we obtained and reviewed selected data concerning the current portfolio of HUD/FHA projects serviced and originated by Greystone. We also reviewed current reviews performed by Independent Public Accountants of Greystone's operations.

It is our opinion that there is not sufficient cause to warrant Mortgagee Review Board action against Greystone. While Greystone could have been more diligent in the maintenance of its mortgage files, we do not believe that the violations contained in HUD's monitoring report are as serious as inferred. In many instances, the HUD monitoring report to the Board did not give sufficient weight to mitigating factors including HUD Field Office involvement in the matters, and that several of the projects were experiencing financial difficulties when the servicing rights were acquired by Greystone. However, we should mention that during this review we noticed an outstanding surety bond issued in 1991 (Waters Edge Apartments, FHA No. 023-35302) involving over \$354,000. Although the issue is getting old, we recommend that HUD seek recovery from the insurance company that issued the surety bond. This matter and the others are discussed in detail on a project by project basis in the subsections that follow.

BACKGROUND

Greystone Servicing Corporation is an approved seller/servicer of FHA, GNMA, and Fannie Mae mortgages. At November 30, 1998, Greystone was servicing 564 multifamily loans totaling \$3,314,984,000. To date, nineteen loans totaling \$179,469,000 are in default constituting approximately 5.41 percent of the outstanding amount. The default amount is mitigated by the probable refinancing of three defaulted hospitals loans in New York State that account for \$99,955,814 of the outstanding default amount. Upon the expected refinancing of these loans, the actual default rate will drop to approximately 2.4 percent. During the period reviewed, Greystone originated 17 loans that totaled \$195,367,300 with only one loan in default for \$757,631. Greystone believes this construction loan default will be brought current shortly.

Greystone advised that a primary part of its business is obtaining the servicing rights on projects experiencing financial difficulties and working with mortgagors to restructure these loans. At the time of HUD's monitoring, Greystone had 110 of these troubled projects in its portfolio with only twelve in default.

Our review of Independent Public Accountant Reports performed on Greystone Servicing Corporation for the periods ending December 31, 1996 and 1997, as well as special reviews performed on the GNMA portfolio serviced by Greystone dated February 21, 1997 and April 29, 1998, showed only minor exceptions. Greystone has subsequently implemented actions to correct these exceptions.

REVIEW RESULTS

Diamond Ridge, FHA No. 052-35475

HUD's Monitoring Issues:

Greystone failed to document the cause of the project's default or any restructuring efforts in process to bring the loan current.

Greystone's Position:

Greystone vigorously maintains that the Baltimore HUD Field Office was the principal reason for the delayed claim process. Greystone states that as early as December 1994, HUD was told that the cause of the project's default was low occupancy levels.

OIG's Evaluation:

Our review of documentation maintained by Greystone, including written communications to the HUD Field Office shows that HUD was aware of the cause of the project's default. In addition, documentation shows that HUD was involved in the negotiation process and bears at least partial responsibility for any delays in the claim process. Therefore, we conclude that the evidence indicating that Greystone is completely culpable in this matter is not convincing.

Michigan Beach, FHA No. 071-94030

HUD's Monitoring Issues:

Violations include Greystone's failure to obtain project financial statements prior to filing for a 30 day extension to elect to assign the mortgage. Also, HUD states that the reasons for the project's defaults were not in Greystone's files.

Greystone's Position:

Greystone maintains:

1. The Chicago HUD Field Office approved the extension with full knowledge of the project's problems and background.
2. That Greystone had draft financial statements at the time of the extension request.
3. That the project work out agreement was completed in June 1997, and without the extension would not have been possible.

OIG's Evaluation

We conclude that there is no adverse effect resulting from the purported violations. Our evaluation of the matters showed the following:

1. The project is under a work out agreement.
2. The documentation shows that HUD was aware of the causes of the default and that Greystone was also cognizant.

Westminister Apartments, FHA No. 063-94014

HUD's Monitoring Issues:

Greystone files do not contain sufficient financial information to warrant the multiple Partial Payment Claim (PPC) extensions filed with HUD.

Greystone's Position:

Greystone claims to have been in possession of adequate financial information prior to the request for extensions.

OIG's Evaluation:

Greystone provided us with documentation that shows that it had received sufficient financial information on which to file PPC extensions with HUD. This information was received prior to HUD's March 1997 review. HUD accepted the assignment of the project on June 30, 1997.

Oakton Apartments, FHA No. 000-94051

HUD's Monitoring Issues:

Greystone received the project from GNMA in October 1993. At the time, the project was one month delinquent and had \$218,303 in the Reserve for Replacement Account. HUD maintains that the funds from the Reserve would have been a prudent way to cure the default.

Greystone's Positions:

Greystone maintains that the Reserve for Replacement Account did not contain enough funds to satisfy the delinquency spanning two month rather than the one month as claimed in the HUD monitoring report. In addition, Greystone sought and received a legal opinion from its attorneys

stating that HUD Regulations do not require mortgagees to use reserve for replacement funds to satisfy project delinquencies.

Apart from the above, Greystone contends that when the loan was assigned to HUD, it was only four months in arrears (plus the two months that were delinquent at the beginning). Greystone shows that eleven mortgage payments were made by the owner during the ensuing period leading to assignment.

Greystone further states that its attempts to bring the project current were frustrated by the unwillingness of the syndicated partnership to contribute additional funds to aid the project. While collection and vacancy losses increased along with operating expenses, the project was still operating at a deficit. Greystone concluded that the project should be assigned since a partial payment claim requirement could not be met.

OIG's Evaluation:

Our approach to this case was to find the net effect of Greystone's failure to request that the reserve for replacement funds be used to satisfy the outstanding delinquency at the time the project was assigned to Greystone.

Factors Considered:

- Prior loan servicer had elected to assign the mortgage before Greystone acquired servicing rights.
- At the time of assignment to Greystone, the project was in delinquency for two months, not one as reported. The reserve was not sufficient to cover all of the delinquency.
- During the ensuing period leading to the assignment, the mortgagor made eleven mortgage payments with a payment escrow amounting to \$1.64 million.
- When HUD accepted assignment of the project it was four months delinquent. The reserve totaling \$226,476 and the payment escrow of \$1.64 million was used to reduce the insurance claim.
- Greystone would have benefited by receiving servicing fees for the period leading to the assignment of the loan to HUD.
- FHA regulations do not seem to require mortgagees to apply reserve for replacement funds to satisfy project loan delinquencies.

Our analysis has concluded that it is doubtful that the use of the reserve funds would have cured the project's financial problems. Moreover, it appears that the net effect of Greystone's actions

would have resulted in at most a small additional loss to HUD. Considering the fact that HUD accepted and paid the claim and due to the time elapsed since the settlement, it does not seem practical to try and obtain recompense from Greystone.

Harbor Club Apartments, FHA No. 048-94001

Chalet North Apartments, FHA No. 054-94003

Wyman Tower Apartments, FHA No. 052-94025

Western Run/Fox Glen Apartments, FHA No. 052-94015

HUD's Monitoring Issues:

Greystone did not document any efforts to resolve the projects' defaults. The files do not show any collection efforts or loss mitigation measures.

Greystone's Position:

Greystone defends its efforts on a case by case basis. Greystone states that all of the projects were in default or suffering financial difficulties at the time the servicing rights were acquired. Greystone points to their past successes in turning around projects that were considered for assignment by other servicers. Finally, Greystone challenges HUD's contention that it has not provided sufficient effort to resolve the matters by stating that the leader of HUD's Quality Review Team was substantively involved in reviewing and approving many of the work out proposals on the subject properties.

OIG's Evaluation:

Greystone makes a persuasive argument supported by documentation showing that it performed reasonable efforts to collect and mitigate the loans. In addition, it is obvious that the projects were troubled when they were assigned to Greystone. In reviewing Greystone's acquired portfolio of troubled projects, it is apparent that Greystone has enjoyed success in turning around financially challenged projects.

Columbia Village, FHA No. 041-94002

Wyman Towers, FHA No. 052-94025

Bedford Stuyvesant, FHA No. 012-57168

HUD's Monitoring Issues:

Greystone failed to notify owners of property inspections and to ensure that required repairs were done.

Greystone's Position:

Greystone provides documentation showing that it did notify owners of property inspections. In addition, Greystone states that repair items at the projects were followed up on.

OIG's Evaluation:

While it is apparent that the projects' owners were notified of inspection results, it is also obvious that the repairs were not done in a timely manner. The repairs on Columbia Gardens were not performed prior to the assignment to HUD. Greystone states that there was a lack of funds to complete the needed repairs. Wyman Tower repairs were not performed because the project lacked funds and HUD declined to approve the project for a partial payment claim that addressed the issue. Bedford Stuyvesant repairs appear to have been completed, albeit in a less than timely manner.

It appears that in at least one of the cases (Bedford Stuyvesant) that Greystone could have been more responsive. While this is an issue that Greystone should correct, it is not a sufficiently serious matter, when taken on its own to warrant Mortgagee Review Board action. Appropriate HUD Field Office involvement in the inspections and subsequent repairs should ensure that Greystone meets its obligations to see that needed repairs are performed in a timely manner.

Biscayne View Apartments, FHA No. 066-35203**HUD's Monitoring Issues:**

Greystone did not comply with HUD's request to use \$911,599 in the operating deficit account to bring the project current.

Greystone's Position:

Greystone maintains that its actions were proper and point to the fact that HUD ultimately accepted assignment and paid the claim in full.

OIG's Evaluation:

In reviewing the documentation surrounding the matter, it is clear that HUD reversed its decision concerning the acceptance of the assignment and did in fact receive the funds from the operating deficit account and paid the insurance claim in full. It is our opinion, an attempt to try to reverse prior HUD actions and hold Greystone responsible would not result in a successful action. In addition, it appears that the rapid financial deterioration of the project would make the assignment inevitable.

Waters Edge Apartments, FHA No. 023-35302**HUD's Monitoring Issues:**

In 1991, written instructions from the Boston HUD Field Office for a partial payment of claim required the Mortgagor to deposit and Greystone to hold \$354,577 in a debt service reserve fund

account. Prior to the closing the Mortgagor advised that it would obtain a surety bond to fund the escrow in lieu of cash.

When the Mortgagor defaulted, Greystone failed to file a claim for the bond in accordance with the surety bond contract. Namely, Greystone failed to file the claim in a timely manner resulting in the refusal of the insurance carrier to honor the surety bond.

Greystone's Position:

Greystone provides the following defense of the issues:

1. Part of the nine month delay in filing the bond claim was due to Greystone's attempts to pressure the Mortgagor into contributing additional funds to cure the default.
2. When the surety bond claim was filed, the insurance company retained legal counsel and raised a series of baseless objections to payment.
3. After assignment of the loan to HUD, Greystone sent the surety bond to HUD and advised of attempts to collect. The matter was referred to HUD's General Counsel in Washington. Despite this, HUD has taken no action to collect.
4. By paying the FHA insurance claim without reservation, HUD acknowledges that Greystone acted properly.

OIG's Evaluation:

Our review of the documentation including the correspondence with the insurance company's legal counsel, seems to indicate that the lack of a timely claim was not the most significant reason why payment was refused. The principal issue seems to revolve around whether proceeds from a surety bond for operating deficits can be used for debt service.

We agree with Greystone's contention that after assignment of the loan , it becomes HUD's responsibility to collect on the surety bond, if possible. HUD will need to proceed with collection efforts, and if necessary litigate the matter with the insurance company.

We are unable to determine the culpability of Greystone in this matter. The nine month delay in filing the claim may not be excessive. The surety bond contract only provides that the claim be filed "as soon as possible". In addition, HUD was a party to the acceptance of the bond in the 1991, partial payment transactions, thereby assuming some of the responsibility of ensuring that the bond met the transaction requirements.

Waters Edge Convalescent Center, FHA No. 035-43048

HUD's Monitoring Issues:

Greystone should have exercised its authority to have the project's income and fees assigned to Greystone under provisions of the construction mortgage document, rather than pursuing a debt restructuring.

Greystone's Position:

The HUD Field Office in Newark was fully aware of the project's problems. In fact, HUD's failure to process the construction drawdowns in a timely manner facilitated the default. Moreover, HUD refused to accept a viable workout that would have ensured the success of the project.

OIG's Evaluation:

Our review of the matter substantiates Greystone's contention that delays occurred in HUD's processing of construction drawdowns. Whether or not this was a contributing factor to the default is open to conjecture. In addition, we are not sure that there would have been sufficient income being generated during the construction phase to satisfy any defaults.

Apart from the above, and more importantly, we found that HUD reduced its insurance claim by over one million dollars, which has apparently led to legal action against Greystone by the investors.

CONCLUSIONS AND RECOMMENDATION

Based on our inquiry, we believe that Mortgagee Review Board actions are not warranted for the following reasons:

1. Many of the issues included in HUD's report to the Board were resolved by correspondence and documentation provided by Greystone.
2. The HUD monitoring review gives no weight to HUD Field Office involvement in the transactions for which Greystone is being chastised. Clearly, HUD was involved and in many instances approved and processed transactions now being questioned.
3. The time that has elapsed between the dates of the questioned transactions and the HUD monitoring and follow up actions are excessive.
4. Greystone's success in turning troubled projects around was not considered during the monitoring. HUD should have applied a cost/benefit ratio to

Greystone's willingness to take projects deemed by other servicers as financially insolvent.

5. Other issues included in the HUD report are routine deficiencies normally found during mortgagee reviews. These deficiencies do not rise to a level that would require Board action and should be addressed by HUD through its Field Offices.

In connection with our review, we did notice an outstanding surety bond issue (Waters Edge Apartments FHA No. 023-35302) and we are recommending that HUD consider seeking recovery from the insurance company that originated the surety bond. HUD should seek not only the principle due under the bond, but also interest on the outstanding amount.

Within 60 days, please furnish this office, for the recommendation cited 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 or directives issued related to the audit.

Should you or your staff have any questions, please contact me or William H. Rooney, Assistant District Inspector General for Audit, at 212-264-8000, extension 3976.

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