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MULTIFAMILY HOUSING

Impact of Loan Sales on Tenants and Properties Varies by Property

G A O
Accountability * Integrity * Reliability

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Abbreviations

FHA	Federal Housing Administration
HUD	Department of Housing and Urban Development
IRP	Interest Reduction Payment
MHDC	Missouri Housing Development Commission

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The Honorable Wayne Allard
Chairman
The Honorable John F. Kerry
Ranking Minority Member
Subcommittee on Housing
and Transportation
Committee on Banking, Housing,
and Urban Affairs
United States Senate

In 1994, in an effort to make better use of its resources, the Department of Housing and Urban Development (HUD) undertook a program designed to liquidate its inventory of multifamily mortgages. Through nine sales held between August 1994 and December 1996, HUD sold over 1,200 of the almost 2,400 multifamily mortgages in its portfolio. Two of the sales involved properties in which some or all of the units were subsidized by HUD—a sale of 158 partially assisted multifamily mortgages and a sale of 26 subsidized multifamily mortgages to the Missouri Housing Development Commission. In addition, these two loan sales contained special conditions, including protections against discrimination for assisted tenants and funding to help finance property improvements. This report describes the impact of these sales on affected tenants and properties.

If you or your staff have any questions about this report, please call me at (202) 512-7631. Key contributors to this report are listed in appendix VIII.

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Executive Summary

Purpose

By the early 1990s, the Department of Housing and Urban Development (HUD) owned about 2,400 multifamily mortgages that it had formerly insured. Lenders had assigned these mortgages to HUD after borrowers had defaulted on them. This large inventory of troubled mortgages consumed a disproportionate amount of HUD staff time and prevented the agency from properly servicing its portfolio of insured mortgages and preventing further defaults. To protect the financial interests of the federal government; maintain housing for low-income persons; and maintain existing housing in a decent, safe, and sanitary condition, the Congress enacted the Multifamily Property Disposition Reform Act of 1994. The act broadened HUD's authority to sell mortgages, and HUD sold over 1,000 mortgages at auctions held from October 1994 through December 1996. According to HUD, these sales of multifamily mortgages resulted in budgetary savings of $1.3 billion. In addition, in September 1996, HUD negotiated a sale of subsidized mortgages to the Missouri Housing Development Commission, the Missouri housing finance agency.

This report focuses on two of these loan sales. GAO focused on these sales because they were the only multifamily loan sales involving properties that were receiving HUD subsidies and had HUD funds available to them for property improvements. One sale, called the partially assisted loan sale, involved 158 mortgages for 155 properties.[1] Each of these properties was receiving what is called project-based rental assistance from HUD for fewer than half of its apartment units. HUD provides this assistance directly to property owners who enter into rental assistance contracts with HUD under which they agree to rent the assisted units to eligible households for specified rents. When these contracts expire, property owners are free to set their own rents and may raise them above levels affordable to households that formerly benefited from project-based rental assistance. As project-based contracts expired at properties in the partially assisted loan sale, HUD provided the eligible households with tenant-based assistance in the form of vouchers and certificates that they could use to rent affordable units of their choice. The other sale, called the Missouri sale, involved 26 mortgages for 19 properties that HUD sold to the Missouri Housing Development Commission. For these mortgages, HUD had provided two types of subsidies–below-market interest rates for the mortgages themselves (applicable to nearly all of the mortgages) and project-based rental assistance for more than half of the units in each of the

[1] A property may have more than one mortgage.

properties. In contrast to the Missouri sale, the partially assisted loan sale agreement includes certain provisions to protect the recipients of tenant-based assistance.[2] For both loan sales, HUD established accounts to finance property improvements.

The Subcommittee on Housing and Transportation asked GAO to examine the impact of HUD's multifamily loan sales on tenants and on the underlying properties. As agreed with the Chairman's and Ranking Minority Member's offices, this report examines, for the partially assisted loan sale, (1) the impact on tenants as project-based assistance contracts expire and (2) the steps HUD has taken to ensure that mortgage purchasers honor the tenant protections. For both the partially assisted and the Missouri loan sales, this report also examines changes in the condition of a sample of properties that, before the sales, HUD had identified as the most physically distressed and, after the sales, had the highest estimated property improvement costs.

Background

To market the partially assisted mortgages, HUD transferred the ownership of a pool of 158 mortgages into a trust owned by a general partner and a limited partner. HUD, the limited partner, retained a 30-percent equity share, assuming that the mortgages would appreciate in value after the sale. The general partner—WHUDA Real Estate Limited Partnership–retained a special servicer to service the mortgages and manage both their liquidation and the sale of any foreclosed properties. Under the trust agreement, HUD established a deferred maintenance account of $29 million to pay primarily for property improvements and protection and retained an "equity monitor" to oversee the loan servicer's real estate management and performance and to ensure that tenant protections were recorded in deed covenants. To protect tenants, the agreement requires mortgage purchasers to (1) honor existing subsidy agreements and tenant leases and (2) rent apartments to the recipients of tenant-based assistance unless it is unreasonable to do so. Additionally, the agreement gives

[2]The Missouri loan sale agreement does not appear to include any protection for the recipients of tenant-based assistance. However, as of Aug. 12, 1998, all of the expiring project-based assistance contracts had been renewed for the Missouri properties.

assisted tenants and housing authorities[3] the right to seek judicial enforcement of these protections.

The Missouri loan sale was a closed negotiation between the Missouri Housing Development Commission and HUD. Under the loan sale agreement, the Commission assumed HUD's former regulatory responsibilities for the mortgages and agreed to make its "best efforts" to invest at least $8.4 million in ongoing HUD subsidy funds to rehabilitate the properties. The loan sale agreement also allows HUD to request annual reports from the Commission on the subsidy funds it has received and expended.

As of November 30, 1998, project-based assistance contracts had expired for 33 of the 155 partially assisted loan sale properties, making 885 households eligible to receive vouchers or certificates. To obtain information on the experience of tenants at these partially assisted properties and the monitoring and enforcement of tenant protections, GAO mailed questionnaires to all HUD field offices and public housing authorities with responsibility for these properties. GAO also acquired more detailed information on tenants at six properties through file reviews and interviews with HUD headquarters and field officials, housing authority officials, and tenants. To obtain information on the condition of both partially assisted and Missouri loan sale properties, GAO judgmentally selected 11 partially assisted and 6 Missouri properties as case studies. GAO's findings for these properties cannot be projected to all of the properties in the loan sales.

Results in Brief

At the partially assisted properties whose project-based assistance contracts had expired, over three-quarters of the eligible households were able to use the tenant-based assistance that HUD provided in place of project-based assistance. Of the households that used tenant-based assistance, 65 percent stayed in the same units and the remainder moved. Among the households that moved, about 50 had to do so, according to housing authorities, because the owners of the three properties where these households had resided refused to rent to recipients of tenant-based assistance. Although the financial impact of the conversion from project-

[3]Tenant-based assistance programs are administered by state or local housing agencies, which in our sample were generally housing authorities. In this report, we refer to these agencies as housing authorities.

based to tenant-based assistance varied, the average monthly rent of households that received vouchers increased by about $56. At one property, delays in the conversion process led to losses in subsidy payments, but these problems did not directly affect tenants.

Among the protections for assisted tenants that HUD established in the partially assisted loan sale agreement is one that prohibits property owners from unreasonably refusing to rent to households with tenant-based assistance. HUD also established the right for tenants and housing authorities to seek judicial enforcement of this protection. However, the Department did not fully inform housing authorities, tenants, and property owners of these protections. As a result, most housing authorities were unaware of their right to seek judicial enforcement. In addition, representatives of the three properties where owners refused to accept tenant-based assistance told GAO they did not know of the prohibition against unreasonably refusing to rent to households using tenant-based assistance. Without knowing of their right to seek judicial enforcement, tenants and housing authorities cannot reasonably be expected to ensure the enforcement of tenant protections. Furthermore, without knowing of the prohibition against unreasonably refusing to rent to households using tenant-based assistance, property owners have little incentive to rent to such tenants. When GAO told HUD officials that the owners of three properties had refused to rent to households using tenant-based assistance, the officials declined to offer an opinion on whether the owners' refusals had been unreasonable. GAO is making recommendations to increase interested parties' awareness of the tenant protections and to determine the appropriateness of certain property owners' actions (see ch. 3).

According to the results of inspections conducted by HUD and others at or near the time of the partially assisted and Missouri loan sales and by GAO during its visits to the most physically distressed properties that it selected as case studies, conditions at these properties are improving. The improvements generally addressed major problems with building exteriors, apartment interiors, and property grounds. Overall, the improvements were more advanced for the partially assisted properties than for the Missouri properties because a much higher percentage of partially assisted mortgages were delinquent, allowing the special servicer to foreclose on the properties and begin improving them. In addition, the likelihood that owners would receive an acceptable return on their investment in property improvements depended, in part, on their perception of the strength of the local housing market, particularly for partially assisted properties—which relied more on market rents than did the Missouri properties. HUD has made very limited use of the procedures it has established for monitoring the financial and real estate management of both loan sales. Specifically, since April 1998, HUD has been without a monitor to oversee the financial performance of the loan servicer in the partially assisted loan sale. In addition, HUD has not requested an annual report on the use of subsidy funds in the Missouri loan sale because, according to the responsible multifamily asset management official, he was unaware of this provision. The official also said he has other sources of information on the condition of the properties and the status of the mortgages (see ch. 4).

Principal Findings

Under Tenant-Based Assistance, Most Households Remain in the Same Units but Pay More Rent, on Average

About 80 percent of 885 eligible households, residing in 31 partially assisted properties[4] whose project-based assistance contracts had expired as of November 30, 1998, were subsequently able to use tenant-based assistance to rent units. Although these households could choose to rent elsewhere, 458 households remained at the properties where they had received project-based assistance. However, housing authorities reported that about 50 households were unable to use tenant-based assistance at three properties whose owners refused to accept tenants using this assistance. Most households received vouchers and on average paid about $56 per month more for housing, although the financial impact of the conversion varied with the household's decision to stay or move, the size of the unit, and the property.

The tenant households surveyed by GAO were generally satisfied with the conversion from project-based to tenant-based assistance. At the six partially assisted properties where GAO obtained detailed data, more than half of the households reported having enough time or more than enough time to look for a new home. Moreover, about 70 percent of these households described the assistance and information they had received from housing authorities during the conversion as good to excellent. For one property owner, the conversion involved delays and losses in subsidy payments, but these problems did not directly affect assisted tenants.

[4]Although contracts had expired at 33 properties, all of the project-based units at 2 properties were vacant and therefore had no eligible households.

Interested Parties Were Not Fully Informed of Tenant Protections

HUD provided interested parties with some information about the tenant protections established in the partially assisted loan sale agreement but did not make sure that all parties were fully informed of them. Specifically, HUD wrote a letter to tenants notifying them of the sale and describing some of the protections, which it had published in full in the *Federal Register*. HUD asked its field staff to post the letter and the *Federal Register* notice at properties that would be affected by the conversion to tenant-based assistance. In addition, HUD had made its equity monitor responsible for ensuring that the owners of delinquent mortgages recorded the tenant protections in deed covenants. However, HUD did not determine whether its field offices posted the letter and *Federal Register* notice, and it did not notify housing authorities or property owners of the protections. Furthermore, although the equity monitor's contract expired in March 1998, HUD has not awarded a new contract for an equity monitor, and HUD staff have not assumed the equity monitor's functions. HUD officials recognize the importance of these functions and are pursuing a contract for equity-monitoring services.

Only half of the HUD field offices responding to GAO's survey reported being aware that tenants and housing authorities have the right to seek judicial enforcement when property owners unreasonably refuse to rent to households with tenant-based assistance. Additionally, most tenants and housing authorities that GAO surveyed were unaware of this right. Representatives of the three properties where owners refused to accept tenant-based assistance likewise said they were unaware of the prohibition against unreasonably refusing to rent to households with such assistance.

Conditions Have Improved at Most Reviewed Properties

All but 1 of the 17 properties GAO reviewed as case studies were undergoing moderate to substantial improvements at the time of GAO's review. These improvements generally addressed the major deficiencies that HUD had identified in its property inspection reports prior to the loan sales. These deficiencies included problems with the building exteriors (i.e., aging roofs, deteriorated walls), apartment interiors (i.e., worn-out carpets and floors and vacant, uninhabitable units) and property grounds (i.e., erosion and parking lots with broken lights and cracked pavement). The Missouri case study properties were generally in poorer condition than the partially assisted case study properties at the time of the loan sales. At a majority of the partially assisted case study properties, GAO found that improvements to the roofs, gutters, and exterior walls had been completed, but interior improvements were not as advanced. Progress at the Missouri properties was generally slower than at the partially assisted properties.

While GAO's findings for the case study properties cannot be projected to all of the properties in the loan sales, they show that conditions at the worst properties are improving.

Through discussions with the property owners and others, GAO identified three factors—delinquency and foreclosure rates, restrictions and incentives in the loan sale agreements, and the perceived strength of local housing markets—that have influenced the pace and extent of improvements to GAO's case study properties. However, the impact of these factors differs by loan sale. For the partially assisted loan sale, a high percentage of the mortgages were delinquent. This allowed the loan servicer to foreclose on the properties and begin improving them. The market-oriented incentives and restrictions in the loan sale agreement influenced the loan servicer's investment decisions. Specifically, they required the loan servicer to estimate the potential for future rent increases that would be needed to support projected property improvements. Such housing market considerations also influenced the investment decisions of both the original and new private owners of these properties. Improvements to the Missouri properties were influenced more by the requirement in the Missouri loan sale agreement that the Missouri Housing Development Commission use its "best efforts" to invest HUD subsidy funds to rehabilitate the properties. Because relatively few of the Missouri mortgages were delinquent, the Commission was limited in its ability to foreclose on them and make the necessary property improvements. However, the Commission provided substantial funding to improve the three delinquent mortgaged properties and helped arrange for alternative subsidized funding for a fourth property. Housing market considerations were of limited relevance for the Missouri properties because more of their revenue is generally derived from project-based assistance payments than from market rents.

For both loan sales, HUD retained monitoring rights and established procedures primarily to oversee financial and real estate performance and compliance with the terms of the sales. Although HUD has been attempting for nearly 2 years to select an equity monitor for the partially assisted sale, as of January 4, 2000, it had not completed its final selection. The selection has taken so long because the panel reviewing bids required several attempts to produce an initial report ranking prospective bidders that was acceptable to the Office of Procurement and Contracts. In addition, in response to concerns expressed by the Office of Procurement and Contracts and the Office of General Counsel, the panel had to obtain comparable cost data for the finalists before submitting its recommendation for the final selection. For the Missouri loan sale, HUD has not exercised its right to obtain a written monitoring report from the Commission because it was unaware of this right and because other information on these properties was available.

Recommendations

GAO recommends that the Secretary of Housing and Urban Development, among other things, (1) notify housing authorities and tenants of the tenant protections and the right to seek judicial enforcement established for the partially assisted loan sale, (2) expeditiously retain an equity monitor to monitor the real estate management of the loan servicer, and (3) request a progress report from the Missouri Housing Development Commission that will allow the Department to evaluate the cost and financing of improvements and the resulting increase in the useful life of each property.

Agency Comments

GAO provided HUD with a draft of this report for its review and comment. HUD agreed to implement the report's recommendations, with one exception, and expressed its commitment to following up fully on its multifamily loan sales. (See app. VII.) HUD disagreed with GAO's recommendation that HUD ask the Missouri Housing Development Commission in writing to provide annual reports to HUD, as permitted in the Missouri loan sale agreement. HUD thought that such a request would be burdensome and would duplicate information it already receives through other sources. In response to HUD's concerns, GAO revised its recommendation to specify the type of information that would allow HUD to know how well its funds are invested. Such information—including the cost of and financing for improvements since the loan sale–is not included in the reports HUD cites in its letter but would be useful to HUD as it designs future sales of subsidized mortgages. In addition, the recommendation no longer calls for such a report to be provided annually.

HUD also expressed concern that GAO did not adequately recognize that the sales were designed to minimize the need for staff-intensive monitoring. GAO believes the report adequately addresses the design of the sales. For example, the report explicitly notes that HUD's reliance on housing authorities to enforce tenant protections is consistent with HUD's intention to reduce its role in compliance monitoring. GAO is not suggesting that HUD undertake monitoring beyond that delineated in the loan sale documents, but rather that HUD ensure that the parties it expects to act on behalf of tenants know of their ability to do so. HUD also expressed concern that GAO did not adequately recognize the positive impact of the loan sales on the properties and their residents and on the health of the Federal Housing Administration's insurance funds. In response, GAO included in the report HUD's estimates of the budget savings due to the sale of multifamily mortgages.[5] HUD also provided technical corrections and clarifications, which GAO incorporated in the report where appropriate.

[5]See *Housing Finance: Budget Savings From the Sale of HUD Loans* (GAO/RCED-99-203, July 19, 1999).

Introduction

Since 1934, the Federal Housing Administration (FHA), an agency within the Department of Housing and Urban Development (HUD), has insured lenders against losses on mortgages on single-family and multifamily properties that otherwise might not have qualified for conventional financing. By the early 1990s, HUD owned about 2,400 multifamily mortgages that lenders had assigned to HUD after borrowers had defaulted on the HUD-insured mortgages.

This large inventory of troubled mortgages consumed a disproportionate amount of FHA staff time and prevented the agency from properly servicing its portfolio of insured mortgages and preventing further defaults. Concerned about the growing number of multifamily mortgages owned by HUD and the deteriorating condition of the properties underlying these mortgages, the Congress broadened HUD's authority to sell the mortgages it held.[1] Specifically, the act allowed the Secretary of Housing and Urban Development to dispose of multifamily mortgages in a manner that, among other things, protects the financial interests of the federal government and, in the least costly fashion, addresses certain goals. Among these goals are preserving the availability of housing affordable to low-income persons; preserving and revitalizing residential neighborhoods; maintaining existing housing in a decent, safe, and sanitary condition; and minimizing the involuntary displacement of tenants.

In March 1994, HUD initiated an aggressive program to sell FHA's inventory of HUD-held mortgages. From October 1994 through December 1996, HUD held seven auctions in which it sold 1,093 multifamily mortgages. According to HUD, these auctions of multifamily mortgages resulted in budgetary savings of $1.3 billion. One such sale consisted of about 158 mortgages on partially assisted multifamily properties (properties in which at least one but fewer than half of the units received what is called project-based rental assistance). Under project-based rental assistance, a property owner agrees to rent some or all of a property's units to lower-income households at rents specified in a contract with HUD. In return, HUD pays the property owner a rental subsidy for the part of the rent that exceeds 30 percent of the assisted household's income. In addition, HUD negotiated the sale of 26 subsidized multifamily mortgages to the Missouri Housing

[1]Multifamily Housing Property Disposition Reform Act of 1994 (P.L. 103-233).

Development Commission (MHDC).[2] As of September 30, 1998, about 1,100 multifamily mortgages remained in HUD's portfolio, a large portion of which have subsidies much like those in the Missouri loan sale portfolio.

Partially Assisted Sale

The partially assisted sale consisted of mortgages on multifamily properties in which up to 50 percent of the units were subsidized by HUD–hence the name "partially assisted." In the properties affected by this sale, fewer than 24 percent of the units, on average, had received such project-based subsidies. This sale was different from FHA's previous multifamily loan sales, which were whole loan sales and not structured sales (described in the next paragraph).

FHA used a structured sale to market the partially assisted mortgages. This approach was based, in part, on the experience of the Resolution Trust Corporation in disposing of assets from the savings and loans crisis. In effect, FHA transferred the ownership of a pool of 158 mortgages into a trust that was owned 70 percent by a general partner—WHUDA Real Estate Limited Partnership–and 30 percent by a limited partner–HUD. The trust was established to (1) acquire the pool of mortgages, (2) issue and sell bonds, (3) service the mortgages and manage any properties acquired through foreclosure, (4) dispose of the mortgages and properties in an orderly manner that would maximize the economic return to the owners of the trust, and (5) engage in any activities needed to accomplish the preceding tasks.

HUD retained an equity position in the trust on the assumption that the private market would undervalue the mortgage portfolio at the time of the sale, given the market's lack of experience with partially assisted properties. HUD could then share in any appreciation of the properties if the mortgages performed better than expected and any foreclosed properties were effectively managed and sold.

[2]HUD provided subsidies for multifamily properties by subsidizing the rents of individual apartments and/or subsidizing the mortgage payments. A mortgage is considered to be "subsidized" if (1) it was insured under a Section 236 or 221(d)(3) below-market interest rate mortgage subsidy program or (2) more than 50 percent of the units in the property securing the mortgage received project-based rent subsidies. The partially assisted mortgages were unsubsidized mortgages.

The general partner retained the ARCHON Group as the special servicer (asset manager) for the mortgage pool. The servicer's major responsibility is to service the mortgages with a view toward their liquidation and the sale of any property obtained as a result of foreclosure. The servicer is also responsible for (1) determining the manner of liquidation and the sale price, consistent with the trust's obligations to the bondholders under the indenture, and (2) maximizing the economic return to the general and limited partners. (Table 1 describes this partnership.)

Table 1: Partnership Created to Manage the Partially Assisted Loan Sale

General partner	Limited partner
WHUDA Real Estate Limited Partnership	HUD
70 percent ownership	30 percent ownership
Active investor	Passive investor
Full control over how the purchased assets (mortgages) are serviced (resold, restructured, foreclosed) and how the properties are managed	No control over how the assets are serviced except that HUD retained responsibility for managing the Section 8 contracts
Could receive greater profits if the mortgages and foreclosed properties performed better than expected	Could receive larger equity payments if the mortgages and foreclosed properties performed better than expected
Paid $141 million to HUD for its 70-percent equity position	Contributed $60 million to the trust for its 30-percent equity position[a]

[a]HUD contributed $60 million to the trust from the $650 million in payments it received ($141 million from the general partner plus $509 million from bond proceeds).

To fund the purchase of the partially assisted mortgages for the trust, bonds were sold to one investor for $509 million. The bondholder is paid in full before equity distributions are made to the equity holders. Seven different categories of bonds were sold, each category with a different credit rating provided by the credit agencies. The highest-rated bonds were paid off first, and the lowest-rated bonds were redeemed last. The first payment to HUD was received in April 1999 after the bonds had been paid off. According to a senior HUD official, HUD had received a total of $22,941,235 as of July 31, 1999.

The trust agreement established a Deferred Maintenance Account with $29 million funded by HUD from its $60 million contribution. This account may be used to pay for "property improvements" and "property protection" for the properties backing the mortgages. Property improvement funds cover replacement, renovation, and repairs. Property protection funds cover property taxes, hazard insurance, “maintenance charges and assessments,” utility charges, and other charges. The servicer is authorized to spend these funds only to the extent that it has determined (in its discretion) that its expenditures are recoverable (will increase the liquidation proceeds above expenses) when a mortgage or property is sold.

HUD retained an “equity monitor” to conduct limited oversight of the trust’s real estate management and compliance with reporting requirements. A more detailed description of the equity monitor’s responsibilities can be found in chapter 4. HUD selected AM&G, certified public accountants and consultants, to serve as the equity monitor for 18 months following the loan sale. As of January 4, 2000, HUD had not selected a new equity monitor.

Missouri Housing Finance Agency Sale

On September 25, 1996, HUD closed the first negotiated sale of HUD-held subsidized mortgages to a state housing finance agency–the Missouri Housing Development Commission (MHDC)–under the provisions of the 1994 Multifamily Disposition Act. According to HUD officials, this sale represented an effective way to reengineer subsidized mortgages for the benefit of the real estate, the mortgages, the residents, and the affected neighborhoods.

The Missouri sale differed from FHA’s other multifamily loan sales in three respects. First, all the mortgages in this sale were subsidized–that is, a majority of the units in the properties backed by these mortgages were rent restricted and had project-based Section 8 subsidies, or the mortgages had received interest subsidies under either the Section 236 or the Section 221(d)(3) below-market interest rate program. Second, the sale was negotiated between the two parties, whereas FHA’s previous sales under the 1994 act had been marketed to all parties wishing to bid on the mortgages. Finally, in taking ownership of the mortgages, MHDC assumed all regulatory responsibilities previously borne by HUD. These responsibilities included servicing the mortgages and administering the Section 8 contracts.

The Missouri sale consisted of 26 mortgages on 19 properties with a total of 2,200 units. The unpaid principal balance (mortgage amount) on these mortgages was almost $30 million. MHDC paid HUD $10 for these mortgages and agreed to use its “best efforts” to finance (1) improvements worth approximately $8.4 million[3] for the properties supporting the mortgages and (2) "resident initiatives."[4] The funding for property improvements and resident initiatives comes primarily from the continuation of existing subsidies provided by HUD (e.g., Section 8 rental assistance payments and interest reduction payments). MHDC deposits these subsidy payments in a restricted account known as the Interest Reduction Payment (IRP) Account, as required by the loan sale agreement. As of June 30, 1999, MHDC had received a net total of about $6.3 million in subsidy payments from HUD. Any funds in this account can also be used to restructure/support a single mortgage or combination of mortgages in this sale. This approach represents cross-subsidization in the mortgage portfolio–the strong mortgages can support the weak ones, making the whole portfolio of sold mortgages stronger.

The only oversight mechanism in the loan sale agreement that we could identify is a provision that authorizes HUD to request (in writing) that MHDC prepare a report to HUD that includes a comprehensive accounting of how the IRP funds have been spent and a certification from MHDC's executive director that the agency is in compliance with the obligations in the loan sale agreement. As of October 1, 1999, HUD had not asked MHDC for such a report.

Project-Based and Tenant-Based Assistance

Section 8 rental housing assistance is the main form of federal housing assistance for the nation's low-income residents. Section 8 assistance is tied either to units in specific properties (project-based assistance) or to individuals who live in affordable rental housing of their choice (tenant-based assistance). HUD provides project-based Section 8 rental subsidies to the owners of certain mortgaged properties under housing assistance payments contracts.

[3]An amount estimated by HUD at the time of the loan sale.

[4]Resident initiatives can include projects such as providing residents with access to computers and software, educational opportunities, and self-sufficiency and job training.

Starting in 1975, HUD signed 20- to 40-year contracts with private owners to provide project-based Section 8 subsidies to their properties. These long-term contracts are now expiring, creating uncertainty about whether the properties will continue as affordable housing. During the next 5 years, two-thirds of all project-based Section 8 contracts will expire, affecting almost 14,000 properties containing a million subsidized housing units, according to HUD's April 1999 report on affordable housing.[5] Until recently, budget constraints have limited renewals to 1 year, multiplying the number of contracts that face expiration each year.

With project-based assistance, a household generally pays 30 percent of its income toward rent, and HUD pays the balance. When the household moves out, it cannot take the subsidy with it, but instead, the next eligible household uses the subsidy so that the property itself remains subsidized.

As required by law, if the owner of a mortgaged property decides to stop operating under a project-based subsidy contract, the owner must provide at least 180 days' notice to HUD and the tenants.[6] Owners who fail to provide the required notice must either (1) renew their contracts for up to another 180 days while a new notice is being served or (2) permit the tenants to remain in their units for 180 days without increasing the share of rent they were paying while the property was under contract.

When a project-based rental subsidy contract is terminated, HUD attempts to provide the tenants with tenant-based assistance, using Section 8 vouchers or certificates that are renewable annually. These vouchers and certificates are administered by a state or local housing authority.[7] A housing authority receives a fee from HUD for administering the tenant-based program. The housing authority's administrative responsibilities include determining households' eligibility and ensuring that units meet housing quality standards.

[5]See *Opting In: Renewing America's Commitment to Affordable Housing* (Apr. 1999).

[6]The required notice period has been statutorily increased. Owners who do not intend to renew an expiring project-based subsidy contract generally must now give HUD and the affected tenants a year's notice.

[7]See footnote 3 in the executive summary.

Under tenant-based assistance, tenants may choose where they live, as long as the units they select meet HUD's rent and quality standards. Generally, under the certificate program, an assisted household pays 30 percent of its adjusted monthly income for rent, and the housing authority pays the balance. However, a household with a certificate typically can not choose to rent a unit whose gross rent[8] exceeds the area's fair market rent. Incontrast, a household with a voucher is assisted through a subsidy payment to the landlord equal to the difference between 30 percent of the household's adjusted monthly income and a payment standard for the housing unit based on the fair market rent for a unit of a similar size in the area. In addition, a household with a voucher may elect to pay more or less than 30 percent of its adjusted monthly income for rent depending on whether the gross rent for the chosen unit is higher or lower than the payment standard.

Title V of HUD's fiscal year 1999 appropriations act (P.L. 105-276) authorized HUD to consolidate the tenant-based voucher and certificate programs into one voucher program, effective October 1, 1999. Under this consolidation, all voucher holders were automatically transferred to the new voucher program. In addition, voucher holders who were generally paying less than 30 percent of their income toward rent because they had selected relatively less expensive units will eventually pay 30 percent or more of their income toward rent. Furthermore, all certificate holders will be transferred to the new voucher program by October 1, 2001.

Converting From Project-Based to Tenant-Based Assistance

The process of converting from project-based to tenant-based assistance is complex and vulnerable to delays. It involves property owners, several HUD offices, and housing authorities, as well as assisted tenants. After a property owner decides not to renew an expiring project-based assistance contract, the owner sends a notification letter to Multifamily Housing field staff. These staff are responsible for requesting funding for tenant-based assistance from Multifamily Housing staff in headquarters and notifying Public and Indian Housing field staff of the owner's decision. The Public and Indian Housing field staff contact the housing authority and ask it to administer the tenant-based assistance, which includes certifying the tenants and issuing vouchers or certificates to those affected. Multifamily Housing staff in headquarters review the need for tenant-based assistance

[8] The gross rent equals the contract rent for a unit plus an allowance for utilities.

and, if necessary, reallocate funding to the Office of Public and Indian Housing in headquarters. The Office of Public and Indian Housing in headquarters assigns budget authority to HUD's Financial Management Center, which provides the funding for tenant-based assistance to the housing authority. Delays can occur at any of these stages in the conversion process.

Tenant Protections

Before the June 1996 partially assisted loan sale, HUD had established certain protections for assisted tenants in properties with HUD-held mortgages. When these mortgages were sold, HUD extended the same protections to the tenants. These protections, published in the Federal Register, included requirements that (1) for mortgages that are delinquent when sold, present and future property owners assume federal rental subsidy contracts until the contracts expire, (2) mortgage purchasers foreclose in a manner that will not change assisted tenants' leases, (3) property owners do not unreasonably refuse to rent units to tenants using housing assistance certificates or vouchers,[9] and (4) for mortgages that are delinquent when sold, mortgage purchasers record the first and third protections in covenants on deeds. In addition, the loan sale agreement gave tenants and public housing authorities the right to seek judicial enforcement of the tenant protections.

Objectives, Scope, and Methodology

In this report, we reviewed two of HUD's multifamily loan sales, the partially assisted loan sale and the Missouri loan sale. We selected these two sales because they were the only multifamily loan sales in which (1) the properties were receiving housing subsidies and (2) HUD provided funds for property improvements.

Impact on Tenants at Partially Assisted Properties

To measure the impact on tenants of the conversion from project-based to tenant-based assistance at partially assisted properties, we identified all of the sale properties whose Section 8 project-based contracts had expired as of November 30, 1998. In total, we identified 33 properties that had operated under 37 contracts. For this universe of properties and contracts, we mailed questionnaires to the 17 HUD Multifamily Housing field offices that had administered the contracts and were responsible for initiating the

[9]This tenant protection is not applicable to the mortgages HUD currently holds.

conversion to tenant-based assistance for the assisted households. We also mailed questionnaires to the 29 public housing authorities (or other local agencies) responsible for administering the tenant-based assistance for these assisted households after the project-based contracts expired. We received responses from all of the HUD field offices and public housing authorities (or other local agencies) and, on the basis of these responses, included 31 properties in our analysis. Two properties were excluded because all of the project-based units were vacant and therefore did not have households eligible for conversion to tenant-based assistance. Our analysis of these surveys provided us with general information, such as agency officials' insights and opinions on the loan sale and conversion process, general data on the contracts and affected households, and data on average rents by contract at the time the contracts expired. The questionnaires we used, along wih the report, are available on the Internet and can be found at http://www.gao.gov/cgi-bin/getrpt/RCED-00-31.

To obtain detailed data on the impact of the conversion on tenants, we selected six case study properties located in three states: Missouri (Hillside Park Apartments and Dunleith Towers), North Carolina (Century Oaks and Meadowbrook Apartments), and Texas (Gulf Royale Apartments and Hammerly Walk). We judgmentally selected the six properties because their project-based assistance contracts had not been renewed as of November 30, 1998, a substantial number of units had received project-based assistance, and enough time had elapsed to complete the conversion to tenant-based assistance. Because the properties were judgmentally selected, the results of our case study analyses cannot be generalized to all of the partially assisted properties whose project-based contracts have expired.

For these six case study properties, we obtained detailed information through interviews with and surveys of officials with HUD's Office of Multifamily Housing and Office of Public and Indian Housing and officials with local public housing authorities involved in the conversion from project-based assistance to tenant-based assistance. These staff provided rent and income data for individual households, which enabled us to measure the financial impact on the affected tenants. They also described each property, the conversion process at each property, and characteristics of assisted households, such as their age, employment, and size. In addition, we conducted structured telephone interviews with 49 of the 75 households that were living at the properties whose contracts had expired and had received vouchers or certificates through the conversion process. We were unable to interview the remaining 26 households generally because we could not reach them by telephone or they did not have telephones.

Steps Taken to Ensure That Tenant Protections Are Honored

To determine what steps HUD has taken to ensure that the purchasers of partially assisted loans have honored tenant protections, we conducted interviews with HUD Multifamily Housing headquarters and field staff. We also included questions on the protections in the surveys mailed to HUD Multifamily Housing field offices and public housing authorities. Finally, we included questions on the protections in our telephone surveys of tenants affected by the conversion. Responses to these interview and survey questions enabled us to determine the extent to which information on the tenant protections was disseminated and compliance with the protections was monitored and enforced.

Conditions at Partially Assisted Properties

To determine how conditions have changed at the most physically distressed properties since the partially assisted loan sale, we judgmentally selected 10 case study properties from the portfolio. We also selected an eleventh property—Parkway Center–because it had the highest projected property improvement costs estimated by the special servicer, ARCHON. (See app. I for a list of these case study properties.) Our initial selection was based on each property's need for physical improvements, as indicated by a negative rating in the most recent physical inspection report issued by HUD before the loan sale and/or in property inspection reports prepared by HUD contractors as part of the due diligence performed by HUD prior to the loan sale. Our final selection was based on the number of items with urgent or major physical improvement needs indicated in these reports, as well as the projected property improvement costs estimated by ARCHON.[10]

This judgmental sample allowed us to gain a firsthand perspective on how conditions have changed for a selection of the most physically distressed properties. However, because of the selection criteria used, the results of this analysis cannot be generalized for all properties backing mortgages in the partially assisted sale.

In doing this analysis, we interviewed HUD officials, reviewed HUD's due diligence files for the partially assisted loan sale, interviewed senior

[10]Gulf Royale Apartments was the only property included in both the property condition and tenant impact portions of our work.

officials with ARCHON, reviewed ARCHON's business plans for the selected properties, interviewed the property managers, and visited the properties.

Conditions at Missouri Housing Development Commission Properties

To determine how property conditions have changed at the most physically distressed properties since the Missouri loan sale, we judgmentally selected six multifamily properties. (See app. II for a list of these case study properties.) Our selection was based on each property's need for physical improvements as indicated by the most recent physical inspection report issued by HUD before the loan sale, MHDC's independent assessment of these physical needs at the time of the loan sale, and the dollar amount of improvements estimated by MHDC for each property. While this judgmental sample allowed us to gain a firsthand perspective on how property conditions have changed, because of the selection criteria used, the results of this analysis cannot be generalized for all properties backing mortgages in the Missouri sale. Because HUD's existing subsidies were not removed as a result of the Missouri loan sale, we did not evaluate the impact of the sale on tenants.

In examining the changes in the physical condition of the six case study properties, we interviewed HUD officials, reviewed HUD's due diligence files for the Missouri loan sale, interviewed senior MHDC officials, collected detailed information on the properties through a data collection instrument, interviewed the property managers, and visited the properties.

We performed our work from August 1998 through January 2000 in accordance with generally accepted government auditing standards.

Households Were Able to Use Tenant-Based Assistance to Find Housing, but Many Paid More Toward Rent

At the partially assisted properties where project-based assistance contracts had expired, a majority of the households that were eligible for tenant-based assistance used it to rent apartments, primarily in the same properties. Of the households that moved, most chose to do so, but some were forced to leave. A majority of the households at our case study properties were satisfied with the assistance they received from housing authorities during the conversion process and said they had enough time to find new homes. Although delays can occur during the conversion from project-based to tenant-based assistance, HUD and/or property owners took steps to shield households from the effects of these delays. After the conversion, a majority of assisted households paid proportionally more of their incomes toward rent. Moreover, because of recent legislative changes, households that did not initially pay more toward rent are likely to do so in the future.

Majority of Eligible Households Were Able to Use Tenant-Based Assistance

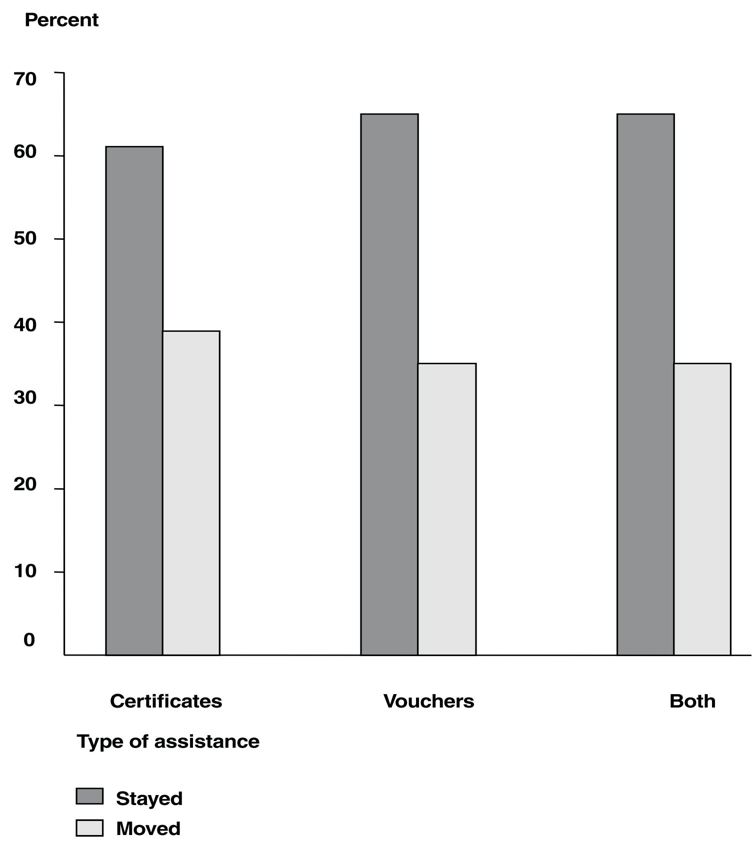
Housing authorities offered tenant-based assistance to 885 eligible households, 706 of whom used it to rent units.[1] Of these 706 households, over 90 percent (655 households) used vouchers and the remainder (51 households) used certificates. Of 139 households that were offered but did not use the assistance, some declined it, while others accepted but then never used it. The housing authorities reported that they did not know why most of the 51 households that declined assistance did so; however, they reported that some households had chosen to move in with friends or relatives. Housing authorities also reported that most of the 88 households that accepted but did not use the assistance did not stay in touch with the housing authorities; thus, the authorities did not know why the households did not use the assistance.

A majority of the 706 households that used tenant-based assistance remained at the properties where they had received project-based assistance. While tenant-based assistance gives households the flexibility to move if they wish, 65 percent of these households did not move, according to the housing authorities we surveyed. As indicated in figure 1,

[1]HUD authorized housing authorities to review the eligibility of households in 1,034 units, located in 31 properties. Although we identified 33 properties with expired project-based contracts covering 1,225 units, we did not include 2 of these properties in our analysis because, according to HUD field staff we surveyed, all of the project-based units in these properties were either vacant or occupied by unassisted households when the properties' project-based contracts expired. Likewise, some of the other properties had some units authorized for project-based assistance that were vacant or occupied by unassisted tenants.

65 percent of the 655 households that used vouchers stayed at the same properties and 35 percent moved away from these properties. Additionally, 61 percent of the 51 households that used certificates stayed and 39 percent moved.

Figure 1: Percentage of Households Using Certificates and Vouchers That Stayed and Moved



Source: GAO's survey of public housing authorities.

According to the housing authorities we surveyed, assisted households were able to use tenant-based assistance at 25 of the properties where they had formerly received project-based assistance.[2] At five properties, however, households were unable to use their tenant-based assistance to rent units and, as a result, some households were forced to move. At two of the five properties, the owner or manager raised rents above the levels the housing authority considered reasonable for the area, thereby precluding assisted households from using tenant-based assistance at these properties. At the three remaining properties, the owner or manager refused to accept tenant-based assistance, and, as discussed further in chapter 3, 50 households were unable to use their tenant-based assistance at these properties.[3] Finally, at one additional property, we could not determine whether the owner was willing to accept tenant-based assistance because the households either moved or did not accept tenant-based assistance.

At our six case study properties, most assisted households used their tenant-based assistance to remain at the properties where they had received project-based assistance. At four of the properties where assisted households received vouchers, 41 households initially remained at the properties, while only 6 households moved. At the two remaining properties, where assisted households received certificates, 25 households stayed and 3 moved.

Our telephone survey of 49 assisted households at the six case study properties suggested reasons why most of these households stayed at the same properties. Most of the households that stayed expressed general satisfaction with their current homes, and 76 percent said they had no plans to move in the near future. Among the most important reasons for staying, they frequently cited (1) proximity to services such as shopping, schools, work or medical facilities; (2) satisfactory rents; and (3) satisfactory neighborhood conditions. Eighty percent said they were either more satisfied or about as satisfied with their apartments after the conversion as they had been before. Although they generally reported that interior common areas were in about the same condition, 42 percent

[2]The owners of two properties initially refused to accept tenant-based assistance but later agreed to accept it.

[3]Under the tenant protection provisions of 24 C.F.R. part 290, the owners of certain properties cannot unreasonably refuse to rent to tenants receiving housing assistance. See ch. 3 for more information on tenant protections.

reported that exterior features, such as roofs, landscaping, and roads, were in better condition since the conversion to tenant-based assistance. Additionally, about 70 percent said they were somewhat or very satisfied with the condition of their neighborhoods and felt somewhat or very safe from crime on the streets near their homes.

Of the nine assisted households at our case study properties that moved to other properties, two that received vouchers and all three that received certificates moved voluntarily. During a telephone interview, one of these households reported that it had chosen to move because the rent at the case study property was higher than it wanted to pay. The four remaining households that received vouchers moved involuntarily. All four households lived in one of the properties where the owner or manager raised rents above the levels the housing authority considered reasonable for the area, precluding these households from using their vouchers at the property.

Households Experienced Few Difficulties During the Conversion to Tenant-Based Assistance

Households were generally satisfied with the amount of time they had to search for new homes and with the assistance housing authorities provided during the conversion to tenant-based assistance. In fact, most households remained in their former units. In addition, although delays sometimes occurred during the conversion, HUD and property owners took steps to ensure that during the delays, assisted households continued to pay the same rents as they had paid under project-based assistance.

Case Study Households Were Generally Satisfied With the Conversion Process

About 70 percent of the case study households who responded told us that, overall, the assistance they received from housing authorities during the conversion process ranged from good to excellent. About 80 percent of the households who responded also said that, overall, the information provided by the housing authorities ranged from good to excellent. To facilitate the conversion, most housing authorities held meetings about using certificates or vouchers, helped tenants fill out forms, provided information about moving, and were available to respond to questions by telephone.

Households' and housing authorities' views on whether households had enough time to search for new homes after being notified of the conversion were mixed. More than half of the households who responded at our six case study properties said they had enough or more than enough time to search for new homes. Households reported having from 1 to 12 months, although about 60 percent reported having between 1 and 3 months. About

35 percent of the responding households told us they would most likely leave their neighborhoods in the future if given the opportunity. Additionally, 55 percent of the housing authorities responding to our survey indicated that assisted households did not have enough time to search for new homes.

HUD and Property Owners Ensured That Delays Did Not Have a Financial Impact on Assisted Households

Although some delays occurred during the conversion process, households were generally shielded from their effects by HUD or the property owner. According to HUD field staff responding to our survey, HUD requested extensions of expiring project-based assistance contracts at seven properties to allow more time for completing the conversion process.[4] Four of these extensions were for less than 6 months. According to the HUD field staff we surveyed, HUD requested these extensions because it needed budget authority for the vouchers or certificates, it needed more time for the conversion to tenant-based assistance, or the owner had not properly notified affected households. However, according to HUD officials, households at the seven properties were unaffected because the extensions allowed the households to continue receiving project-based assistance until the conversion to tenant-based assistance had been completed.

In at least one additional case, where the contract was not extended, the owner protected households financially by absorbing the subsidy portion of the rent during delays in the conversion process, according to a representative of the property owner. Specifically, according to this representative, the housing authority did not have enough time to perform its inspections, and as a result, the property owner absorbed the subsidy portion of the rent for eight households.

[4]In fiscal year 1999, the Office of Public and Indian Housing, in headquarters, reported 89 instances in which it received less than 30 days' notice of an expiring Section 8 contract. To improve the process, this office is contracting to provide comprehensive training for HUD staff (both Multifamily Housing and Public and Indian Housing) on conversion actions and the funding process.

Average Rent Payments Are Higher Under Tenant-Based Assistance

Overall, households that used vouchers after project-based assistance contracts expired—usually because property owners chose not to renew (opted out of) the contracts—were likely to pay more than they previously paid toward rent. This amount varied with the size of the apartment and with the household's decision to stay at the same property or move to another. In contrast, the few households that used certificates after owners opted out of project-based assistance contracts were not required to pay more toward rent because their rent was still calculated in the same way. However, households using certificates may eventually pay more toward rent under recent legislative changes to the Section 8 program.

On Average, Households With Vouchers Paid More Toward Gross Rent After the Conversion

We found that, on average, households with vouchers paid about $56 per month more toward rent after the conversion to tenant-based assistance.[5] According to the housing authorities we surveyed, 93 percent of the 706 households that used tenant-based assistance after the conversion from project-based assistance used vouchers. The increase in rent resulted because the weighted average gross rent[6] for all households with vouchers exceeded the weighted average payment standard[7] by $56 (the average amount of additional rent).[8] However, of these households with vouchers, the average household that moved from the property where it had received project-based assistance had a higher additional rent of $111,[9] while the average household that stayed at the same property had a lower additional rent of $34. Except for households that stayed in three-bedroom units, the

[5]Our analyses were based on survey data made available by housing authorities for 406 households in one-, two-, and three-bedroom units that did not move to units of different sizes when transferring from project-based assistance to vouchers. Tenant-based rent data were the rents reported in effect when households first used this assistance and do not reflect any subsequent rent increases that may have occurred.

[6]Information on gross rents was provided by housing authorities as averages for households in each of six categories: households that stayed at a property in one-, two-, and three-bedroom units and households that moved away from a property in one-, two-, and three-bedroom units. Therefore, the average rent for each category was weighted by the number of households in that category. Gross rents for individual households may have been higher or lower than the weighted average; however, our survey provides data for average gross rents only by the size of the apartment, the type of assistance (voucher vs. certificate), and the household's decision to stay or move.

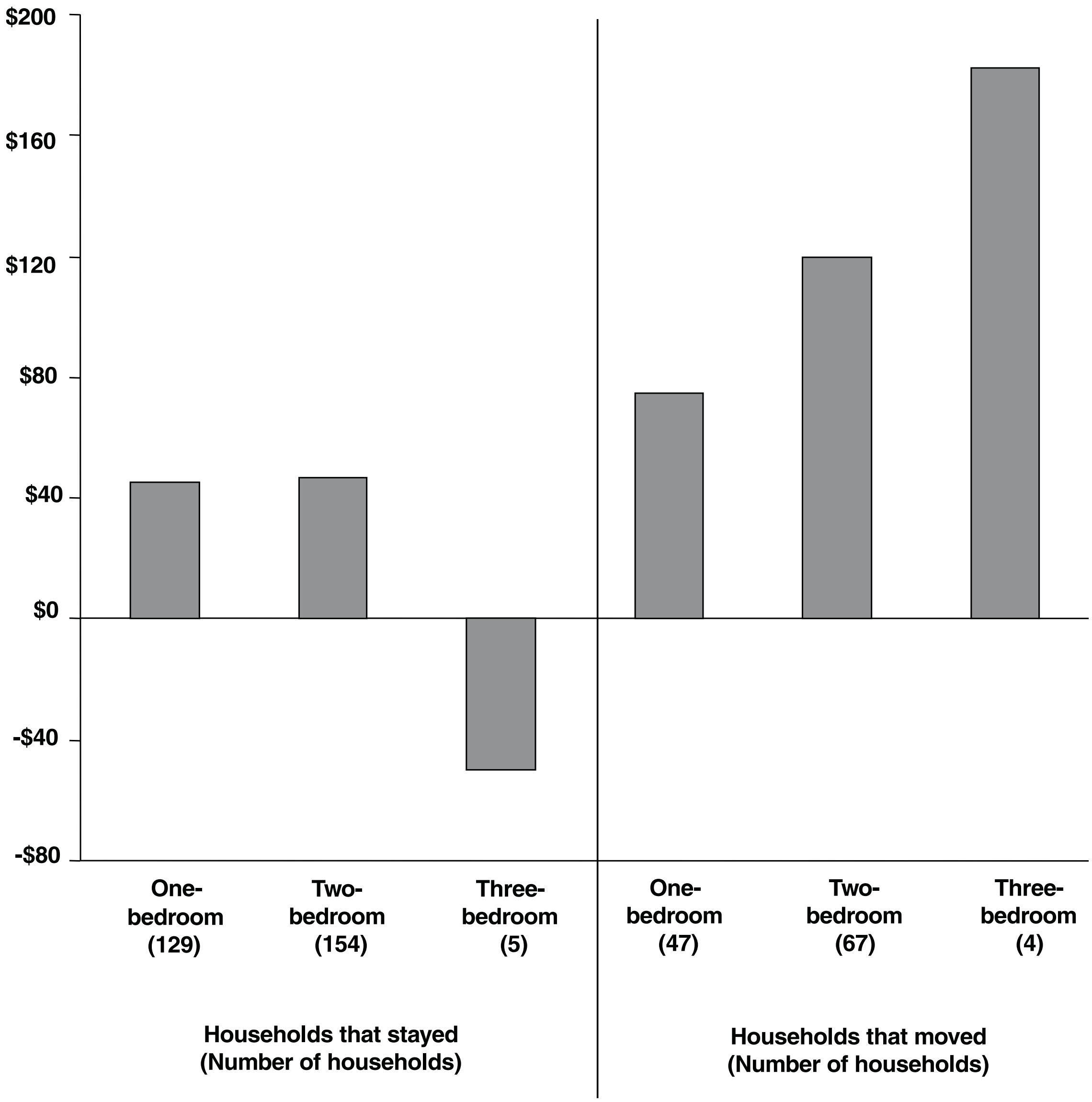
[7]The payment standard is the maximum rent that can be subsidized. It is established by the housing authority at between 80 and 100 percent of the fair market rent. Recently, legislation increased the range within which the payment standard may be set—90 to 110 percent of fair market rent. Fair market rent is determined annually by HUD and is set at the 40th percentile of the market rents for each housing market.

[8]Under project-based assistance, a household is generally responsible for paying 30 percent of its monthly adjusted income toward gross rent. Under the tenant-based voucher program, a household is generally responsible for paying (1) 30 percent of its monthly adjusted income and (2) any difference between the apartment's gross rent and the local housing authority's payment standard. When a household has no income, it is responsible only for a minimum rental payment of not more than $50, which may be waived by the housing authority under certain circumstances. Therefore, a household (with an income) using a voucher in a unit where the gross rent is higher than the payment standard pays a higher percentage of its income for housing (more than 30 percent) than it paid under the project-based program, whether it stayed in the same unit or moved to a different one.

[9]The gross rent is likely to vary more for households that moved, given that the rents charged at different properties are likely to vary more than the rents charged at any one property.

average gross rent exceeded the average payment standard without respect to apartment size or the decision to stay or move. Only for households that stayed in three-bedroom units was the average gross rent below the payment standard, meaning that, on average, these households were able to pay a lower percentage of their incomes toward rent using vouchers than they had paid under project-based assistance. See figure 2. The average additional rent for households at individual properties also varied. For example, at 5 of the 13 properties in which households stayed in one-bedroom units, the average gross rent exceeded the payment standard by more than $56. In addition, even within a property, the additional rent households pay can vary with differences in the rents charged for individual units of the same size.

Figure 2: Monthly Difference in Rent for Households That Received Vouchers in Place of Project-Based Assistance



Notes: Our analyses were based on survey data made available by housing authorities for 406 households in one-, two-, and three-bedroom units that did not move to units of different sizes when transferring from project-based assistance to vouchers. Of the 249 households that were excluded from this analysis, 136 households had resided in one property, for which insufficient data on rents were provided. Difference in rent is measured by the monthly difference between the average gross rent and the applicable payment standard. The gross rent equals the contract rent for a unit plus an allowance for utilities.

Source: GAO's survey of public housing authorities.

Households That Received Certificates Initially Experienced No Financial Impact

Although nearly all households affected by the conversion to tenant-based assistance used vouchers to rent apartments, 51 households used certificates. These households, associated with six properties whose owners opted not to renew their contracts, likely experienced no financial effects from the conversion because their assistance was calculated in much the same way as project-based assistance. In the certificate program, a household typically paid 30 percent of its adjusted income toward rent, just as it did under the project-based assistance program. The certificate subsidy generally covered the difference between 30 percent of the household's income and the gross rent, although the household typically could not choose to rent a unit whose gross rent exceeded the area's fair market rent.

Our analyses of two case study properties–Hammerly Walk and Gulf Royale–show that although gross rents increased by 8 percent and 38 percent, respectively, after the conversion, the certificate subsidies absorbed the increases and most households continued to pay 30 percent of their monthly adjusted incomes toward rent. The only households at these properties that paid more than 30 percent of their monthly adjusted incomes toward rent were those that had very low incomes but were required to make minimum payments towards their housing costs.

Recent Program Changes May Affect Assisted Households

The Congress and HUD have taken some steps to encourage property owners to renew their project-based assistance contracts or mitigate the financial impact on households of the conversion to tenant-based assistance. Recently, HUD began an emergency initiative to allow rents to increase to full market rents to avoid the loss of the best properties. In addition, the FY 2000 HUD Appropriations Act (P.L. 106-74) expanded HUD's authority to renew Section 8 contracts at market rates and to offer enhanced vouchers to tenants of properties that will no longer receive project based assistance.[10] In addition, title V of the FY 1999 HUD Appropriations Act, required that housing assistance certificates and vouchers be merged into a new voucher program, which became effective October 1, 1999.[11] Recently, HUD introduced a rule to implement most of the Section 8 tenant-based provisions of this program, called the Housing Choice Voucher program.[12] Under the new program, households receiving vouchers for the first time on or after October 1, 1999, may not initially pay more than 40 percent of their adjusted monthly incomes toward rent. Households that received vouchers before October 1, 1999, were automatically transferred to the new program. However, households that were paying less than 30 percent of their adjusted monthly incomes toward rent will be required to pay at least 30 percent by October 1, 2001. Because the law increases the allowable payment standard, households with vouchers that were paying more than 30 percent of their adjusted monthly incomes toward rent may eventually pay less, assuming no change in their incomes or gross rents. Households that received certificates before October 1, 1999 will be transferred to this new voucher program over a 2-year period. However, after housing authorities conduct a second annual review of these households' incomes and composition, the households may pay more than 30 percent of their adjusted monthly incomes toward rent.

[10]With an enhanced voucher, a household's portion of the rent remains unchanged because the payment standard for the voucher is set equal to the rent for that unit as long as the household stays in the unit.

[11]Title V of the FY 1999 HUD Appropriations Act (P.L. 105-276).

[12]The final rule became effective on Nov. 22, 1999. See *Fed. Reg.* (Oct. 21, 1999), p. 56894.

HUD Did Not Fully Inform Interested Parties of the Tenant Protections

To prevent tenants in subsidized apartments from arbitrarily losing their homes, HUD established certain protections in the partially assisted loan sale agreement and gave tenants and housing authorities the right to seek judicial enforcement of these protections. Although HUD published these protections in the *Federal Register*, it did little more to provide information about them to interested parties–its own field staff, assisted tenants, housing authorities, and property owners—and it did not advise housing authorities of their right to seek enforcement of the protections. As a result, most of the assisted tenants and housing authority staff and about half of the HUD field staff we surveyed were unaware that assisted tenants and housing authorities can take legal action against property owners who unreasonably refuse to rent units to voucher or certificate holders.[1] Moreover, despite protections against discrimination, according to housing authorities, some property owners declined to accept households using vouchers and/or certificates after the owners' project-based contracts expired. Thus, assisted households did not have the opportunity to remain in these properties when they began receiving tenant-based assistance.

HUD Established Protections for Assisted Tenants at Partially Assisted Properties

In March 1996, HUD published a final rule in the *Federal Register* that provided four basic protections for subsidized tenants when HUD sold multifamily mortgages. This rule was amended in June 1996 to further clarify the applicability of the protections to tenants in fully subsidized and partially assisted properties. The first protection, designed to preserve the mixed-income nature of partially assisted housing when delinquent HUD-held mortgages are sold, requires that property purchasers agree to assume project-based and tenant-based rental assistance contracts until these contracts expire. This protection also applies to future property purchasers who, upon foreclosure, must agree to continue rental assistance contracts until these contracts expire. The second protection prohibits mortgage purchasers from foreclosing in a way that would terminate assisted tenants' leases. This protection was created to eliminate uncertainty about state foreclosure laws that might allow such terminations. The third protection, also designed to preserve the mixed-income nature of partially assisted housing, prohibits property owners from unreasonably refusing to rent units to voucher and certificate holders. Finally, the fourth protection requires purchasers of mortgages that were delinquent when sold to record the first and third protections—those requiring purchasers to assume

[1]Owners may refuse to rent to any household that does not comply with the terms of its lease—including the requirement for timely payment of rent.

federal rental assistance contracts and prohibiting discrimination against voucher and certificate holders—in deed covenants. The covenant requiring the assumption of federal rental assistance contracts must remain in effect until the contract expires. The covenant prohibiting discrimination is applicable until the maturity date of the mortgage at the time HUD offered it for sale.

In addition, HUD provided for judicial enforcement of tenant protections in the loan sale agreement. Specifically, the covenants recording the continuation of any federal rental assistance contracts and prohibiting discrimination against voucher and certificate holders are required to state that voucher or certificate holders, or housing authorities on their behalf, may seek enforcement of the tenant protections in state or federal court.

HUD Does Not Monitor or Enforce Tenant Protections

After establishing the tenant protections, HUD did not create a role for itself in monitoring or enforcing them. Instead, as noted, HUD assigned these responsibilities to assisted tenants and housing authorities. While HUD continued to administer rental assistance contracts for the partially assisted properties and issued policies and guidance on its continuing responsibilities, it did not develop information or guidance for its staff on the tenant protections. HUD officials explained that the Department did not become involved in monitoring or enforcement because one objective of the loan sale was to relieve HUD of responsibilities associated with these mortgages.

HUD did, however, hire an equity monitor to ensure, among other things, that the tenant protections were recorded in deed covenants, as required, when mortgages were restructured, paid off, or foreclosed upon. The equity monitor performed this function until March 30, 1998, when its contract with HUD expired. Although HUD has been attempting for nearly 2 years to select an equity monitor, as of January 4, 2000 it had not completed its final selection and HUD staff had not assumed the equity monitor's functions.

HUD Provided Limited Information on Tenant Protections

Although HUD made tenants and housing authorities responsible for enforcing the tenant protections, it provided tenants with limited information on the protections and their right to enforce them, and it sent no information directly to housing authorities. It also made little information available to its field offices—a step consistent with its decision not to become involved in monitoring compliance with the protections—or to property owners.

Field Offices and Tenants Received Incomplete Information From Headquarters

HUD notified assisted tenants of the tenant protections through its field offices, although this information was incomplete. Specifically, on June 19, 1996, HUD headquarters distributed a sample tenant notification letter to Multifamily Housing officials in the field offices responsible for the partially assisted mortgages that had been sold. HUD asked the field offices to post the letter in a conspicuous place at each affected property within 2 days and to attach the *Federal Register* notice containing the final rule defining the tenant protections. The letter described some of the tenant protections and informed tenants of their right to seek judicial enforcement of them. However, the letter did not mention the protection prohibiting owners from unreasonably refusing to rent units to voucher and certificate holders and did not cite the requirement, applicable for mortgages that are delinquent when sold, that two of the protections be recorded in deed covenants. To acquire this missing information, both field office staff and assisted tenants would have had to read the *Federal Register* notice. According to a HUD official involved in the partially assisted sale, HUD did not intend for its field office staff to monitor compliance with the tenant protections, but rather placed the burden of enforcing the protections on tenants and housing authorities. In addition, according to a former loan sale official, the intent of the tenant notification was to allay tenants' fears of being displaced as a result of the loan sale.

HUD headquarters staff do not know how many field offices complied with their request to post the letter and the *Federal Register* notice at affected properties. Therefore, HUD does not know whether tenants had an opportunity to learn of the protections available to them and of their right to seek judicial enforcement of these protections. About half of the tenants responding to our tenant survey said they were unaware that HUD had sold the mortgage for the property where they lived.

Housing Authorities Were Not Notified of Their Enforcement Right

Although the loan sale agreement gave public housing authorities the right to seek judicial enforcement of the tenant protections, HUD did not notify the housing authorities of this right. According to HUD Multifamily Housing officials, HUD did not provide such notice. The officials said, however, that the housing authorities could have learned of the tenant protections if they had read the final rule published in the *Federal Register*. Yet even if the housing authorities had read the final rule, they would not have learned that they could seek judicial enforcement of the tenant protections on behalf of their tenants. While information supplementing the final rule states that HUD will advise tenants of their right to seek enforcement of the protections, it does not mention the role of housing authorities.

Property Owners Were Not Alerted to the Tenant Protections

According to Multifamily Housing officials, HUD notified property owners that they must continue to abide by all existing covenants, agreements, and contracts. However, this notice did not specifically refer to the requirement that property owners cannot unreasonably refuse to rent to voucher and certificate holders. For owners, as for housing authorities, information on the protections was simply available in the final rule published in the *Federal Register*. In fact, HUD may initially have confused the owners about their obligations toward tenants by allowing the owners to use a generic form letter that suggested the owners might refuse to accept vouchers or certificates. This letter, which HUD expected the owners to use as a model for notifying tenants that the Section 8 project-based assistance contract at their property was about to expire, was the same letter that HUD provided for all expiring Section 8 contracts. The letter included options for owners to check off, including one that said “We do not plan to accept certificates or vouchers.” In October 1998, HUD changed this form to note that the owners of subsidized properties are prohibited from discriminating against voucher or certificate holders.

Many Parties Are Unaware of Tenant Protections

Our telephone interviews and survey data indicate that HUD staff, tenants, and housing authorities are generally not aware of the tenant protections. While Multifamily Housing officials we spoke with at headquarters were aware of the protections, HUD’s principal contact for field staff on administering Section 8 contracts at loan sale properties was not. In addition, only half of the field offices responding to our survey said they were aware that tenants and housing authorities may take legal action against property owners who unreasonably refuse to rent units to voucher and certificate holders. Slightly over 80 percent of the assisted tenants and housing authorities responding to our surveys said they were not aware of this right.

Some Owners Have Refused to Accept Vouchers or Certificates

Although our survey data showed that the majority of households chose to remain in the properties where they received project-based assistance, tenants at some properties may not have had that opportunity. Despite the tenant protection prohibiting property owners from unreasonably refusing to rent to voucher and certificate holders during the terms of their mortgages, housing authorities responding to our survey reported that some owners refused to accept vouchers or certificates when their project-based Section 8 contracts expired. Unaware of this protection, the housing authorities did not seek to enforce it. As a result, eligible households were unable to use tenant-based assistance at these properties.

In responding to our survey, housing authorities reported that the owners or managers of 3 of the 31 properties in our study refused to accept vouchers or certificates. Fifty households from these properties were affected by the conversion from project-based to tenant-based assistance. Housing authority officials working with tenants at these three properties said they were unaware of HUD's tenant protections and believed they had no authority to make the owners accept tenant-based assistance. The tenant protection prohibiting owners from unreasonably refusing to rent to voucher and certificate holders allows assisted households affected by the conversion to tenant-based assistance to remain at the properties where they formerly benefited from project-based assistance as long as the properties meet rent and quality standards. According to housing authority staff associated with the three properties, rents were within an acceptable range for the Section 8 program. Of the 50 affected households, housing authorities reported, 37 accepted tenant-based assistance and had to move elsewhere to use it. Representatives of the three properties told us they were unaware of any tenant protections associated with these properties. They also said they could not find any tenant protection covenants in the deeds to the properties or in other property sale documents. When we informed HUD officials of the three properties where owners refused to rent to households using tenant-based assistance, they were unaware of the specifics of these cases and declined to offer an opinion on whether the owners had unreasonably refused to rent to these households.

According to the housing authorities we surveyed, the owners or the managers at two other properties initially said they would refuse to accept vouchers and certificates but ultimately decided to accept them before their project-based assistance contracts expired. At one property, pressure from tenants, negative local press coverage, and efforts by the housing authority to explain the Section 8 program's requirements apparently contributed to the owner's decision to accept vouchers or certificates from current tenants affected by the conversion to tenant-based assistance. However, according to the property's management, the owner did not plan to accept vouchers or certificates from other assisted households in the future. At the other property, the management was persuaded to participate in the program by HUD field staff who had read the *Federal Register* notice. This HUD field office was one of those we surveyed that reported any awareness of the tenant protections. While the housing authorities associated with these two properties reported that assisted households were not adversely affected by the owners' initial refusals to accept vouchers or certificates, some formerly assisted households moved before the Section 8 project-based contracts for their properties expired. These households may have moved because the property owners initially said they would not accept vouchers or certificates.

Conclusions

Without complete information about the protections HUD established for assisted tenants, HUD field staff, tenants, housing authorities, and property owners may not know when these protections are not being honored. These parties therefore cannot take the steps necessary to enforce the protections if violations are identified. Additionally, as long as the equity monitor's position remains unfilled, no one is ensuring that the protections are being recorded in deed covenants, which inform property owners of the protections and strengthen the legal basis for enforcing the protections. Some property owners were unaware of the protection prohibiting them from unreasonably refusing to rent to voucher and certificate holders and were refusing to accept current residents with such assistance. Without knowing of this protection, property owners have little incentive to rent to households using tenant-based assistance. Furthermore, this protection applies to all voucher and certificate holders—not just those formerly assisted under project-based contracts. Therefore, as long as the units that were formerly under project-based assistance are not available to current tenants who wished to use tenant-based assistance, these units are not available to other prospective voucher and certificate holders.

Recommendations

To ensure that all affected parties receive information on the tenant protections and that procedures are in place for enforcing the protections, we recommend that the Secretary of Housing and Urban Development

- notify housing authorities and assisted tenants associated with partially assisted loan sale properties of the tenant protections and of their right to seek judicial enforcement of these protections;
- follow up with housing authorities to determine whether they are able to enforce the tenant protections or whether further steps are needed to enforce the protections;
- ensure that HUD Multifamily Housing field staff are aware of the tenant protections;
- ensure that the tenant protections are being recorded in deed covenants;
- provide information on the tenant protections to the owners of all partially assisted loan sale properties and ensure that the owners understand the prohibition against unreasonably refusing to rent to voucher and certificate holders for the appropriate time period; and
- determine whether the three properties that, according to housing authorities, refused to accept vouchers and certificates, and the one property that accepted vouchers only from current tenants, violated the prohibition against discrimination and if so, take appropriate enforcement action.

Agency Comments and Our Evaluation

HUD agreed to implement these recommendations. For example, HUD said it would undertake actions that would help to ensure that all affected parties receive information on the tenant protections and that appropriate actions are taken to enforce any violations of these protections. According to HUD, the recent provision of vouchers at market rents, called enhanced vouchers, should mitigate our concerns about owners' willingness to accept tenant-based assistance. While we agree that enhanced vouchers would give property owners an incentive to rent to households using vouchers, we believe that if the owners of partially assisted loan sale properties are not aware of their obligation to accept tenant-based assistance, they may still refuse to rent to households using tenant-based assistance, even when this assistance includes an additional subsidy.

Conditions Have Improved at Most Selected Case Study Properties

Conditions are improving for a judgmental sample of partially assisted and Missouri properties we visited. The improvements generally addressed major deficiencies that HUD had identified in its reports of property inspections conducted before the mortgages were sold. These deficiencies included problems with the building exteriors, apartment interiors, and property grounds. Improvements to apartment interiors were not as advanced as those to building exteriors, and grounds improvements were generally farther along than interior improvements. In addition, improvements were more advanced for the partially assisted properties than for the Missouri properties. A variety of funding sources were used to improve both groups of properties, especially the Missouri properties, which housed a higher percentage of low-income residents and were generally in poorer condition. Several factors influenced both the timing and amount of investment in improvements, particularly at the partially assisted properties. These factors included the percentage of delinquent mortgages, the willingness and/or ability of the loan servicer to foreclose on delinquent mortgages, the incentives and restrictions included in the loan sale agreement to promote or limit the expenditure of property improvement funds, and property owners' perception of the local demand for rental housing. Though applicable, these factors were less relevant for the Missouri properties because most of these properties depend more on Section 8 project-based assistance payments and less on market rents. For both loan sales, HUD retained certain monitoring rights, including the right to retain an equity monitor for the partially assisted sale and the right to request reports for the Missouri sale. However, HUD has not had an equity monitor since April 1998 because it has not completed the selection of a new contractor. Moreover, HUD has not exercised its right to request reports on the Missouri sale, in part because it was unaware of this provision.

Partially Assisted Case Study Properties

Improvements addressing at least some major deficiencies had begun or had been completed at all of the 11 partially assisted properties we visited. This section discusses the location of these properties; describes their size and type, Section 8 project-based assistance, and financial condition; summarizes their physical condition at the time of the loan sale; and identifies the improvements made to them since the loan sale.

Location and Description of Properties

The partially assisted loan sale portfolio consisted of 158 mortgages, including those for the 11 properties we visited. Three of these properties are in Texas, two each in Louisiana and Georgia, and one each in California, Colorado, Illinois, and Missouri. A majority of the properties are located in central cities, with the remainder in suburban communities. Although some of the buildings were built as early as 1900 and 1918, the majority were constructed between 1976 and 1982. The properties vary in size, from 19 units (Historic South St. Louis) and 26 units (Tangiers) to 1,050 units (Parkway Center). The Parkway Center property also includes a medium-sized office building and a large supermarket (the only one in downtown Denver). However, a majority of the properties have between 128 and 204 units. Garden-style apartment buildings predominate, but two properties have high-rise elevator buildings and two include town houses. The type of construction ranges from brick to stucco and wood siding. In all but three of the properties, a majority of the units have two or three bedrooms.

At the time of our visits, 7 of the 11 properties we visited had Section 8 project-based assistance contracts, and 4 had opted out of the Section 8 project-based program. Of these four properties, two had tenants with Section 8 vouchers and two were vacant and under construction (Coral Reef and Back Bay). Only three of the properties (Ashton Pines, Gulf Royale, and Shallowford Oaks) were rented to households with significant numbers of children (relative to the number of units). Most of the other properties catered to young singles, the elderly, college students, and military personnel.

ARCHON—the special servicer—had foreclosed on 9 of the 11 properties we visited. Three remained under ARCHON's management (Ashton Pines, Gulf Royale, and Parkway Center) at the time of our visit, and six had been sold to new owners before our visit. Before selling these six properties, ARCHON managed them for between 6 and 27 months. Seven properties provided information on occupancy rates, which ranged from 82 percent (Ashton Pines) to 100 percent (Shallowford Oaks). (See app. I.)

Condition of Properties at the Time of the Loan Sale

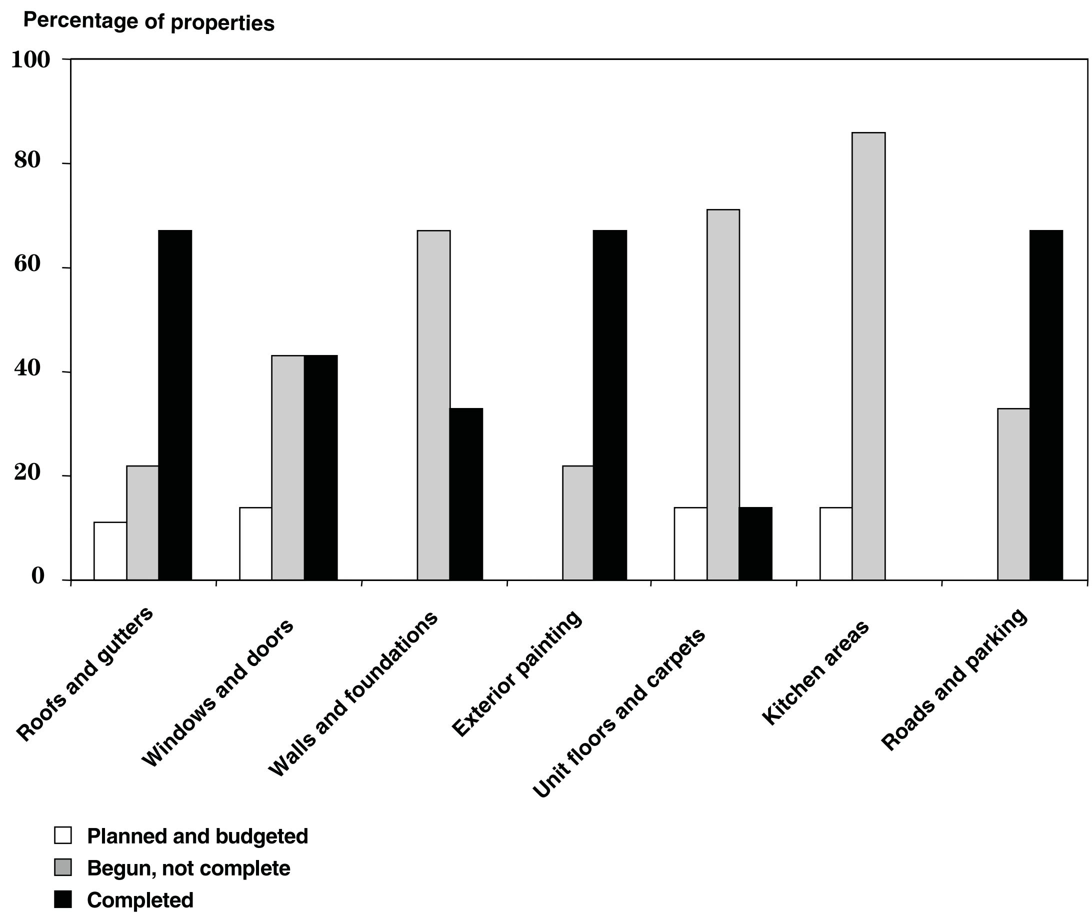
Except for Parkway Center, all of our case study properties were physically distressed. Of these distressed properties, all but one (Frenchman's Wharf) had major exterior and interior problems in June 1996, when HUD sold the partially assisted mortgages. The major exterior problems affected roofs and gutters, windows and doors, painting, and walls and foundations. The kitchens were the most problematic interior areas, especially at one property (Ashton Pines), where 67 out of 184 units were uninhabitable at the time ARCHON foreclosed on the property. Interior roads and parking lots also presented major problems at a majority of the properties. At four properties, the sites had unique problems, such as a broken bulkhead alongside a canal, a broken lake pump, poor drainage and erosion, and rotten retaining walls.

Improvements to Properties Since the Loan Sale

The physical condition of most of our partially assisted case study properties has substantially improved since the loan sale, particularly through exterior improvements that either have been completed or are under way. For example, the repair or replacement of roofs and gutters has begun or been completed for all but one of the nine properties that had problems in this area at time of the loan sale. The repair or replacement of exterior walls and foundations has begun or been completed at all six properties that had problems in this area. The painting of exterior walls and trim has also begun or has been completed at all nine of the properties that needed exterior painting at the time of the loan sale. Interior improvements have taken longer. For example, kitchen renovations have not been completed at any of the seven case study properties with major kitchen-area problems. Such renovations are in progress at six properties; however, little has been done to improve the kitchens in units with project-based assistance at two of these properties. Plans for new kitchens have been approved for the seventh property. Progress in replacing interior floors and carpets was also generally mixed, particularly at case study properties where major work in this area was needed. However, at the time of our visit, renovations had been completed for the 67 formerly uninhabitable (down) units at Ashton Pines. Efforts to replace or repair the pavement of parking lots and interior roads had also been completed or begun at all but one of the case study properties (Frenchman's Wharf) where such repairs were needed. Major improvements had also been made to landscaping and recreational facilities.

Figure 3 illustrates the status of improvements for the partially assisted case study properties with the most frequently cited problems. For a more detailed listing of the problems identified at the time of the loan sale and the status of the improvements observed during our visit to each case study property, see appendix III. For a brief description and photographs of the improvements made to each case study property, see appendix V.

Figure 3: Status of Improvements for Most Frequently Cited Problems at Partially Assisted Case Study Properties



Note: The data for "Exterior painting" do not add to 100 percent because they include a property where no work had begun and no plans were provided by the owner.

Missouri Case Study Properties

All but one of six Missouri loan sale properties we visited were undergoing substantial improvements. While improvements had begun at five of the properties, they had been completed in only a few properties at the time of our visits. This section discusses the location of these properties; describes their size and type, Section 8 project-based assistance, and financial condition; summarizes their physical condition at the time of the loan sale; and identifies the improvements made to them since the loan sale.

Location and Description of Properties

The Missouri negotiated loan sale consisted of 26 mortgages on 19 properties. We visited six of these properties, which are located throughout the state, with two in Kansas City and one each in St. Louis, Columbia, St. Joseph, and Harrisonville. Except for one property that was built in 1982, all of the properties were constructed between 1968 and 1973. The case study properties ranged in size between 50 units (Thunderbird) and 280 units (Brittany Village I & II), but most were between 110 and 137 units. Although five of the six case study properties consisted primarily of garden-style apartments, two also included town houses; the sixth property (Columbia Square) consisted entirely of town houses. All but one of the case study properties (Murphy Blair, built of brick and stucco) were wood frame buildings with stucco or wood siding. Finally, a majority of the units at all of the case study properties had two or three bedrooms.

Five of the six properties we visited had Section 8 project-based assistance contracts, three of which were renewed before our site visits. The contract for the fourth property (East Hills Village) was renewed soon after our visit. One of the properties had never had a project-based assistance contract, but 41 households, occupying about 15 percent of the units, were using Section 8 vouchers or certificates at the property at the time of our visit. Three of the six properties (Columbia Square, East Hills, and Murphy Blair) would not have sufficient rent revenues to cover their operating expenses if their Section 8 project-based assistance contracts were terminated and their rents were reduced to market rents. For these case study properties, no funds would be available to cover the mortgage payments. (This scenario does not consider the possibility that some tenants might obtain Section 8 vouchers or certificates.)

Substantial numbers of children—as many as 500 at Columbia Square—resided at all of the case study properties. The majority of the households at most of the properties were headed by single mothers, most with several children. The occupancy rates were all fairly high, ranging from 80 percent (Chip Village) to 99 percent (Columbia Square). (See app. II.)

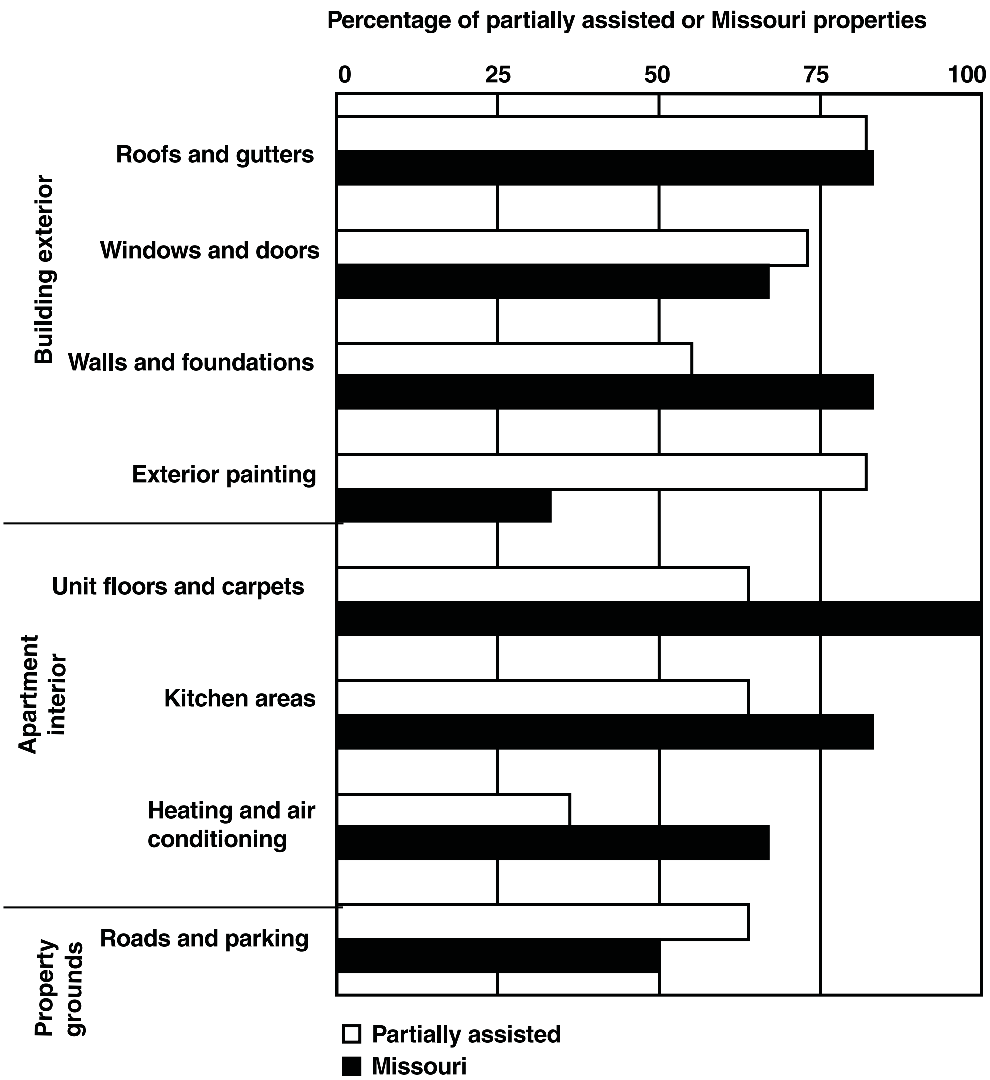
At the time of our visits, only one of the case study properties had gone into foreclosure. This property was then sold to a local nonprofit community development corporation. The mortgages for two other properties were delinquent at the time of the loan sale, but the properties were operating under workout agreements with MHDC that required the owners to invest any surplus cash flow in property improvements and maintenance. Under one of the agreements, a new owner, who acquired Brittany Village less than a year after the loan sale, agreed to invest the mortgage payments and

$300,000 in equity in property improvements. Under the other agreement, Murphy Blair retained a new property management company about a year after the loan sale. The property owner agreed to invest the mortgage payments in property improvements and deferred maintenance.

Condition of Properties at the Time of the Loan Sale

At the time of the Missouri loan sale—September 1996—our Missouri case study properties were generally in much worse condition than our partially assisted case study properties (see fig. 4). All of our Missouri case study properties had serious exterior problems, including aging roofs, drafty windows, and deteriorated walls. All of these properties also had serious interior problems, from broken air-conditioning and/or heating systems to worn out carpets and floors. These problems made several units in each property uninhabitable. Badly maintained parking lots and interior roads presented problems at three of the six properties, and erosion was serious at two properties.

Figure 4: Most Frequently Cited Problems at All Case Study Properties

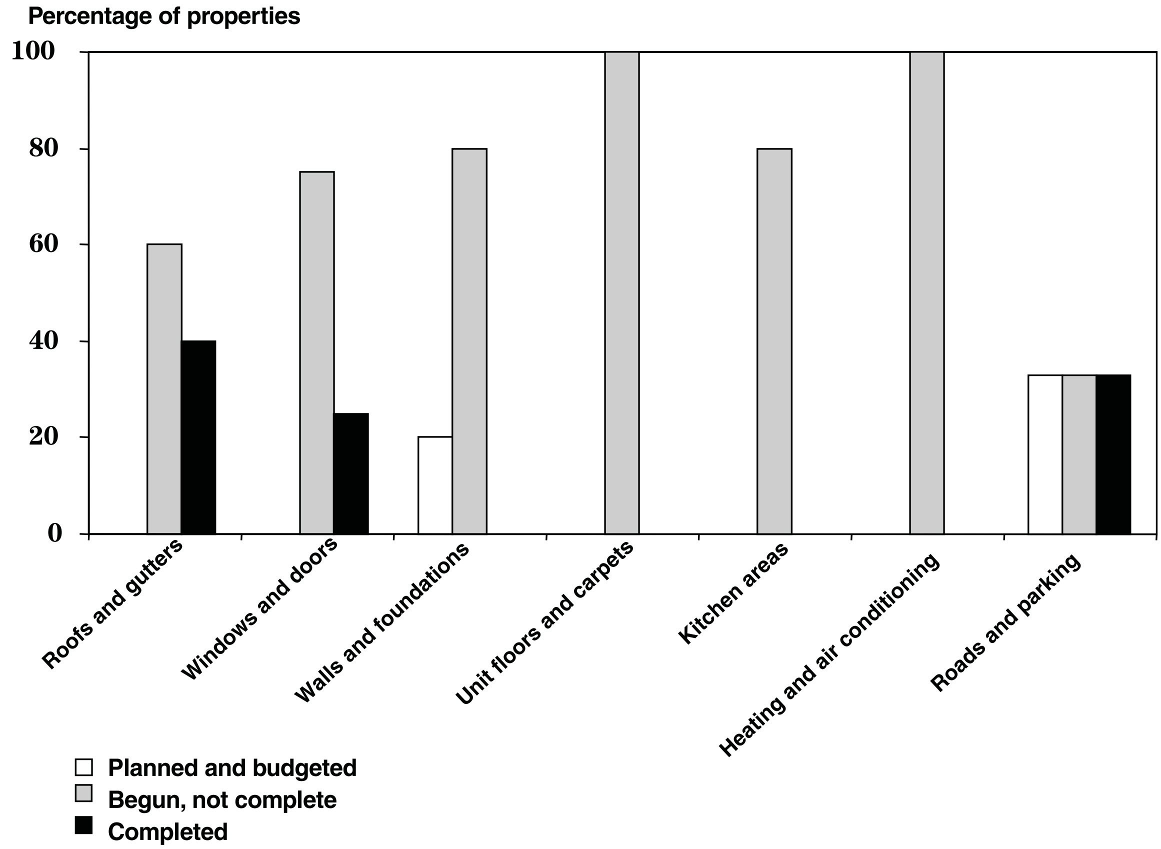


Improvements to Properties Since the Loan Sale

Substantial improvements were being made at all but one of our Missouri case study properties–East Hills Village. The owners of this property were negotiating a significant financing package with MHDC that would fund not only the substantial renovation of existing buildings but also the creation of a community/office center and a multipurpose facility (indoor gymnasium). Before we visited this property, MHDC had agreed to release about $70,000 from the property's replacement reserves to replace several stoves, heating and air-conditioning equipment, and carpets and to repair roofs. Each property owner was addressing the major problems identified in earlier HUD and MHDC property inspection reports. The most dramatic improvements we observed were at Chip Village, where a new owner had finished renovating 30 percent of the buildings and had started renovating three more buildings. These renovations included repairing roofs and replacing siding, stairwells, and windows. Brittany Village has made more progress than the other Missouri case study properties, largely because MHDC was able to find a new owner familiar with affordable housing and willing to devote the necessary resources to the property's long-term improvement.

Figure 5 illustrates the status of improvements for the Missouri case study properties with the most frequently cited problems. For a more detailed listing of the problems at the time of the loan sale and the status of the improvements at the time we visited each property, see appendix IV. For a brief description and photographs of the improvements made to each property, see appendix VI.

Figure 5: Status of Improvements for Most Frequently Cited Problems at Missouri Case Study Properties



Note: The data for “Kitchen areas” do not add to 100 percent because they include a property where no work had begun and no plans were provided by the owner.

Case Study Properties Relied on Different Funding Sources for Improvements

Improvements to our partially assisted case study properties were funded by ARCHON, from the Deferred Maintenance Account initially funded by HUD, and/or by current and previous property owners. Improvements to our Missouri case study properties were accomplished using more varied sources of funds, both public and private. Subsidized funding was needed to improve the Missouri properties because a high percentage of low-income tenants resided at each one.

ARCHON Used a Different Funding Strategy for Each Foreclosed Partially Assisted Property

- According to its annual business plans, ARCHON made different amounts of funds available for improvements at each of the nine case study properties that it had foreclosed on and managed. These funds came from the Deferred Maintenance Account, which HUD had initially funded with $29 million. As of December 31, 1998, improvements funded through this account totaled about $13 million for all of the partially assisted properties that ARCHON managed. The total amount spent for the nine ARCHON-managed properties that we visited was about $5.2 million at that time.
- ARCHON spent nearly half of the $5.2 million on one property, Parkway Center. With 1,050 units, this was the largest property we visited, but it was not physically distressed at the time of the loan sale. According to ARCHON's business plan, the purpose of these improvements was to enhance the property's market value in order to "reposition the multifamily component of the property to compete at a higher level in the marketplace." Since December 1998, ARCHON has spent another $2.4 million to construct a new clubhouse/health center and outdoor pool.
- ARCHON invested significant amounts to improve two of our other case study properties–Ashton Pines and Gulf Royale. Together, these two properties used 66 percent of the $2.6 million remaining from the $5.2 million that ARCHON invested in our case study properties. At the time of foreclosure, only 69 percent of Ashton Pines' units were occupied, and the property was in very poor condition. However, as noted in ARCHON's business plan, the property was in an excellent location, next to two major traffic arteries and 1 mile from an interstate highway. Several retail developments and a new hotel had recently been completed nearby. According to ARCHON's asset manager, the local rental housing market was strong, and no new multifamily housing projects had been constructed in the market area for several years. ARCHON invested in Gulf Royale, its business plan indicated, because, despite a poor location, the local rental housing market was very strong and rents would be raised substantially as soon as the Section 8 project-based assistance contract expired (at which time the property's value would increase by over $300,000).
- By contrast, ARCHON invested no money in one property (Historic South St. Louis) and spent only $4,756 to improve another (Del Prado). According to ARCHON's business plan for Historic South St. Louis, the property had several "major weaknesses," despite its location in an historic neighborhood adjacent to downtown St. Louis. For example, two fire-damaged units were vacant and uninhabitable, and the cost of renovating them would "most likely exceed their market value." In

addition, the property was small and consisted of several scattered buildings located on different blocks in a neighborhood where the housing market was “experiencing flat rents and soft demand.” At Del Prado, the business plan cautioned, “The physical condition . . . is a severe liability.” Major problems included “an antique elevator,” potential environmental hazards, and negative pressure (believed to be caused by poorly weatherized windows) that resulted in “astronomical” utility bills for the residents. Moreover, according to the plan, the neighborhood housing “niche” was “not attractive to all Chicago residents,” making rents unlikely to rise as much as was common in Chicago at that time.

- On a per-unit basis, through December 1998, ARCHON spent more to improve Ashton Pines and Gulf Royale (over $6,100) than Parkway Center (less than $2,500). In fact, ARCHON also spent more per unit ($2,663) to improve another case study property, Back Bay in Galveston. According to ARCHON’s business plan, its strategy was to preserve the asset value of Back Bay, not to “improve” the property. The new owners confirmed this finding during our interview with them. Conversely, the new owners, whose strategy is to substantially improve the property’s market value, have budgeted another $1.8 million, or $9,375 per unit, to substantially rehabilitate Back Bay.

Tables 2 and 3 show how much ARCHON invested for different types of improvements at our partially assisted case study properties.

Table 2: ARCHON-Funded Property Improvements, as of December 31, 1998, at Partially Assisted Case Study Properties

	Name of property					
Type of improvements	**Ashton Pines**	**Back Bay**	**Coral Reef**	**Del Prado[a]**	**Frenchman's Wharf[b]**	**Gulf Royale**
Building exterior					[c]	
Roofs and gutters	$128,900	$115,400	$42,300			$101,400
Windows and doors						
Walls and foundations		59,000	19,500			45,300
Painting	105,700					79,900
Porches, balconies, steps						
Other	112,200					
Apartment interior					[c]	
Unit floors and carpets	16,200	132,100	81,100			47,600
Kitchen area	39,900	78,100	65,200			38,400
Bath area						
Heating, cooling, and hot water systems	4,300	30,800	23,000			11,700
Unit painting		66,600	66,400			77,200
Common area	1,500	15,600	10,700			12,600
Other	482,200[d]					
Property grounds					[c]	
Landscaping (lawn and plants)	20,500					54,500
Sidewalks and walkways						
Fencing			3,700			
Interior roads, parking lots, garages, carports, lighting, and signage	183,600	13,600	400			50,700
Recreation facilities (swimming pools, tennis courts, health club, children's play areas)	10,700					31,700
Support facilities and services (security, laundry rooms, food banks, clubhouse, management offices)	64,200					1,900
Other						
Total	**$1,169,900**	**$511,200**	**$312,300**	**$4,800**	[c]	**$552,800**
Number of units	184	192	176	198	644	90
Cost per unit	**$6,358**	**$2,663**	**$1,774**	**$24**	[c]	**$6,142**

continued

Note: Dollar figures are rounded to the nearest hundred.

[a]Expenditures not itemized; totals obtained from ARCHON's 1997 and 1998 business plans.

[b]According to ARCHON, property improvement expenses are not applicable; asset was held as a mortgage.

[c]Not applicable.

[d]Expense to bring previously uninhabitable units up to housing quality standards.

Table 3: ARCHON-Funded Property Improvements, as of December 31, 1998, at Partially Assisted Case Study Properties, Continued

	Name of property				
Type of improvements	**Historic South St. Louis[a]**	**Parkway Center**	**Shallowford Oaks[b]**	**Tangier**	**Westbury Park**
Building exterior			[c]		
Roofs and gutters		$68,600		$11,700	
Windows and doors		10,100			
Walls and foundations		43,000			
Painting		1,211,100			
Porches, balconies, steps					
Other					$14,300
Apartment interior			[c]		
Unit floors and carpets				10,100	1,100
Kitchen area					2,100
Bath area					
Heating, cooling, and hot water systems		173,500			
Unit painting		103,000			
Common area		504,500			
Other		43,400			
Property grounds			[c]		
Landscaping (lawn and plants)					
Sidewalks and walkways		191,900		29,600	
Fencing					
Interior roads, parking lots, garages, carports, lighting, and signage		219,800			
Recreation facilities (swimming pools, tennis courts, health club, children's play areas)		[d]			
Support facilities and services (security, laundry rooms, food banks, clubhouse, management offices)		[d]			700
Other					
Total	**$0**	**$2,568,900**	[c]	**$51,400**	**$18,200**
Number of units	19	1,050	204	26	128
Cost per unit	**$0**	**$2,447**	[c]	**$1,977**	**$142**

Continued

Note: Dollar figures are rounded to the nearest hundred.

[a]Expenditures not itemized; totals obtained from ARCHON's 1997 and 1998 business plans.

[b]According to ARCHON, property improvement expenses are not applicable; asset was held as a mortgage.

[c]Not applicable.

[d]A new clubhouse/health facility and pool, costing $2,440,000, will be completed in mid-1999.

Owners Also Funded Improvements at Partially Assisted Case Study Properties

At 8 of our 11 partially assisted case study properties, the original or new owners (other than ARCHON) have financed substantial or moderately extensive property improvements. These eight properties include two on which ARCHON did not foreclose and six on which it did foreclose. The two properties remained in the control of the original owners, while the other six were under ARCHON's management for a time, until they were sold to new owners. For three of these properties, the new owners also acquired other adjacent multifamily properties so that they could address high crime or other negative influences related to the properties. Our information on how much the two original and six new owners spent on improvements is not complete, since several of the owners were unwilling to provide this information. However, as the following examples show, a number of these owners funded substantial improvements at their properties.

The new owner of Back Bay and Coral Reef, who specializes in renovating distressed properties and selling them to long-term buyers, purchased an adjacent multifamily property that had several problem tenants and needed substantial rehabilitation. Correcting the problems at this property, the owner believed, was necessary to protect the owner's investment in Back Bay and Coral Reef, which included $4.7 million in rehabilitation costs for both properties ($12,772 per unit).

Similarly, the new owner of Tangiers purchased a total of 78 units (52 in addition to the 26 at Tangiers), located in nine different buildings encompassing two city blocks. This strategy enabled the new owner to control the quality of both the housing and the tenants for the submarket area. The property improvements at Tangiers included painting all the exterior walls the same color, erecting a new wooden fence on the property, and renovating over one-third of the interior units (the remainder will be renovated as they become vacant). The owner is also planning to repave the parking lot in 2000.

The new owner of Historic South St. Louis, who already made a significant investment in the same neighborhood, decided to acquire and improve this case study property to protect and enhance the value of his other properties. He noted the poor condition of the scattered-site buildings–particularly of a town house with two fire-damaged, vacant, uninhabitable units–at the time of his purchase. The new owner completely rehabilitated these two units and replaced the roof. For most of the buildings, exterior bricks have been tuck-pointed, and windows and wood trim have been painted. During our site visit, this owner said he planned to increase rents to market levels when the Section 8 project-based assistance contract expired in August 1999 and would try to attract young professionals as renters.

The owner of Shallowford Oaks, the original owner of this property, invested substantially in improvements after hiring the current property management company in September 1993. According to company officials, the property was then in very poor condition, with 25 percent of the units vacant and 25 percent of the tenants not paying their rent. Toilets were missing in bathrooms; porch doors were missing; and walls, ceiling, and flooring were crumbling. The lawns had turned to dirt. Both swimming pools were closed for over a year because of their physical condition. Company officials told us that the property has been improved as follows:

- The roofs of all the buildings were replaced, together with the gutters, flashing, and canopies.
- Carpets and appliances were replaced in all the units.
- Flooring and subflooring were repaired or replaced in many units.
- Erosion was addressed through backfilling, installing French drains, repairing or building retaining walls, and performing some foundation work.
- The lawn was restored, and additional landscaping was done.
- The lower pool was repaired and reopened. The second pool was filled in with dirt and turned into an open, grassy area.

We observed many of these improvements during our site visit, including those to the roofs, swimming pool, and landscaping.

Diverse Funding Sources Were Used to Improve Missouri Case Study Properties

Public funding was used more than private funding to improve the Missouri loan sale properties we visited. MHDC provided funding directly through the Interest Reduction Payment (IRP) Account (established in the loan sale agreement between MHDC and HUD, as discussed in ch. 1) and indirectly through “redirected mortgage payments” (which are, in effect, grants from MHDC because they allow borrowers under workout agreements to “redirect” their mortgage payments to pay for property maintenance and improvements). Other public funding sources included tax-exempt bonds and Missouri/federal low-income housing tax credits. Private financing and owners’ property replacement reserves and/or funding from the owners made up the remainder of the funding for improvements. Table 4 identifies the funding sources for improving each of our six case study properties and indicates that, as of September 1999, a total of $12,858,284 had been either spent or committed. This total includes $2.8 million in IRP funding, $1.8 million in redirected mortgage payments, $3.9 million in other public funding, $3.25 million in private financing, and over $1 million in funding from the owners and replacement reserves.

Table 4: Funds Used and Committed, as of September 1999, to Improve Missouri Case Study Properties

	Name of property						
	Brittany Village I and II	**Chip Village**	**Columbia Square**	**East Hills Village**	**Murphy Blair Gardens**	**Thunderbird**	**Total**
Mortgage status	In default/ workout agreement[a]	Foreclosed/ new nonprofit owner	Current mortgage	Current mortgage	In default/ workout agreement[a]	Current mortgage	
IRP funding	$600,000[b]	$1,400,000[b]		$112,000[c]	$500,000[b]		**$2,612,000**
Additional IRP funding					$209,000[d]		**$209,000**
Redirected mortgage payment[a]	$500,000	[e]			$1,284,946		**$1,784,946**
Replacement reserves		$20,090	$336,000	$69,454		$55,000	**$480,544**
Funding from owner	$300,000	[e]	$171,490	$106,034[f]			**$577,524**
Private financing		$500,000[g]		$2,750,000[h]			**$3,250,000**
Public funding		$1,272,700[i]		$2,671,570[j]			**$3,944,270**
Total funding	**$1,400,000**	**$3,192,790**	**$507,490[k]**	**$5,709,058[l]**	**$1,993,946**	**$55,000**	**$12,858,284**
Number of units	280	137	128	110	117	50	**822**
Cost per unit	**$5,000**	**$23,305**	**$3,965**	**$51,900**	**$17,042**	**$1,100**	**$15,643**
MHDC funding per unit[m]	$3,929	$10,219	[e]	$1,018	$17,042	[e]	**$5,603**

[a]Property owners signed mortgage workout agreements with MHDC that required them to apply their mortgage payments for property maintenance and improvements.

[b]Mortgage.

[c]Total of IRP payments to the property for the next 14 years.

[d]Grant.

[e]Not applicable.

[f]Deferred developer fee.

[g]First mortgage loan from NationsBank Community Development Corporation.

[h]Tax-exempt bond purchased by Bank of America.

[i]From state Affordable Housing Assistance Program tax credits.

[j]Federal and state low-income housing tax credits.

[k]$206,875 was spent as of the time of our site visit.

[l]Financing commitments have been obtained from all funding sources, and construction is expected to begin in the fall. Includes $725,000 to construct two new nonresidential buildings (community and office facilities).

[m]Includes both IRP funding and redirected mortgage payments.

Nearly half of the total funding for improvements ($5.7 million) will be used to rehabilitate one property, East Hills Village, whose condition at the time of our site visit was worse than that of any property in either loan sale. This funding is equal to $51,900 per unit when the costs of constructing a new community center/office and a multipurpose building (about $725,000) are included and about $45,400 per unit when these costs are excluded. The funding sources for East Hills Village include a private-activity (tax-exempt) bond purchased by Banc of America Securities LLC, federal and state low-income housing tax credits syndicated by ESIC (an affiliate of the Enterprise Foundation), IRP funds to be paid over 14 years, and a deferred developer fee (in effect, a loan by the developer/builder to the property).

Another quarter of the total funding will be used for major exterior and interior renovations at Chip Village, as well as for the renovation of its office/community center and the construction of new playground areas. The funding sources for this project include IRP funds, a loan from NationsBank Community Development Corporation, and tax credits from the Missouri Affordable Housing Assistance Program.

MHDC provided all of the funding to improve Murphy Blair, including a planned below-market interest mortgage of $500,000 and redirected mortgage payments amounting to $1,284,946, which are not repayable to MHDC. This extensive subsidy was needed, according to MHDC officials, because the property was very poorly managed at the time of the loan sale and extensive improvements were needed to increase occupancy levels and make many of the units habitable. MHDC brought in an experienced property management company that moved quickly to initiate these improvements and increase security by constructing a wrought iron fence around the property and installing new lighting. According to an MHDC official, this management company was recently the successful bidder on a blighted, HUD-foreclosed rental town house property adjacent to Murphy Blair Gardens. The purchase of this additional property will allow the company to better control the selection of tenants in this housing submarket.

Columbia Square and Thunderbird had sufficient replacement reserves and cash flow to begin renovations in accordance with their long-term construction plans. Columbia Square does not require additional subsidies for improvements. Thunderbird officials have been discussing the possibility of an IRP mortgage with MHDC officials.

Several Factors Influence the Timing and Amount of Investment in Property Improvements

Several factors have influenced the timing and amount of investment in improvements to both partially assisted and Missouri case study properties. However, the importance of these factors has differed for the two loan sales.

Three Factors Have Influenced Improvements at Partially Assisted Properties

Through our analysis of a previous study, the loan-servicing agreement, ARCHON's business plans, and discussions with the owners of our case study properties, we identified three factors—high delinquency and foreclosure rates, restrictions and incentives in the loan sale agreement, and the owners' perceptions of the strength of local housing markets—that have influenced the pace and extent of improvements to our partially assisted case study properties.

High Delinquency and Foreclosure Rates

When the portfolio of 158 partially assisted mortgages was sold in June 1996, over 90 percent of the mortgages were delinquent. According to an Abt Associates study for HUD,[1] this high rate of delinquency allowed ARCHON to foreclose quickly and gain control of the properties. The study also found that quick foreclosures can prevent further deterioration, facilitate the expenditure of property improvement funds, and allow the improved properties to be sold to new owners. As discussed, ARCHON foreclosed on 9 of our 11 case study properties, completing seven foreclosures within a year of the loan sale. An eighth foreclosure (on Parkway Center), completed in January 1998, took longer because it involved a court-appointed receiver.

[1]According to an Oct. 1998 study of FHA's asset sales conducted by Abt Associates for HUD, the expected foreclosure rate for the partially assisted loan sale was much higher (37 percent) than for any of FHA's other sales of nonperforming multifamily loans (27 percent). The study also found that the foreclosure rate would have been 19 percent if HUD had retained ownership of these loans.

After foreclosing, ARCHON followed the same strategy as other purchasers of HUD's multifamily mortgages, according to the Abt Associates study. This strategy was designed primarily to maximize the value of the properties before selling them to new owners. First, the purchasers performed deferred maintenance and improved the properties. Then they removed any "problem" tenants, including those that had failed to pay their rent. Next, they increased occupancy and raised the rents. Finally, they sold the properties to new owners.[2]

Restrictions and Incentives in the Loan Sale Agreement

The terms of the loan-servicing agreement require ARCHON, as the loan servicer, to liquidate the partially assisted portfolio so as to maximize the economic return to the purchasers and to determine, using its reasonable business judgment, that any expenditure of funds will be recoverable when the mortgage is liquidated and the property is sold. However, the servicing agreement also gives ARCHON the authority to spend additional property improvement funds to correct violations of Section 8 housing quality standards at nonforeclosed properties without regard to whether these funds may be "recoverable" when the properties are sold. In effect, this standard recognizes both the risk and the potential for reward inherent in improving the partially assisted properties. Specifically, the loan servicer was required to estimate the potential for future rent increases that would be needed to support projected property improvements. This market-oriented approach is closely related to the third factor influencing property improvements, the owners' perception of local housing markets.

Owners' Perceptions of Local Rental Housing Markets

Property owners' perceptions of local rental housing markets were also important influences on both ARCHON and the private owners of our partially assisted case study properties. However, these perceptions often significantly differed. For example, according to ARCHON's business plan, three foreclosed properties (Del Prado, Historic South St. Louis, and Westbury Park) were located in areas that had demonstrated little potential for the future rent increases that would be needed to support projected property improvements. ARCHON therefore sold these three properties without appreciably improving them. However, the new owners, who perceived the local housing markets differently, began to improve the properties. Similarly, the new owners of Back Bay and Coral Reef, noting several recent major public and private investments in the local Galveston

[2]In some instances, according to this study, owners began soliciting new owners soon after foreclosure, especially when properties were located in high-crime areas or required substantial rehabilitation.

housing market, not only made substantial improvements to these two properties but also purchased and improved an adjacent problem property. Because ARCHON did not have the authority to purchase additional properties to improve a housing submarket, it could not pursue this strategy for maximizing the value of its portfolio.

Owners' Perceptions of Local Housing Markets Were Less Important for Missouri Properties

The pace of improvements has been slower at our Missouri case study properties than at our partially assisted case study properties for several reasons, including lower delinquency rates, differences in the terms of the loan sale agreements, and differences in the importance of local housing markets.

Low Delinquency Rates

Compared with the partially assisted loan sale, the Missouri loan sale included a fairly small percentage of mortgages that were delinquent—15 percent (4 of 26 mortgages) at the time of the sale. As a result, MHDC was more limited than ARCHON in its ability to foreclose on the associated properties and take steps to improve them. The mortgages for three of our six Missouri case study properties were, however, delinquent at the time of the loan sale. As discussed earlier in this chapter, MHDC foreclosed on one of these properties, arranged for a new owner to be placed in another, and hired a new property manager for the third. The alternatives involving the new owner and the new property manager avoided time-consuming, costly foreclosure proceedings and resulted in substantial improvements to the two properties. At the foreclosed property (Chip Village), MHDC made no improvements itself but waited for the new nonprofit owner to take control of the property. This strategy postponed some improvements but leveraged IRP funds by attracting Missouri affordable housing tax credit funds, which are available only to nonprofit organizations.

Incentives in the Loan Sale Agreement

The Missouri loan sale agreement requires MHDC to use its “best efforts” to ensure that the owners of the mortgaged properties associated with the sale spend at least $8,441,000, provided by HUD, to rehabilitate these properties within 5 years of the closing date of the loan sale. Under this requirement, MHDC is not responsible for rehabilitating each property in the loan sale, but it is expected to offer financial incentives, such as loans, grants and/or mortgage restructuring, to the owners to encourage them to make improvements. When MHDC foreclosed on one delinquent property, arranged for a new owner to be placed in another, and hired a new property manager for the third, it exercised its “best efforts” on behalf of these properties. In addition, MHDC offered subsidized IRP loans to the owners of the three case study properties whose mortgages were not delinquent or foreclosed. One of the owners, who began talking with MHDC in October 1999 about the possibility of using an IRP loan to complete certain property improvements, may accept MHDC’s offer. The other two owners declined MHDC’s offer. Nevertheless, MHDC helped arrange for a substantial amount of subsidized funding for one of these owners. The manager for the other case study property maintained that the property could not carry additional debt and complained that the interest rate on the IRP loan was too high–7 percent compared with the 1-percent rate that HUD was offering under its FHA/Section 8 mortgage-restructuring program.[3]

Owners’ Perceptions of Local Rental Housing Markets

Owners’ perceptions of local housing markets are less important for the Missouri sale than for the partially assisted sale because the Missouri properties are more dependent for their cash flow on Section 8 assistance payments than on private market rents. In addition, MHDC, unlike ARCHON, is not limited by a provision restricting investments in improvements to those that can be recovered if a property is sold.

HUD’s Monitoring Procedures Focus on Real Estate and Financial Management

HUD’s monitoring procedures for the partially assisted loan sale focused primarily on the loan servicer’s real estate management and performance. The monitoring procedures for the Missouri loan sale focused primarily on MHDC’s compliance with the loan sale agreement and financial management of HUD’s subsidy funds. According to our review of the monitoring procedures for both loan sales, neither set of procedures

[3]During our interview with this property manager, we noted that MHDC is not requiring, as is FHA for the Section 8 loan-restructuring program, that property owners reduce rents to market levels.

focused on the improved quality of the properties–even of those that were in poor condition at the time of the loan sales. However, AM&G, HUD's equity monitor, did conduct physical inspections during visits to 10 selected properties as part of its real estate management monitoring responsibilities. As discussed in chapter 3, the equity monitor's contract expired in March 1998, and HUD has not retained a new equity monitor because of delays in the selection process. For the Missouri sale, HUD simply required MHDC to provide a written report, at HUD's written request, on the status of the IRP funding. HUD never asked for such a report, and the official responsible for multifamily asset management said he was unaware of the provision allowing HUD to request such a report. This official also said he obtains information on the Missouri sale properties from other sources.

HUD Limited the Equity Monitor's Scope of Work to Overseeing Real Estate Management

To oversee ARCHON's compliance with the partially assisted loan sale agreement and management of the mortgages and associated properties, HUD retained AM&G as the equity monitor. One of the duties identified in the scope of services for AM&G was the "oversight monitoring of underlying collateral." As part of this duty, AM&G was to perform two assessments of ARCHON's performance—(1) a comparison of the actual performance of selected properties against ARCHON's business plans and related operating and capital budgets for these properties and (2) an evaluation of ARCHON's liquidation performance against the expected results of implemented strategies.

AM&G selected 10 mortgages and properties for review, comparing ARCHON's 1997 and 1998 business plans and commenting on any major changes, both positive and negative. For example, in several cases, AM&G compared the amounts projected for deferred maintenance in the two business plans and noted any differences in the projected proceeds for both years. In some instances, AM&G classified ARCHON's planned capital improvements as "speculative," compared with the projected increase in the properties' value following these improvements.

Because AM&G's contract was not renewed at the end of March 1998, HUD does not know whether any of the equity monitor's concerns about specific properties materialized. Despite HUD's attempts to retain a new equity monitor, as of January 4, 2000, HUD had not selected an equity monitor to oversee the partially assisted loan sale. According to the responsible contracting official, this procurement—which was initiated in December 1997–has taken much longer than is typical. As late as September 1999, the technical evaluation panel was asked to obtain additional information from the companies that are candidates for the contract. According to a Multifamily Housing official, the costs for the companies' offers were not prepared on a comparable basis, and the candidates were asked to provide comparable cost information.

HUD Established Limited Reporting Requirements for the Missouri Loan Sale

For the Missouri loan sale, HUD established limited reporting requirements, under which MHDC is to prepare a report for HUD, "within a reasonable period of time after written request therefor by the Seller (HUD)." This report is to include

- a certification by MHDC's executive director that the purchaser (MHDC) is in compliance with the obligations under the loan sale agreement;
- the dates, amounts, and sources of deposits into the IRP account;
- the dates, amounts, and purposes of withdrawals from the IRP account; the balance remaining in the IRP account;
- a calculation of the incremental subsidy funds (all non-IRP funds required to be deposited in the IRP account, such as Section 8 payments); and
- such other information as HUD shall reasonably request.

HUD may not request this information more often than once annually. As of October 1, 1999, HUD had never asked MHDC in writing for such a report. The HUD official responsible for multifamily asset management told us that he was unaware of this provision. However, he has discussed the Missouri loan sale with the MHDC's executive director. In addition, through its inspections of subsidized multifamily properties, HUD can know whether some of the properties with Section 8 units meet housing quality standards. According to MHDC's executive director, he sends MHDC's annual reports to HUD's Kansas City field office. However, according to the executive director, this report includes only a brief description of the IRP account. For the Missouri loan sale, it does not appear that HUD required any monitoring of conditions at the loan sale properties or of improvements to these properties.

Conclusions

Through a combination of more active management, stronger local rental housing markets, and funding provided by HUD and others for property improvements, nearly all of the most physically distressed properties in both loan sales have been improved. The loan sales have thus increased the number and quality of habitable rental units, upgraded neighborhoods, and enhanced the value of the properties to investors, including HUD.

HUD has made very limited use of the procedures it established to monitor the real estate and financial management of both loan sales. Without a competent equity monitor to review ARCHON's multimillion-dollar investment decisions, we believe, HUD is not in a position to determine whether ARCHON's real estate management performance is satisfactory. HUD officials expressed their desire to retain an equity monitor to protect HUD's financial interests but noted that delays in the contracting process have prevented them from making a final selection. In our view, retaining an equity monitor would allow HUD to make this determination and would, at the same time, help to ensure compliance with the requirement that tenant protections be recorded in deed covenants. Similarly, without monitoring information on the condition of improvements in the properties, HUD is not, in our judgment, in a position to evaluate MHDC's investment decisions. Exercising its right to request reports should, we believe, provide HUD with the information it needs to assess MHDC's compliance with the terms of the Missouri loan sale agreement.

Under the Missouri loan sale agreement, HUD could "reasonably request" information in addition to financial management information from MHDC and review MHDC's use of its "best efforts" to ensure that the owners of the Missouri properties rehabilitate them according to specific standards. Together, these provisions should allow HUD to ask MHDC for information on the cost and sources of funding for improvements that go beyond routine repairs and maintenance and extend each property's expected useful life, as well as information on MHDC's role in encouraging these improvements. Such information could be useful to HUD in designing future sales of subsidized multifamily mortgages, since the HUD-held mortgages in HUD's current portfolio closely resemble the mortgages in the Missouri sale.

Recommendations

To ensure that the federal funds provided for property improvements are being used in accordance with the terms of the partially assisted loan sale agreement, we recommend that the Secretary of Housing and Urban Development retain a new equity monitor to review the actions of the general partner and special servicer, including the servicer's use of property improvement funds. The monitor should focus on actions taken since April 1998, when the previous equity monitor's contract expired.

To ensure that MHDC has used its “best efforts” to encourage existing owners to rehabilitate their properties, we further recommend that the Secretary ask MHDC in writing to provide a progress report to HUD. Besides providing the information specified in the loan sale agreement, this report should indicate how much funding has been spent on improvements that extend each property’s expected useful life, what other funding has been used to finance these improvements, and what role, if any, MHDC may have had in encouraging these improvements. This information may provide useful lessons to HUD for the design of any future subsidized multifamily loan sales.

Agency Comments and Our Evaluation

HUD agreed with the first recommendation in this chapter and said that its selection of an equity monitor should occur soon. HUD disagreed with the second recommendation—that it request written progress reports from MHDC—because it believed that such a request would be burdensome and would produce the same type of information it already receives from other sources. To distinguish the type of information on property improvements that we believe HUD needs to assess from the property inspection data that HUD referred to in its letter, we revised the recommendation to clarify the type of information that HUD should request from MHDC. We believe that with this information, HUD will be in a better position to know how well its property improvement funds are being invested, both to increase the useful life of affordable housing properties and to leverage funding from other sources, including the state, to achieve long-term property improvements. In addition, our revised recommendation does not call for such a report to be provided annually because a one-time analysis of the information requested should be sufficient to assist in designing future sales of subsidized loans.

HUD also expressed concern that the report failed to “fully appreciate the significantly different investor risk and reward potential for improvement in partially assisted properties versus the Missouri sale subsidized properties as a major cause for the significant private sector investment.” In response, we included two clarifications that should further underscore the distinction we originally made between property improvements under the two loan sales. First, we incorporated some of HUD’s language to further emphasize the market orientation of the loan-servicing agreement. Second, we better described how incentives in the loan sale agreement and owners’ perceptions of local housing markets influenced the pace and extent of improvements to partially assisted properties.

Profiles of Partially Assisted Case Study Properties at the Time of GAO's Site Visits

Table 5: Profiles of Partially Assisted Case Study Properties

Property	Ashton Pines	Back Bay	Coral Reef	Del Prado	Frenchman's Wharf I & II	Gulf Royale
City and state	Shreveport, Louisiana	Galveston, Texas	Galveston, Texas	Chicago, Illinois	New Orleans, Louisiana	Texas City, Texas
Year built	1976	1980	1972	1918	1977/79	1970
Number of units	184	192	176	196	644	90
Number of project-based Section 8 units	0	[a]	[a]	78	64	0
Number of tenant-based Section 8 units	23	[a]	[a]	[b]	[b]	29
Bedroom mix						
Studio				54		
1 bedroom	64	48	84	125	440	34
2 bedrooms	96	144	92	17	204	48
3+ bedrooms	24					8
Occupancy rate	82%	[a]	[a]	[b]	93%	95%
Profile of typical household	Young couple or single	[a]	[a]	Elderly or single	Family or single	Family
Number of children	107	[a]	[a]	Very few	Very few	70
Type of structure	Garden	Garden	Garden	Elevator	Garden	Garden
Type of construction	Brick and stucco	Wood frame	Stucco and wood trim	Brick	Wood frame with siding	Brick, veneer, and wood siding
Foreclosure history	May 1997	Sept. 1996	Sept. 1996	Mar. 1997	None	Aug. 1996
Current loan/property ownership	Issuing trust	Dec. 1998, new owner	Dec. 1998, new owner	Apr. 1998, new owner	Loan	Issuing trust
Date of GAO's site visit	May 12, 1999	May 11, 1999	May 11, 1999	June 8, 1999	May 13, 1999	May 11, 1999

[a]Because gut rehabilitation is under way, occupancy rate is almost zero.

[b]Information not obtained.

Table 6: Profiles of Partially Assisted Case Study Properties, Continued

Property	Historic South St. Louis	Parkway Center	Shallowford Oaks	Tangier	Westbury Park
City and state	St. Louis, Missouri	Denver, Colorado	Chamblee, Georgia	Rancho Cordova, California	Marietta, Georgia
Year built	1900	1982	1967	1981	1981
Number of units	19	1,050	204	26	128
Number of project-based Section 8 units	4	187	41	6	26
Number of tenant-based Section 8 units	[a]	[a]	[a]	[a]	[a]
Bedroom mix					
Studio					
1 bedroom	6	434	40	8	44
2 bedrooms	13	616	80	18	84
3+ bedrooms			84		
Occupancy rate	[a]	97%	100%	92%	93%
Profile of typical household	Family or single	Elderly, disabled, or single	Family	Family	Family or single
Number of children	Very few	Very few	400-600	[a]	50
Type of structure	Town house	Elevator and town house	Garden	Garden	Garden
Type of construction	Masonry	Brick	Brick	Wood frame, slab on grade	Wood frame with siding
Foreclosure history	Oct. 1996	Jan. 1998	None	Mar. 1997	Oct. 1997
Current loan/property ownership	Sept. 1997, new owner	Issuing trust	Loan	Sept. 1998, new owner	Apr. 1997, new owner
Date of GAO's site visit	Apr. 23, 1999	June 9, 1999	July 8, 1999	July 7, 1999	July 8, 1999

[a]Information not obtained.

Profiles of Missouri Case Study Properties at the Time of GAO's Site Visits

Table 7: Profiles of Missouri Case Study Properties

Property	Brittany Village I & II	Chip Village	Columbia Square	East Hills Village	Murphy Blair Gardens	Thunderbird
City and state	St. Joseph, Missouri	Kansas City, Missouri	Columbia, Missouri	Kansas City, Missouri	St. Louis, Missouri	Harrisonville, Missouri
Year built	1968	1973	1971	1972	1982	1973
Number of units	280	137	128	110	117	50
Number of project-based Section 8 units	0	42	121	102	115	50
Number of tenant-based Section 8 units	41	23	[a]	[a]	[a]	0
Bedroom mix						
1 bedroom	36	41	64	46	56	10
2 bedrooms	100	74	64	64	54	25
3 bedrooms	120	11	0	0	7	15
4+ bedrooms	24	11	0	0	0	0
Occupancy rate	96	80	99	93	93	92
Profile of typical household	Family with children	Single-parent family	Single-parent family	Single-parent family	Single-parent family	Single-parent family
Number of children	250	150	200-500	217	200	40-50
Type of structure	Garden	Garden/ town house	Town house	Garden	Garden/ town house	Garden
Type of construction	Wood frame and Stucco	Wood frame	Wood frame	Wood frame	Brick and stucco	Wood frame and stucco
Foreclosure history	Current to workout loan terms	Foreclosed	Current to original loan terms	Current to original loan terms	Current to workout loan terms	Current to original loan terms
Current loan/property ownership	June 1997, new owner	New owner	Loan	Loan	Sept. 1997, new management team	Loan; around Aug. 1998, new management
Date of GAO's site visit	Oct. 6, 1998	Apr. 20, 1999	Apr. 21, 1999	Apr. 20, 1999	Apr. 22, 1999	Apr. 21,1999

[a]Information not obtained.

Status of Improvements at Partially Assisted Case Study Properties, at the Time of GAO's Site Visits

Table 8: Status of Improvements at Partially Assisted Properties

	Name of property					
Type of improvements	Ashton Pines	Back Bay	Coral Reef	Del Prado	Frenchman's Wharf I & II	Gulf Royale
Building exterior						
Roofs and gutters	C	C	C	C	B	C
Windows and doors		P	B	B	C	C
Walls and foundations	C	B	B	C	C	C
Painting	C	B	B		C	C
Porches, balconies, steps		P	B			B
Other						
Apartment interior						
Unit floors and carpets	B	P	B	B		B
Kitchen area	B	P	B	B		B
Bath area			B	B		
Heating, cooling, and hot water systems	B	P	B	B		B
Unit painting		P	B	B		B
Common area				B[a]		
Other	B[b]	P	B			
Property grounds						
Landscaping (lawn and plants)	C	P	B			C
Sidewalks and walkways			B	N/O	N	C
Fencing		P	B			N/O
Interior roads, parking lots, garages, carports, lighting, and signage	C	P	B		P	C
Recreation facilities (swimming pools, tennis courts, health club, children's play areas)	C	P	C		N	C
Support facilities and services (security, laundry rooms, food banks, clubhouse, management offices)	C	P	C	C[c]		
Other			C[d]		C[e]	

Continued

Legend

N Work not begun at the time of GAO's visit and/or no plans for work in identified categories
P Work planned and a budget developed
B Work begun but not completed at the time of GAO's visit
C Work completed
N/O Not observed

Note: Shading indicates that major problems had been identified at the time of the loan sale in HUD's pysical inspection or due diligence reports.

[a]Repair and upgrade elevators.

[b]Extensive deferred maintenance on vacant, uninhabitable units.

[c]New washers and dryers for laundry room.

[d]Repair to bulkhead.

[e]Repair to lake, lagoons, and pumps.

Table 9: Status of Improvements at Partially Assisted Properties, Continued

	Name of property				
Type of improvement	**Historic South St. Louis[a]**	**Parkway Center[b]**	**Shallowford Oaks**	**Tangier**	**Westbury Park**
Building exterior					
Roofs and gutters	**B**	C	C	C	**P**
Windows and doors	**B**		**C**		**N/O**
Walls and foundations	**B**	C	C	C	**B**
Painting	**C**	C		C	**N**
Porches, balconies, steps	B		B		B
Other					
Apartment interior					
Unit floors and carpets	B		C	B	B
Kitchen area	B			B	P
Bath area			C		B
Heating, cooling, and hot water systems		C		B	**B**
Unit painting	**B**	C	B		
Common area		**C**			
Other		C		C[c]	**B[d]**
Property grounds					
Landscaping (lawn and plants)	**B**		C		
Sidewalks and walkways		C			P
Fencing		C		B	
Interior roads, parking lots, garages, carports, lighting, and signage	**N/O[e]**	**C**	**C**	**B**	**C**
Recreation facilities (swimming pools, tennis courts, health club, children's play areas)		B	**C**		
Support facilities and services (security, laundry rooms, food banks, clubhouse, management offices)		C			
Other			**C[f]**		**B[g]**

Continued

Legend

N Work not begun at the time of GAO's visit and/or no plans for work in identified categories
P Work planned and a budget developed
B Work begun but not completed at the time of GAO's visit
C Work completed
N/O Not observed

Note: Shading indicates that major problems had been identified at the time of the loan sale in HUD's physical inspection or due diligence reports.

[a]Information on this property's problems obtained from HUD's property inspection report and other HUD inspection forms.

[b]Information on this property's problems obtained from ARCHON's 1998 business plan.

[c]Repair fire alarm system and install automatic sprinkler system.

[d]Several vacant, uninhabitable units (prior to the loan sale), including one with extensive fire damage at the time of GAO's site visit.

[e]Poor lighting.

[f]Poor drainage.

[g]Retaining walls.

Status of Improvements at Missouri Case Study Properties, at the Time of GAO's Site Visits

Table 10: Status of Improvements at Missouri Case Study Properties

	Name of property					
Type of improvement	**Brittany Village I & II**	**Chip Village**	**Columbia Square**	**East Hills Village**	**Murphy Blair Gardens**	**Thunderbird**
Building exterior						
Roofs and gutters	**C**	B	**B**	**B**	**B**	**C**
Windows and doors	**C**	**B**	**B**	P	**B**	B
Walls and foundations	B	**B**	**B**	P	**B**	**B**
Painting	C	B	**B**		**C**	
Porches, balconies, steps		**B**		**P**	**B**	
Other			C[a]			
Apartment interior						
Unit floors and carpets	**B**	**B**	**B**	**B**	**B**	**B**
Kitchen area	B	**B**	**B**	**B**	**B**	**N**
Bath area	B			P	B	
Heating, cooling, and hot water systems	**B**	B	B	**B**	**B**	**B**
Unit painting	**B**	B		P	**B**	
Common area	C					
Other	**B**[b]	**B**[c]	**B**[d]	P	B	**P**[e]
Property grounds						
Landscaping (lawn and plants)	B	P		P	P	
Sidewalks and walkways	P	**N/O**		P		
Fencing				P	C	
Interior roads, parking lots, garages, carports, lighting, and signage	**C**	P	**B**	**P**	B	P
Recreation facilities (swimming pools, tennis courts, health club, children's play areas)	C	**P**		P	P	
Support facilities and services (security, laundry rooms, food banks, clubhouse, management offices)		B		P	P	
Other		C[f]			N/O[g]	P[h]

Continued

Legend

N Work not begun at the time of GAO's visit and/or no plans for work in identified categories
P Work planned and a budget developed
B Work begun but not completed at the time of GAO's visit
C Work completed
N/O Not observed

Note: Shading indicates that major problems had been identified at the time of the loan sale in HUD's physical inspection or Missouri's due diligence reports.

[a]Replaced sliding patio doors with nine pane doors and windows.

[b]Five vacant, uninhabitable units undergoing renovation.

[c]Six vacant, uninhabitable units.

[d]Insulation, caulking, and weather stripping.

[e]Two units vacant and uninhabitable because of foundation damage.

[f]Repairs for three retaining walls completed.

[g]Sidewalk washed out by broken sewer.

[h]Major erosion problems throughout the site.

Conditions and Improvements at Partially Assisted Case Study Properties at the Time of GAO's Site Visits

Property	Status of improvements
Name: **Ashton Pines** Location: Shreveport, Louisiana Total number of units: 184 Tenant-based Section 8 units: 23 Type of structure: Garden Type of construction: Brick and stucco Year built: 1976	This foreclosed property, managed by ARCHON, is in the final stages of a $1.5 million renovation that includes a complete roof replacement, exterior painting, parking lot paving overlay, gutter and downspout replacements, siding and stucco repairs, new playground equipment, extensive renovation of the leasing office, rehabilitation of uninhabitable units, conversion of a tennis court to basketball courts, and repairs to a swimming pool.

Typical building, new roof, gutters, painting

odel kitchen in a rehabilitated unit

Recreation facilities for young children

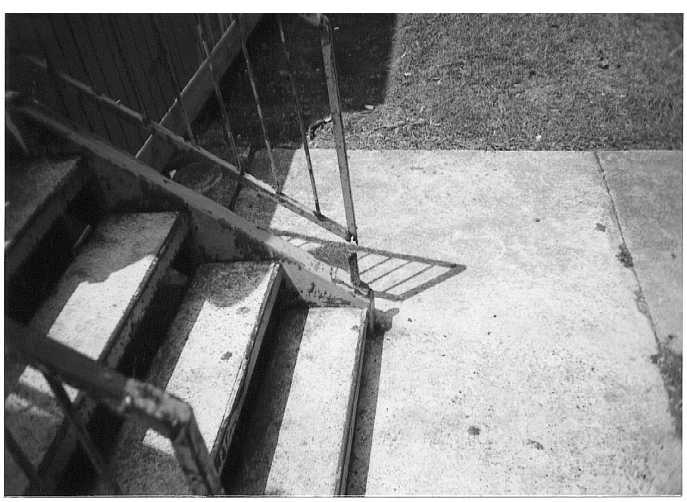
Tennis court converted to basketball courts

Property
Old name: **Back Bay**
New name: Baywalk Apartments
Location: Galveston, Texas
Total number of units: 192
Section 8 units: 0
Type of structure: Garden
Type of construction: Brick and wood frame
Year built: 1980

Status of improvements
The new property owner is planning to spend $1.8 million for both exterior and interior rehabilitation. The interior work will involve painting, kitchen repairs, and new appliances. The exterior work will concentrate on landscaping; repairing and replacing areas with wood rot; and painting and repairing patios, stairs, and handrails. In addition, a new leasing office costing about $75,000 will be constructed. The same owner has also purchased Coral Reef and an adjacent problem rental property.

Typical building with new roof and gutters

Rotten wood removed, awaiting replacement and painting



Rusted balcony railing awaiting replacement

Adjacent property purchased by developer

Property	Status of improvements
Old name: **Coral Reef** New name: Island Bay Resort Location: Galveston, Texas Total number of units: 176 Section 8 units: 0 Type of structure: Garden Type of construction: Stucco and wood frame Year built: 1972	New owners have begun a $2.9 million rehabilitation of this property. The interiors will get new flooring and carpeting; new painting; new doors; and new kitchen countertops, sinks, appliances, and fans. The exterior work includes a new roof, roof treatments, and new and additional stairs to the second floor balconies, as well as exterior wall repairs and painting, new patio doors, new sidewalks, and a new front fence. A new entry to the property and substantial repairs to and reconfiguration of the clubhouse/rental office are planned. The same owner also purchased Back Bay.

New roof, balconies, and steps

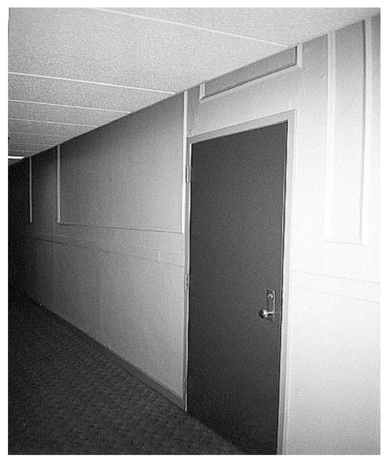
odel kitchen after rehabilitation

rench doors that replaced sliding glass doors

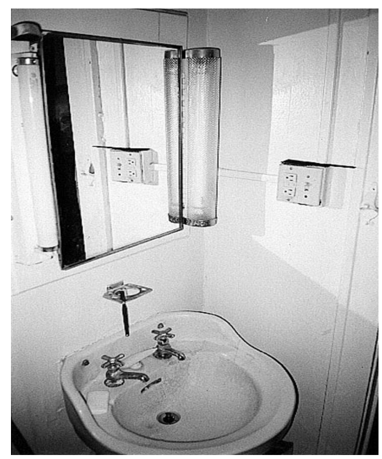
reparation of exterior for painting

Property	Status of improvements
Name: **Del Prado** Location: Chicago, Illinois Total number of units: 196 Project-based Section 8 units: 78 (not being renewed) Type of structure: Elevator high-rise Type of construction: Brick Year built: 1918	This 13-story apartment building, constructed in 1918 as a hotel and converted in 1979 to apartments, is located on Lake Michigan. The new owner has replaced the roof over the lobby and extensively renovated about a third of the units—repainting, cleaning carpets, and replacing appliances. This owner has also installed new washers and dryers in the laundry and is painting the hallways from the 3rd to the 11th floors (completed through the 6th floor). A third of the windows have also been repaired, scraped, painted, and caulked. The original bathroom fixtures have not been replaced.

Building, commercial space on first two floors, top two floors closed off



Newly painted hallway and apartment door



ated fixtures in bath area

New laundry room in basement

Property	Status of improvements
Name: **Frenchman's Wharf I & II** Location: New Orleans, Louisiana Total number of units: 644 Project-based Section 8 units: 64 Type of structure: Garden Type of construction: Wood frame and siding Year built: 1977 and 1979 (two sections)	This 644-unit property is built in a crescent shape around a 16-acre lake. The current owner, operating under a provisional workout arrangement, has addressed termite damage, replaced wood where needed, painted the exteriors of all the buildings, and installed new vinyl siding. Bulkhead work on the lake was done. The owner is getting bids to repair a “sink hole” in one of the parking lots. Although sidewalks are repaired “in house” when they cause “health or safety” problems, we saw several large cracks during our visit.

New vinyl siding and freshly painted wood trim

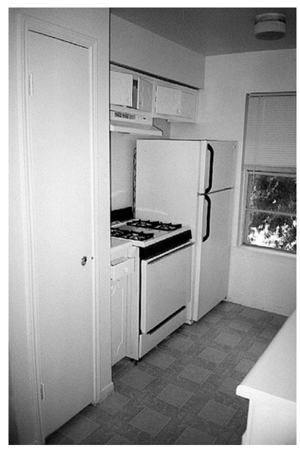
Office and swimming pool across the 16-acre lake

Sink hole in parking area, out for repair bids

A broken sidewalk

Property	**Status of improvements**
Name: **Gulf Royale** Location: Texas City, Texas Total number of units: 90 Tenant-based Section 8 units: 29 Type of structure: Garden Type of construction: Brick veneer and wood Year built: 1970	As the manager of this foreclosed property, ARCHON has invested over $550,000 in improvements. Exterior improvements focused on landscaping, signage, roads/parking areas, painting, roof and gutters, walls, and a pool area. Interior improvements included painting, new flooring and carpeting, new appliances, and new heating and air-conditioning systems. Several cracks in concrete balconies/steps and damage to their metal frames remained at the time of our visit.

New roof, gutters, painting, landscaping



Replacement kitchen in a rehabilitated unit

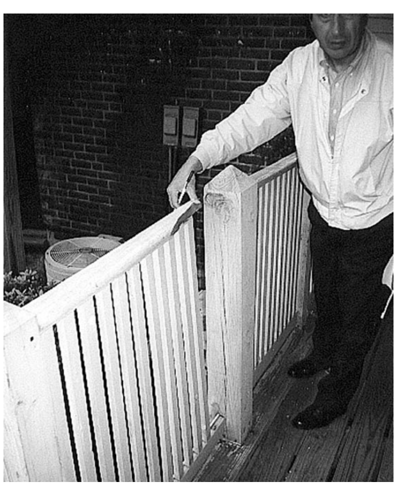
Repaired balcony steps

Cracked concrete and damaged frame in second floor balcony area

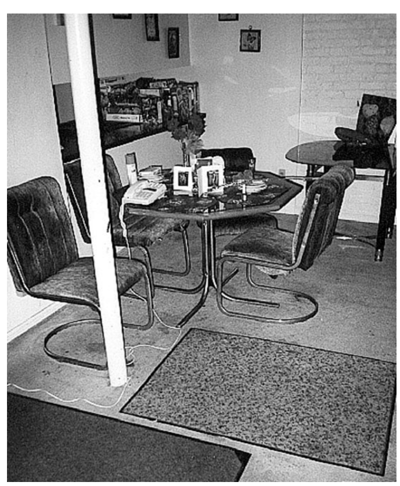
Property	**Status of improvements**
Name: **Historic South St. Louis** Location: St. Louis, Missouri Total number of units: 19 Project-based Section 8 units: 4 (not being renewed) Type of structure: Town house Type of construction: Masonry/brick Year built: 1900	These scattered-site properties were in poor condition when a new owner purchased them from ARCHON. A two-unit town house was fire damaged/gutted and had to be completely rehabilitated. Exterior bricks were tuckpointed, and windows and wood trim were painted. However, two of the Section 8 units we visited exhibited fair to poor conditions, including a hole in the floor, dirty carpeting, and a back porch railing that was broken and unsafe.

A scattered-site building

Renovated -unit town house,
previously fire damaged



roken wooden railing on back
porch of first-floor unit



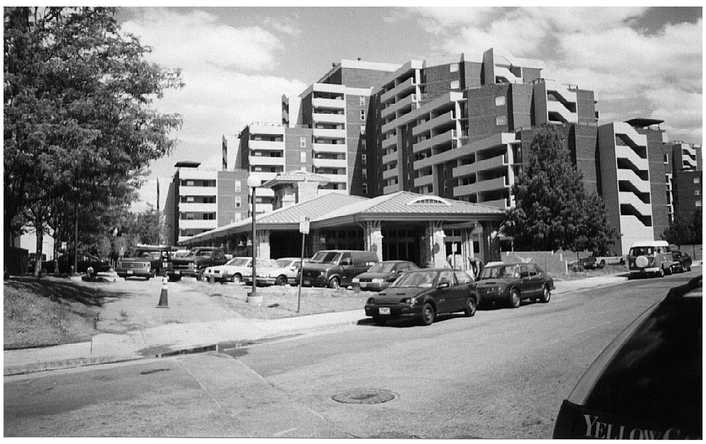
nterior of unit needing painting
and carpet cleaning

Property

Name: **Parkway Center**
Location: Denver, Colorado
Total number of units: 1,050
Project-based Section 8 units: 187
Type of structure: Elevator high-rise and town house
Type of construction: Brick
Year built: 1982

Status of improvements

ARCHON has managed this property, the largest in the partially assisted loan sale, since January 1998. Because the property was in “superior” condition at the time of the loan sale, ARCHON has pursued a “value enhancement” strategy that includes constructing an 8,500-square-foot clubhouse/health center and a larger swimming pool with a jacuzzi and fountain, painting the exterior, upgrading the landscaping, and renovating interior corridors and lobbies. ARCHON had spent over $5 million at the time of our site visit.



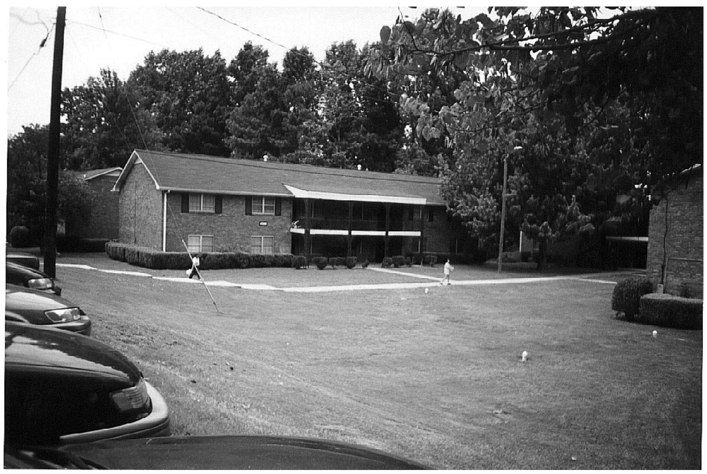
High-rise apartment units and newly constructed clubhouse

Town houses in development

Subsidized units for the elderly/disabled in a high-rise building

pgraded fencing--wrought iron replacing chain

Property	**Status of improvements**
Name: **Shallowford Oaks** Location: Chamblee, Georgia Total number of units: 204 Project-based Section 8 units: 41 Type of structure: Garden Type of construction: Brick Year built: 1967	Substantial renovations (e.g., new roofs and gutters installed in 1995) were begun before the loan sale. After the sale, carpeting and appliances were replaced in all units, and many units acquired new bathroom fixtures. Erosion problems have been addressed, new lawns have been added, and landscaping has been completed. A large pool was fully renovated, and parking lots were repaved.



New roof, gutters, and landscaping

rench doors replaced sliding glass doors

efurbished and reopened swimming pool

Step repair: cracked concrete
covered with nonskid steel cap

Property
Name: **Tangier**
Location: Rancho Cordova, California
Total number of units: 26
Project-based Section 8 units: 6
Type of structure: Garden
Type of construction: Wood frame on slab
Year built: 1981

Status of improvements
The new owner has begun to renovate this property and has purchased several adjacent rental properties. A new fence has been erected around most of the property. The owner has painted all of the exterior buildings the same color and has replaced the carpeting in 11 units. He also plans to renovate each unit as it becomes vacant and repave the parking lot within the next year.

New roof, gutters, and painting

Neighboring property recently purchased by new owner

New replaced fencing on property

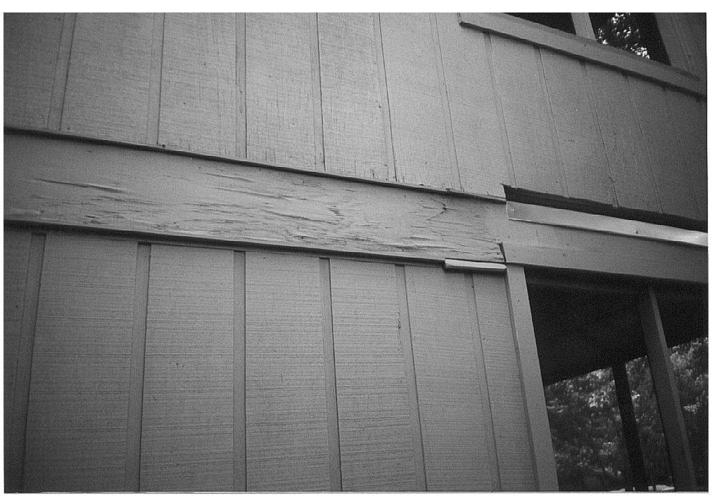
amaged floor and appliances in a kitchen awaiting renovation

Property
Name: **Westbury Park**
Location: Marietta, Georgia
Total number of units: 128
Project-based Section 8 units: 26
Type of structure: Garden
Type of construction: Wood frame with siding
Year built: 1981

Status of improvements
The new owner has performed moderate rehabilitation, such as repaving the parking lot, replacing flashing and headers on screen porches, replacing wood siding on some buildings, and renovating some interior units “as needed.” At the time of our visit, she had begun to replace rotten railroad ties in retaining walls and was renovating a fire-damaged unit.

epairs to interior roads and parking area

Water-damaged siding replaced



amaged header and new flashing

otten railroad ties in retaining wall

Conditions and Improvements at Missouri Case Study Properties, at the Time of GAO's Site Visits

Property
Name: **Brittany Village I & II**
Location: St. Joseph, Missouri
Total number of units: 280
Tenant-based Section 8 units: 41
Type of structure: Garden
Type of construction: Wood frame and stucco
Year built: 1968 and 1969

Status of improvements
The new property owner is implementing a $1.4 million rehabilitation plan. New roofs, gutters, windows, and an entrance door (with side window panels) were nearly complete at the time of our visit. Exterior stucco walls and wood trim had been painted. Parking lots had been resealed. Five formerly uninhabitable units were undergoing extensive renovation.

New roof, windows, and exterior painting

eplacement of entrance door and side window panels

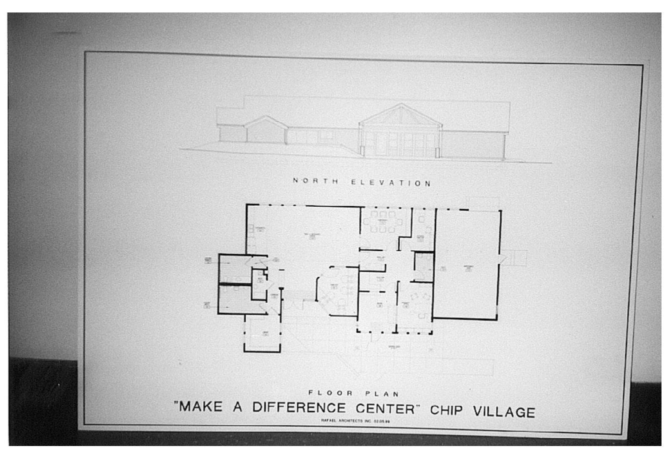
Gutted unit undergoing rehabilitation

Property	**Status of improvements**
Name: **Chip Village** Location: Kansas City, Missouri Total number of units: 137 Project-based Section 8 units: 42 Tenant-based Section 8 units: 23 Type of structure: Garden/town house Type of construction: Wood frame Year built: 1973	The new owner, a nonprofit community developer, is spending nearly $3.2 million to substantially rehabilitate the property. At the time of our visit, several buildings had new roofs and vinyl siding and renovated interior units. New outside stairwells will be added, along with new equipment at two playgrounds and a perimeter fence. Community center/management offices will be reconfigured and renovated to include a new “Make a Difference Center” for children and adults.

New vinyl siding windows, and steps

isting wood siding windows, and steps

Newly renovated kitchen

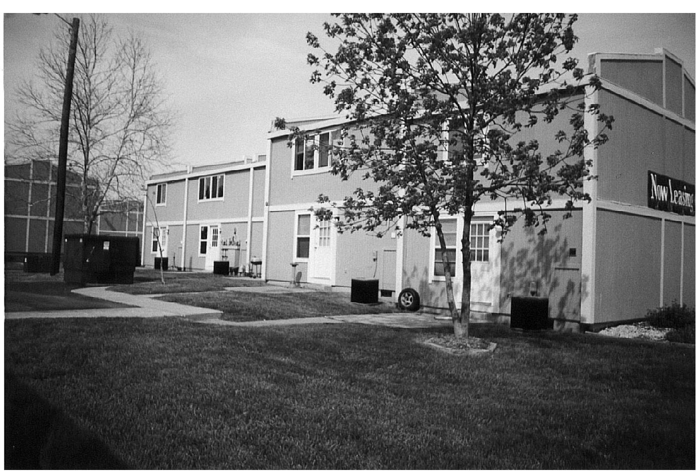


New layout for Make a Difference Center

Property	Status of improvements
New Name: **Columbia Square** Old Name: Worley Apartments Location: Columbia, Missouri Total number of units: 128 Project-based Section 8 units: 121 Type of structure: Town house Type of construction: Wood frame (modular) Year built: 1971	The existing owner is implementing the second year of an 8-year ($507,500) rehabilitation plan, funded from replacement reserves and surplus cash flow. When we visited, the front two buildings had new roofs, vinyl siding, and entrance door dormers. A majority of the units had new windows, and in all of them, a rear sliding glass door had been replaced with a French door and side window. As a result, the units are much more energy-efficient, and tenants' utility costs have gone down. The remaining buildings will be painted and their roofs will be replaced “as needed.”

New vinyl siding, windows, and dormers for buildings at the property's entrance

New front doors and windows for buildings not at the property's entrance

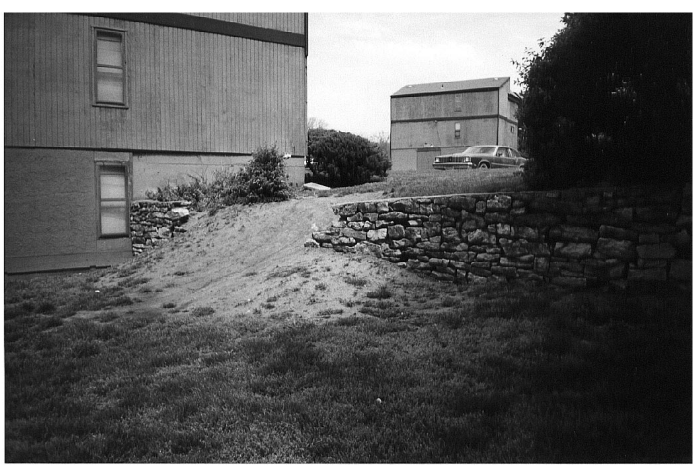


New French doors and side windows at the rear entrances

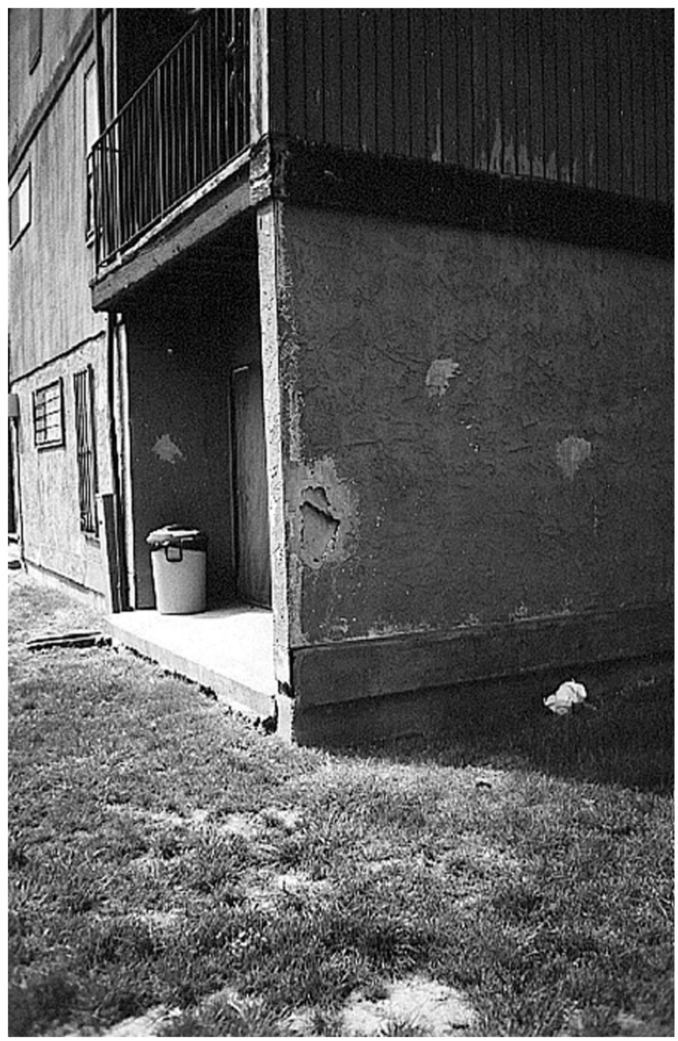
Newly renovated itchen

Proper;ty:	Status of improvements
Name: **East Hills Village** Location: Kansas City, Missouri Total number of units: 110 Project-based Section 8 units: 102 Type of structure: Garden Type of construction: Wood frame Year built: 1972	At the time of our site visit, the condition of this property was worse than that of any other case study property. However, the existing owner has received financial commitments that will provide about $5.5 million to substantially rehabilitate the existing structures and to construct a new gymnasium/community center and a management office building.

verview of property and par ing lot



rosion problem



eteriorating wood siding

Property	Status of improvements
Name: **Murphy Blair Gardens** Location: St. Louis, Missouri Total number of units: 117 Project-based Section 8 units: 115 Type of structure: Garden Type of construction: Brick and stucco Year built: 1982	A new property management company has nearly completed a substantial rehabilitation (approximately $2 million in three stages) of this property. Exterior work includes new roofs, brick repairs, and painting, as well as a new wrought iron security fence and lighting that have helped reduce crime. Interior renovations include new refrigerators, stoves, carpets, and windows for vacant and turned-over units. This property is adjacent to Murphy Blair Townhouses, a property that is over 50-percent vacant and recently underwent foreclosure by HUD.

verview of property and parking lot

New wrought iron security fence and lighting

Newly renovated living room

Boarded-up units in adjacent Murphy Blair Townhouses

Property	Status of improvements
Name: **Thunderbird** Location: Harrisonville, Missouri Total number of units: 50 Project-based Section 8 units: 50 Type of structure: Garden Type of construction: Wood frame and stucco Year built: 1973	At the time of our site visit, a new property management company had begun substantial exterior renovations (new roofs and repairs to correct structural problems) and was about to start renovating two uninhabitable units. According to MHDC, new playground equipment was installed after we visited, and the total rehabilitation costs as of September 1999 were $55,000. Major erosion problems and signs of wear on exterior walls remained to be corrected.

verview of property and entrance sign

Signs of wear on exterior wood siding

ncorrected erosion problem

ninhabitable unit undergoing gut rehabilitation

Comments From the Department of Housing and Urban Development

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

January 4, 2000

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

Mr. Stanley J. Czerwinski
Associate Director, Housing and Community
Development Issues
United States General Accounting Office
Washington, DC 29548

Dear Mr. Czerwinski:

Thank you for the opportunity to comment on your draft report entitled Multifamily Housing: Impact of Loan Sales on Tenants and Properties Varies by Property (GAO/RCED-00-31).

HUD/FHA is pleased that the GAO in its evaluation reveals no basis for questioning the validity of note sales as a HUD policy initiative, that the case studies demonstrate a positive impact on housing physical quality and generally satisfactory housing choice for tenants who are provided tenant based assistance as a result of owner opt-outs of project based contracts. We are somewhat concerned that the report generally fails to fully assess and acknowledge the extent to which HUD designed the sales to align interests with those of the purchaser in order to minimize the need for staff intensive monitoring as part of the sales strategy. Further, while the report recognizes the different potential for mortgagee control emanating from delinquent status and foreclosure, in attempting to assess why one sale saw greater physical improvement the report fails to fully appreciate the significantly different investor risk and reward potential for improvements in partially assisted properties versus the Missouri sale subsidized properties as a major cause for the significant private sector investment.

There is no assertion by GAO that a different sales strategy would have better minimized losses or any suggestion that HUD was misguided in employing a structured note sale strategy in lieu of continuing to monitor in-house or foreclosing and selling on its own. In fact, these loan sales contributed significantly to mitigating the problem of holding and servicing HUD-held notes, which had been identified as a material weakness in FHA audits for many years. In its field surveys and site visits, GAO has found no incidence of tenant disaffection or decline in quality of shelter. Although the draft report identifies issues of improvement in HUD information dissemination, monitoring and reporting processes, it finds no case where a flaw in process has led to a substantive

-2-

problem. Further, concerns that GAO sets forth about owner acceptance of tenant based assistance are mitigated by the recent provision of enhanced vouchers for opt-out in HUD's FY 2000 budget, a provision HUD strongly supported. This resolves a potential problem for residents and owners for cases where new market rents are above the voucher payment standard. This should be fully recognized in GAO's analysis.

In the two sales studied by GAO, the Missouri state agency and the partially assisted sales, HUD used structures in which seller and buyer shared an identity of interest as stakeholders in a common pool of assets. The Missouri sale was conceived as the first step in a progression of pooled asset sales in which HUD and its natural partners in providing affordable housing - - the State Housing Finance Agencies- - would combine staff expertise with economic self-interest and a shared public purpose mission to restructure and liquidate financially troubled assets and improve housing quality, to the ultimate benefit of the taxpayers in general and lower income households in particular. In the partially assisted sale, HUD retained a 30 percent interest in the assets as a limited passive partner but one with an obvious interest in the performance of the trust servicer retained by the general partner.

In the absence of problems in the design of the program and its execution in Missouri and the partially assisted trust sales, the GAO has focused on the secondary and tertiary elements of monitoring and routine reporting. We believe the report should recognize this by more explicitly acknowledging the positive impact the loan sales have had on the properties and their residents, and the health of the FHA insurance funds.

GAO Recommendations and HUD/FHA's Responses:

Recommendation:

- HUD should notify housing authorities and assisted tenants associated with partially assisted mortgage sale properties of the tenant protections and of their right to seek judicial enforcement of these protections, as established for the partially assisted loan sale.

HUD's Response:

The Department agrees with this recommendation and will implement it. This will entail following through on information previously provided in the course of the sales and further legal analysis of scenarios.

-3-

Recommendation:

- HUD should follow up with housing authorities to determine whether they are able to enforce tenant protections or whether further steps are needed to enforce the protections.

HUD's Response:

The Department agrees with this recommendation and will implement it. This will entail following through on information previously provided in the course of the sales. As noted above, some aspects of potential economic disincentive to owners are significantly improved by the recent provision of enhanced vouchers in opt-outs.

Recommendation:

- HUD should ensure that the Multifamily field staff are aware of the tenant protections.

HUD's Response:

The Department agrees with this recommendation and will implement it. This will entail following through on information previously provided in the course of the sales. As potential concerns were raised by GAO during the course of the audit, the Department sent out reminders to field office leadership regarding tenant protections. This guidance will be consolidated with dissemination of other information discussed above.

Recommendation:

- HUD should ensure that the tenant protections are being recorded in deed covenants.

HUD's Response:

The Department agrees with this recommendation and will implement it as appropriate to the specific loan. We will make it a priority for the new equity monitor, which should begin work shortly.

Recommendation:

- HUD should provide information on the tenant protections to the owners of all partially assisted mortgage sale properties and ensure that the owners understand their obligation to accept voucher and certificate holders, when reasonable to do so, for the appropriate time period.

-4-

HUD's Response:

The Department agrees with this recommendation and will implement it consistent with owners' legal requirements. This will entail analysis of specific applications and following through on information previously provided in the course of the sales.

Recommendation:

- HUD should determine whether the three properties that according to housing authorities refused to accept vouchers and certificate, and the one property which only accepted vouchers from current tenants, violated the protection against discrimination and if so, take appropriate enforcement action.

HUD's Response:

The Department agrees with the recommendation to evaluate and will implement it. If a violation is found, basis for enforcement action by HUD will be evaluated also. We will rely on advice of counsel regarding actually taking enforcement action.

Recommendation:

- To ensure that the federal funds provided for property improvements are being used in accordance with the terms of the partially assisted loan sale agreement, we recommend that HUD expeditiously retain a new equity monitor to review the actions of the general partner and special servicer, including the servicer's use of property improvement funds The monitor should focus on actions taken since April 1998, when the previous equity monitor's contract expired.

HUD's Response:

We agree, and our choice for contract award should occur soon. The contractor can monitor the servicer's use of property improvement funds to the extent this is consistent with the contract's scope , which focuses on whether (1) the servicer's practices are executed in a manner which can reasonably be expected to maximize the Net Present Value in the transaction, and (2) the contractual obligations are fulfilled. We will assure that actions taken since April 1998 are adequately addressed.

Recommendation:

- To ensure that the Missouri Housing Development Commission (MHDC) has used its "best efforts" to encourage existing owners to rehabilitate their properties, we further recommend that HUD ask MHDC in writing to provide annual reports to HUD. Besides providing the information specified in the loan sale agreement, these reports

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should indicate how conditions have changed at each property since the time of the loan sale, what other funding has been used to finance these improvements and what role, if any, MHDC may have had in encouraging these changes. This information may provide useful lessons to HUD for the design of any future subsidized multifamily loan sales.

HUD's Response:

The Department disagrees with this recommendation. Considering that HUD officials consult informally with the agency and that annual HUD property inspections are required in any event, such reports could be viewed as burdensome and redundant oversight of a motivated and engaged public partner. The Kansas City HUB receives these inspection reports and is able to monitor the status of properties. Further, GAO notes that Missouri provides a report to the HUB. The GAO's evaluation of Missouri's progress was positive. Since GAO did not cite any problems, it would be unfortunate to require increased reporting from Missouri as a result of positive performance.

Enclosed with this letter are extensive and helpful technical comments that HUD's Office of Public and Indian Housing has drafted concerning the report's discussion of tenant assistance and the certificate/voucher programs. In addition, the Office of the Chief Procurement Officer contributed to the response dealing with contracting issues.

In conclusion, let me reiterate our commitment to following up fully on our multifamily loan sales consistent with the positions taken above. The report provides some useful suggestions about the nuts-and-bolts details of program administration. At the same time, we believe it rightfully highlights the program's success in achieving primary policy objectives.

Sincerely.

William C. Apgar
Assistant Secretary for Housing-
Federal Housing Commissioner

GAO Contact and Staff Acknowledgments

GAO Contact

Mathew Sciré (202) 512-6794

Acknowledgments

Patrick Doerning, Bess Eisenstadt, Carolyn Hall, Angelia Kelly, Joan Mahagan, John McGrail, Luann Moy, Lisa Stein, and Jim Vitarello made key contributions to this report.

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