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REPORT TO THE CONGRESS

Opportunities To Reduce Costs In Acquiring Properties Resulting From Defaults On Home Loans

B 114860

Department of Housing and Urban Development
Veterans Administration

BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

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COMPTROLLER GENERAL OF THE UNITED STATES
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To the President of the Senate and the
Speaker of the House of Representatives

This is our report on opportunities to reduce costs in acquiring properties resulting from defaults on home loans insured by the Department of Housing and Urban Development or financed or guaranteed by the Veterans Administration.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U S C 53), and the Accounting and Auditing Act of 1950 (31 U S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget, the Secretary of Housing and Urban Development, and the Administrator of Veterans Affairs

A handwritten signature in cursive script that reads "James B. Stacks".

Comptroller General
of the United States

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ABBREVIATIONS

GAO General Accounting Office
HUD Department of Housing and Urban Development
VA Veterans Administration

CHAPTER 1

INTRODUCTION

The Department of Housing and Urban Development (HUD), pursuant to the provisions of the National Housing Act, as amended (12 U.S.C. 1701 et seq.), insures mortgage loans made by private lending institutions on various types of housing, including individual homes. At December 31, 1971, HUD had about 5.3 million outstanding insured home loans having balances of about \$65.7 billion.

The Veterans Administration (VA), pursuant to the Servicemen's Readjustment Act of 1944, as amended (38 U.S.C. 1801), guarantees home mortgage loans made by private lending institutions to eligible veterans of World War II and the Korean conflict. The Housing Act of 1950 (38 U.S.C. 1811) authorizes VA to make loans to eligible veterans living in small cities, towns, and rural areas if financing is not available from private lenders. The Veterans Readjustment Benefits Act of 1966 (38 U.S.C. 1818) also makes the VA-guaranteed and VA-financed loans available to veterans who served in the Armed Forces after January 31, 1955. VA also provides financing to purchasers who buy properties acquired by VA because of loan defaults. At December 31, 1971, VA had about 3.7 million outstanding guaranteed home loans having balances of about \$38.5 billion and about 279,000 outstanding financed home loans having balances of about \$2.5 billion.

HUD AND VA ACQUISITIONS OF HOME PROPERTIES

When a HUD-insured or VA-guaranteed mortgage loan is in default, the lending institution (mortgagee) can initiate foreclosure action to eliminate the homeowner's (mortgagor's) interest in the property securing the loan and to acquire the property.

As an alternative to foreclosure, the mortgagee can acquire the property from the mortgagor by voluntary deed in full satisfaction of the loan. After foreclosure has been completed or after the property has been acquired by voluntary deed, the mortgagee, in exchange for the insurance or

guaranty payments, generally transfers the property title to the agency which insured or guaranteed the loan. These payments include amounts for the unpaid loan balance, funds advanced by the mortgagee for taxes and insurance, costs incurred by the mortgagee to terminate the loan and to convey the property to the Government, and interest on these items. When a VA-financed loan is in default, VA acquires the property securing the loan either by foreclosure or by voluntary deed.

Because of loan defaults, HUD and VA acquired about 40,200 and 14,100 home properties, respectively, during 1971.

CHAPTER 2

OPPORTUNITY FOR REDUCING COSTS AND TIME

REQUIRED TO ACQUIRE PROPERTIES BY FORECLOSURE

The judicial and power-of-sale methods are the two methods of foreclosure generally used in the 50 States and in the District of Columbia to terminate defaulted loans and to acquire the mortgaged properties. Our review showed that the power-of-sale method of foreclosure used in 26 States and in the District of Columbia is generally less costly and less time consuming than the judicial and other methods of foreclosure which are used in the remaining 24 States. (See app. I.) About 19,500 of the 40,800 properties acquired by HUD and VA in fiscal year 1970 were located in the 24 States not using the power-of-sale method of foreclosure.

We believe that wider use of the power-of-sale method of foreclosure for defaulted HUD-insured, VA-financed, or VA-guaranteed loans would reduce the foreclosure costs incurred by the Government and, in many instances, by mortgagees and would permit HUD and VA to pay mortgagees' claims sooner.

METHODS OF FORECLOSURE

HUD and VA do not specify the method that a mortgagee should use to foreclose a mortgage securing a defaulted loan; instead, foreclosure is carried out in accordance with the requirements of State statutes and with prevailing practices in the area where the mortgaged property is located. After acquiring title to the mortgaged property, the mortgagee generally transfers the property to HUD or VA in exchange for insurance or guaranty payments.

In a judicial foreclosure State, the mortgagee files a complaint with the court naming all the interested parties as defendants. The complaint states the nature and extent of the mortgagor's default and petitions the court for a decree or judgment of foreclosure and sale. After a hearing to resolve any contested questions, the court (1) may enter a decree or judgment which establishes the amount of the debt, (2) orders the mortgagor to pay the debt, and (3) orders

the property to be sold at public auction if the debt is not paid within a specified time. If the mortgagor fails to pay the debt by the specified date, the property is sold at public auction under the auspices of the court. Although anyone may bid on the property at the foreclosure sale, the sale is generally made to the mortgagee.

In States where the power-of-sale method of foreclosure is used, the mortgagee is authorized, without court action, to sell the property upon default. The legal document pledging the property which secures the loan usually stipulates that a notice of sale be published in a newspaper and/or posted in a public place. The foreclosure sale is also made by public auction, and the mortgagee generally is the buyer.

In some States where the judicial or power-of-sale method of foreclosure is used, the mortgagor may redeem the property by repurchase within a specified period after the foreclosure sale. The repurchase price is the same as the foreclosure sale price plus interest, taxes, and other expenses incurred to the date of redemption. Mortgagors, however, generally do not exercise the right of redemption.

VARIATIONS IN FORECLOSURE COSTS AND TIME

Foreclosures of mortgages by the judicial method generally are more costly and more time consuming than foreclosures by the power-of-sale method. A 1968 HUD analysis of the cost of foreclosing 2,700 mortgages showed that the average cost for judicial foreclosures was \$496, whereas the average cost for power-of-sale foreclosures was \$293. The judicial foreclosure costs ranged from \$323 in Louisiana to \$853 in New York; the power-of-sale foreclosure costs ranged from \$165 in Texas to \$655 in South Dakota. (See app. I.)

The variations in foreclosure costs among States using the same foreclosure method were due to variations in attorney fees and in State procedural requirements. For example, the customary fees charged by attorneys in Texas averaged about \$68 a foreclosure, compared with about \$414 a foreclosure in South Dakota. The cost of advertising a foreclosure sale can vary because of State requirements.

For example, Michigan requires advertisements in local newspapers for 12 consecutive weeks, but Alabama requires advertisements for only 3 weeks.

The requirements for judicial foreclosures generally resulted in costs higher than the costs of power-of-sale foreclosures. For example, foreclosure costs averaged about \$437 a foreclosure for the HUD- and VA-acquired properties in four judicial foreclosure States included in our review (Florida, New Jersey, Ohio, and Pennsylvania) compared with \$140 a foreclosure for HUD- and VA-acquired properties in two power-of-sale foreclosure States included in our review (Alabama and Michigan).

Under the judicial foreclosure method, costs can be incurred for filing fees, clerk fees, sheriff fees, and other court-related matters which may not be required for power-of-sale foreclosures. These court-related costs averaged about \$121 a foreclosure in the four judicial foreclosure States, compared with about \$6 a foreclosure in the two power-of-sale foreclosure States.

Attorney fees for foreclosing mortgages securing HUD-insured and VA-guaranteed loans averaged about \$265 a foreclosure in the four judicial foreclosure States, compared with about \$134 a foreclosure in the two power-of-sale foreclosure States. HUD's 1968 analysis showed about the same difference in attorney fees between the two foreclosure methods.

Foreclosure by the judicial method also requires that all parties with an interest in the property be named as defendants in the foreclosure suit; therefore costs are incurred for title abstracts, title reports, foreclosure reports, and other types of title evidence required by attorney and courts to identify these parties. VA's average cost for title evidence in the four judicial foreclosure States was about \$51 a foreclosure. In the two power-of-sale foreclosure States, VA did not incur any costs for title evidence.

We were unable to determine from HUD records the costs which HUD incurred for title evidence in judicial foreclosure States. However, the foreclosure method which a State uses is applicable to both HUD-insured and VA-guaranteed loans;

therefore the cost of title evidence to foreclose a mortgage securing a HUD-insured loan should be comparable to that for a VA-guaranteed loan.

The time required to foreclose a mortgage also varies, depending on the method of foreclosure and the State in which the foreclosure is held. In a manual entitled "FHA-VA Foreclosure and Claim Procedures," published in 1967 by The Loan Administration Committee of the Mortgage Bankers Association of America, the time lapse from initiation of the foreclosure action by the mortgagee to transfer of the property to HUD or VA reportedly ranged from 2 months in Alabama (and in several other States where the power-of-sale method was used) to 23 months in Kansas where the judicial method was used. (See app. I.)

For HUD-insured loans in several States having redemption provisions, the time lapse was significantly greater because HUD generally does not, except in Alabama, accept title to the property until the redemption period has expired. On the other hand, VA accepts title to the property immediately following the foreclosure sale, without regard to any redemption period that may be involved.

Because foreclosures by the power-of-sale method usually require less time, HUD and VA could reduce property acquisition costs and interest payments to mortgagees on the unpaid loan balances by greater use of the power-of-sale method. For example, the average lapse of time, nationwide, from initiation of a judicial foreclosure to transfer of the property to HUD or to VA is about 11 months and 7 months, respectively. If this time could be reduced to 2 months, like in several power-of-sale foreclosure States, HUD's and VA's interest payments could be reduced by \$450 and \$250, respectively, for a defaulted loan having an unpaid balance of \$10,000 and interest payable at a rate of 6 percent. Assuming that HUD or VA would retain the acquired property for the same length of time under either method of foreclosure, the property acquisition costs would be reduced by the amount of savings in interest payments resulting from use of the power-of-sale method of foreclosure.

Mortgagees also would benefit from greater use of the power-of-sale method of foreclosure. Under HUD's policy for paying mortgagees for loan termination and property

conveyance costs, mortgagees must bear one-third of the foreclosure costs. Therefore any reduction in foreclosure costs achieved through greater use of the power-of-sale method would reduce that portion of the foreclosure costs borne by the mortgagees. In addition, mortgagees would be paid sooner because the power-of-sale foreclosure method is less time consuming than the judicial method.

REPORTS RECOMMENDING
UNIFORM MORTGAGE FORECLOSURE LAWS

In December 1968 the National Commission on Urban Problems issued a report entitled "Building the American City," which said that State laws causing slow and costly mortgage foreclosures hamper borrowers because home loans are difficult to obtain and are usually expensive. The report stated also that these foreclosure laws are costly to mortgagees who may be required to finance home loans for as long as 2 years after mortgagors default on loans. The report noted that such foreclosure laws may have been justified many years ago but that they are not warranted for 30-year loans having high loan-to-value ratios.

The Commission recommended that HUD, in consultation with the American Law Institute and other appropriate bodies, draft a uniform usury and mortgage act which would provide a uniform foreclosure law to be adopted by all the States. The Commission recommended further that, after reasonable time for State action has elapsed, the Congress amend the national housing legislation to condition Federal housing assistance programs upon adoption of the uniform usury and mortgage act.

Also, in December 1968, the President's Committee on Urban Housing issued a report entitled "A Decent Home." This report stated that investors, particularly those purchasing HUD-insured and VA-guaranteed loans, preferred to invest in loans in those States having quick foreclosure laws and were reluctant to become involved in multistate lending because the varying State procedures required additional staff expertise and increased administrative costs. Thus, the report concluded, many States, especially those with unattractive foreclosure laws, were deprived of adequate mortgage funds. The Committee recommended that State foreclosure laws, as they applied to federally insured or guaranteed home loans, be preempted by Federal statutes. Legislation to provide a uniform foreclosure law or to preempt State foreclosure laws by a Federal foreclosure law for federally insured or guaranteed home loans has not been submitted to the Congress.

The National Conference of Commissioners on Uniform State Laws is drafting a Uniform Land Transaction Code which will provide for uniform foreclosures. However, even if a draft is approved by the conference, it is uncertain whether the States will voluntarily change their existing foreclosure laws.

CONCLUSIONS

The power-of-sale foreclosure method of terminating defaulted loans and of acquiring the mortgaged properties generally is less costly and less time consuming than the judicial method. Greater use of the power-of-sale foreclosure method for terminating defaulted HUD-insured, VA-guaranteed, and VA-financed loans would reduce the foreclosure costs incurred by the Government and by mortgagees and would enable HUD and VA to pay mortgagees' claims sooner.

AGENCY COMMENTS AND OUR EVALUATION

In our draft report we suggested that HUD and VA propose legislation to preempt State foreclosure laws with a Federal power-of-sale foreclosure law for federally financed, insured, and guaranteed loans. This legislation would incorporate, to the extent practicable, the cost and time-saving features of the power-of-sale foreclosure method now used by certain States.

Both HUD and VA stated that they were in general accord with our suggestion. (See apps. III and IV.) HUD pointed out, however, that a Federal power-of-sale foreclosure law could not be applied to existing mortgage contracts which comply with the laws of the individual States. HUD stated also that opposition to Federal power-of-sale foreclosure legislation would come from those States which give mortgagors a period of time to redeem defaulted loans or from those States and localities where the courts are overwhelmingly solicitous of mortgagors' rights and where the courts require that a personal or written notice of a pending foreclosure be given the mortgagor (A power-of-sale foreclosure is by publication and does not require a personal or written notice.)

Although existing federally financed, insured or guaranteed home mortgage loans would not be affected by the provisions of a Federal power-of-sale foreclosure law, the cost and time-saving features of such a law would be beneficial to HUD and VA in future home mortgage operations.

Mortgagors should be given the same degree of protection that they are given under existing foreclosure laws. Although experience has shown that defaulting mortgagors generally do not exercise the right of redemption, this right is a provision of State laws which perhaps should be included in a Federal power-of-sale foreclosure law.

When initiating a foreclosure in a power-of-sale foreclosure State, HUD gives the mortgagor a written notice of the initiation of foreclosure and of his rights to bring the mortgage current within a specified period of time. We believe any Federal power-of-sale foreclosure law should include similar requirements to protect the rights of mortgagors.

We do not advocate that a Federal power-of-sale foreclosure law be used indiscriminately; however, when a determination is made that a mortgagor will not or cannot make the necessary payments to bring a loan current and when no other recourse is available except foreclosure, the power-of-sale foreclosure method would be the most economical means of terminating the mortgagor's interest in the property.

HUD further stated that the Civil Division of the Department of Justice has under consideration legislation for establishing a Federal foreclosure law which, if enacted, could accomplish the objectives of our proposal. HUD suggested that HUD and VA could either (1) recommend that the Department of Justice proceed as expeditiously as possible in proposing this legislation or (2) seek legislation on their own.

VA expressed the view that any Federal foreclosure legislation should be initiated by the Department of Justice because agencies other than HUD and VA are also involved in the financing, insuring, and guaranteeing of loans which are secured by mortgages on real estate.

The Civil Division of the Department of Justice told us, however, that the legislation which it has under consideration would provide a Federal power-of-sale foreclosure law for mortgage loans only held by the Government and not for mortgage loans which are insured or guaranteed by the Government. We believe that legislation should be enacted which would provide a Federal power-of-sale foreclosure law for all federally financed, insured, and guaranteed home mortgage loans.

RECOMMENDATION TO THE CONGRESS

We recommend that the Congress enact legislation which would establish a Federal power-of-sale foreclosure law for all federally financed, insured, or guaranteed home mortgage loans.

CHAPTER 3

BENEFITS AVAILABLE BY ACQUIRING MORE PROPERTIES

BY VOLUNTARY DEED

When a loan is in default, the mortgagor frequently is willing to voluntarily deed the property securing the loan to the mortgagee for full satisfaction of the loan. This method of acquiring property which secures defaulted loans usually takes less time and is less costly than the foreclosure methods discussed in the previous chapter; therefore it is more beneficial to the Government, the mortgagee, and the mortgagor.

Mortgagees generally terminate defaulted HUD-insured and VA-guaranteed loans and acquire the mortgaged properties by foreclosure, rather than by voluntary deed, because neither HUD nor VA encourages the use of voluntary deeds. In five States included in our review, title to only about 7 percent of the properties acquired on defaulted HUD-insured and VA-guaranteed home loans had been obtained by voluntary deeds in fiscal year 1970. In comparison, VA offices in these same five States obtained title by voluntary deed to about 27 percent of the properties acquired on defaulted VA-financed loans.

We estimate that mortgagees, the seven HUD offices, and four of the six VA offices included in our review could have saved about \$530,000 in fiscal year 1970 if they had made greater use of voluntary deeds to acquire properties securing defaulted insured or guaranteed loans. The properties acquired by these HUD and VA offices represented less than 20 percent of all the properties acquired on defaulted HUD-insured and VA-guaranteed loans; therefore, on a nationwide basis, greater use of the voluntary deed method to terminate defaulted loans could result in substantial savings to the Government and to mortgagees.

Mortgagors would also benefit from greater use of voluntary deeds because they would not have foreclosures shown against them on the public records. In addition, VA's acceptance of voluntary deeds precludes it from assessing

indebtedness claims against the mortgagors. Even though VA attempts to collect such claims when foreclosure actions are taken against mortgagors, the amount of VA's collections have been less than the amount it could have saved by accepting voluntary deeds.

COMPARISON OF COSTS INCURRED AND TIME
REQUIRED TO TERMINATE A DEFAULTED LOAN
BY FORECLOSURE AND BY VOLUNTARY DEED

Using a voluntary deed to terminate a defaulted loan and to acquire the mortgaged property eliminates court and publication costs and sheriff and filing fees and substantially reduces legal and recording fees generally incurred in terminating defaulted loans by foreclosure. Moreover, the average time required to terminate a defaulted loan by voluntary deed is usually less than the time required to terminate a loan by foreclosure. Because the insurance or guaranty payment to a mortgagee under the HUD and VA programs includes property acquisition costs and interest on the unpaid loan balance during the termination period, reducing the loan termination time would result in reducing the interest to be paid by HUD or VA.

At the seven HUD offices and at four of the six VA offices included in our review, the average cost, including interest, to terminate a HUD-insured or VA-guaranteed loan and to acquire the mortgaged property by voluntary deed was from \$15 to \$755 less than the average cost to terminate a loan and to acquire the property by foreclosure in fiscal year 1970. Two VA offices did not acquire any properties securing defaulted guaranteed loans by voluntary deed during fiscal year 1970. At nine offices the acquisitions by voluntary deed required an average of 46 to 285 days less than the acquisitions by foreclosure. Acquisitions by voluntary deed at the other two offices averaged 33 days more than acquisitions by foreclosure, but the additional interest paid on the insurance or guaranty claims for the increased acquisition time was more than offset by the savings realized by eliminating or reducing other foreclosure costs.

The following table compares the average cost incurred, including interest, and the average time required for acquiring properties by foreclosure and by voluntary deed for fiscal year 1970.

| | <u>Foreclosure</u> | | <u>Voluntary deed</u> | | Amount foreclosure exceeds voluntary deed | |
|------------------------|-------------------------|------------------------------------|-------------------------|------------------------------------|---|------------------------|
| | <u>Average cost</u> | <u>Average time (days)</u> | <u>Average cost</u> | <u>Average time (days)</u> | <u>Cost</u> | <u>Time (days)</u> |
| HUD, Birmingham, Ala. | \$ 464 | 151 | \$449 | 184 | \$ 15 | -33 |
| VA, Montgomery, Ala. | 526 | 188 | (a) | (a) | (a) | (a) |
| HUD, Jacksonville, Fla | 652 | 189 | 331 | 129 | 321 | 60 |
| VA, Jacksonville, Fla | 927 | 307 | 293 | 167 | 634 | 140 |
| HUD, Tampa, Fla | 723 | 196 | 484 | 150 | 239 | 46 |
| HUD, Detroit, Mich | 888 | 398 | 344 | 145 | 544 | 253 |
| VA, Detroit, Mich. | 648 | 272 | 569 | 305 | 79 | -33 |
| HUD, Camden, N.J | 1,014 | 325 | 633 | 237 | 381 | 88 |
| VA, Newark, N J. | 1,501 | 374 | 746 | 227 | 755 | 147 |
| HUD, Cleveland, Ohio | 940 | 351 | 559 | 270 | 381 | 81 |
| VA, Cleveland, Ohio | 1,461 | 464 | 820 | 179 | 641 | 285 |
| HUD, Philadelphia, Pa. | 828 | 263 | 480 | 182 | 348 | 81 |
| VA, Philadelphia, Pa | 442 | 150 | (a) | (a) | (a) | (a) |

^aVA did not acquire any properties securing defaulted guaranteed loans by voluntary deed during fiscal year 1970.

HUD's 1968 analysis of the cost of acquiring 306 properties by voluntary deeds in 39 States showed that the cost, excluding interest, to acquire a property by voluntary deed was less than the cost, excluding interest, to acquire a property by foreclosure in all 39 States. The cost differences ranged from \$6 in Alabama to \$568 in New York. (See app. I.)

VARIATIONS IN POLICIES AND PRACTICES
FOR OBTAINING VOLUNTARY DEEDS

The use of voluntary deeds to terminate defaulted HUD-insured, VA-guaranteed, and VA-financed loans and to acquire the mortgaged properties varied significantly within the offices included in our review and within the same States and geographical areas. Our review showed that the success an office had in obtaining voluntary deeds was due primarily to the agency's policies and the individual office's practices concerning this method of acquiring property.

VA's policy for terminating defaulted VA-financed loans encourages the use of voluntary deeds, in lieu of foreclosures, to acquire mortgaged properties. Our review in six States showed that, except in Alabama, the VA offices used this method to acquire about 27 percent of the 793 properties securing defaulted VA-financed loans. The percentages for individual offices ranged from about 19 percent at the office in Florida to about 56 percent at the office in New Jersey. The Alabama VA office did not use this method because the cost to terminate a loan and to acquire the mortgaged property by foreclosure was about the same as by voluntary deed. (See table on p. 18 and app. I.)

In attempting to obtain voluntary deeds to properties securing defaulted VA-financed loans, VA representatives make personal and letter contacts to inform mortgagors of the advantages to them when property is voluntarily deeded, such as not having foreclosures shown on public records and eliminating the possibility of legal debts. In New Jersey and Pennsylvania, the VA offices generally paid property liens, or induced lien holders to release liens without payment, to clear the title so that the property could be acquired by voluntary deed.

The U.S. attorney in Ohio required the VA office to furnish justification of why it had not acquired the property securing a defaulted VA-financed loan by voluntary deed. This requirement applied to all such loans referred to the U.S. attorney for foreclosure.

VA and HUD policies permit mortgagees to terminate defaulted VA-guaranteed or HUD-insured loans and to acquire

the properties by voluntary deeds, but VA and HUD instructions to mortgagees do not encourage mortgagees to use this method as a means of reducing property acquisition costs. For example, HUD instructions do not stress the cost savings to mortgagees and to HUD from accepting voluntary deeds. VA instructions state that it usually would be in the best interest of VA for a mortgagee to accept a voluntary deed when this method of terminating a defaulted loan results in considerable savings in property acquisition costs and when the possibility of collection of a debt¹ from the mortgagor is remote; however, the instructions do not provide mortgagees with any cost or debt collection data to determine whether acceptance of a voluntary deed would be in the best interest of VA.

In August 1970 a VA study showed that the average debt established against VA mortgagors was about \$1,100 and that the net collection amounted to about \$220. Our review showed, however, that at four VA offices the cost of terminating loans by voluntary deed averaged about \$565 less than the cost of terminating loans by foreclosure. We believe loan termination cost and debt collection data on a State-by-State basis should be provided to mortgagees to better enable them to determine when voluntary deeds should be obtained.

Most of the mortgagees' representatives we interviewed considered termination of loans by voluntary deed only when a mortgagor offered to terminate his defaulted loan by this method. Some mortgagees told us that they would not accept voluntary deeds to mortgaged properties. As a result, mortgagees obtained voluntary deeds to only about 7 percent of the 7,677 properties securing defaulted HUD-insured and VA-guaranteed loans in the five States where VA obtained voluntary deeds to about 27 percent of the properties securing defaulted VA-financed loans. Voluntary deed acquisitions by the mortgagees ranged from zero at the VA office in Pennsylvania to about 20 percent at the VA office in Ohio.

¹VA establishes a debt against mortgagors when the unpaid loan balance, including acquisition cost and interest, exceeds the appraised value of the property at time of foreclosure.

Appendix II shows, for each of the 13 HUD and VA offices included in our review, the number of properties acquired by type of loan and the number and percentage of these properties acquired by voluntary deed during fiscal year 1970.

BENEFITS AVAILABLE FROM
GREATER USE OF VOLUNTARY DEEDS

We estimate that mortgagees, the seven HUD offices, and four of the six VA offices included in our review could have saved about \$530,000 if they had obtained voluntary deeds for 27 percent of the properties acquired as a result of defaults on insured or guaranteed loans during fiscal year 1970.

Savings at the HUD offices would have amounted to about \$426,000, of which \$284,000 would have been realized by HUD and \$142,000 by the mortgagees. Mortgagees would have realized savings because, under HUD's policy for paying insurance claims, one-third of the total cost of terminating a defaulted loan must be borne by the mortgagee. Savings at four VA offices would have amounted to about \$104,000, which takes into consideration the income which VA would have lost from debt collections.

The properties acquired by the seven HUD and four VA offices on defaulted insured or guaranteed loans during fiscal year 1970 represented about 20 percent of all properties acquired by HUD and VA during fiscal year 1970. Therefore, on a nationwide basis, substantial savings could be realized by the Government and by mortgagees through greater use of voluntary deeds.

CONCLUSIONS

The voluntary deed method of terminating defaulted loans and acquiring mortgaged properties is less costly to the Government and to mortgagees than foreclosure by either the judicial or power-of-sale method. The voluntary deed method also benefits mortgagors because they are released from liabilities for debts and foreclosures do not appear against them on the public records. However, our review showed that mortgagees generally do not attempt to obtain voluntary deeds to properties securing defaulted HUD-insured and VA-guaranteed loans because HUD and VA do not encourage the use of this method of terminating defaulted loans as a means of reducing property acquisition costs.

AGENCY COMMENTS AND OUR EVALUATION

HUD stated (see app. III) that it had advised mortgagees on numerous occasions of their responsibility to attempt to obtain voluntary deeds and of the financial advantages to both mortgagees and HUD from this method of acquiring properties securing defaulted loans. HUD stated also that it supported new initiatives to encourage mortgagees to accept voluntary deeds and that it would consider several financial incentives to encourage mortgagees to cooperate.

HUD stated that it also must be cognizant of the possible counterproductive effects of a liberal voluntary deed policy because many mortgagees believe that increased emphasis on obtaining voluntary deeds encourages mortgagors to prematurely abandon their contractual obligations, which results in unnecessary loan defaults and in increased property acquisitions. HUD indicated that mortgagors tend to try a little harder to overcome temporary financial difficulties if faced with a real threat of foreclosure. HUD stated also that dollar savings on individual cases should not be permitted to overshadow the possible long-range effects on costs due to increased property acquisitions.

VA, in commenting on our draft report (see app. IV), stated that its policy provided for the acceptance of voluntary deeds to mortgaged properties when it was in the interest of the Government to do so. VA stated also that an extensive and substantial explanation of its policy was

contained in the "Lenders Handbook" which had been widely distributed to lenders participating in the program.

We do not advocate the wholesale use of voluntary deeds as a substitute for mortgage foreclosures. We do believe, however, that when prudent mortgage servicing fails to cure a defaulted loan and the only recourse is to terminate the loan, a reasonable attempt should be made to obtain a voluntary deed if this method of loan termination is less costly than foreclosure.

Although HUD stated that it would consider using financial incentives to encourage mortgagees to obtain a greater number of voluntary deeds, HUD should provide mortgagees with data on loan termination costs to enable them to determine when voluntary deeds should be obtained and should require mortgagees to furnish justifications when voluntary deeds are not obtained.

Although VA's Lenders Handbook provides mortgagees with general criteria to determine when it is in the best interest of VA to accept voluntary deeds to property securing defaulted VA-guaranteed loans, we found that, in four States where mortgagees generally did not attempt to obtain voluntary deeds, the savings in property acquisition costs from use of voluntary deeds in lieu of foreclosure more than offset the average net debt collections resulting from loan foreclosures.

We believe that there may be a number of other States where the savings to VA from accepting voluntary deeds would be greater than its average net collections on debts.

VA should provide mortgagees with data on loan termination costs and debt collections so that they are better able to determine when it is in the best interest of VA to accept voluntary deeds and should require mortgagees to furnish justifications when voluntary deeds are not obtained.

RECOMMENDATIONS TO THE SECRETARY OF HUD
AND THE ADMINISTRATOR OF VETERANS AFFAIRS

We recommend that HUD provide mortgagees with data on loan termination costs to enable them to determine when they

should attempt to obtain voluntary deeds to properties securing defaulted loans and require mortgagees to furnish justifications for foreclosing mortgages instead of accepting voluntary deeds.

We recommend that VA provide mortgagees with data on loan termination costs and debt collections so that they are better able to determine when they should attempt to obtain voluntary deeds to properties securing defaulted loans and require mortgagees to furnish justifications for foreclosing mortgages instead of accepting voluntary deeds.

CHAPTER 4

SAVINGS AVAILABLE TO VA BY ADOPTING

HUD'S POLICY FOR PAYING MORTGAGEES' CLAIMS

Our analysis of HUD and VA policies for paying mortgagees' claims for loan termination and mortgaged property conveyance costs showed significant differences. Had the six VA offices included in our review followed the HUD policy, the costs under the guaranty program could have been reduced by about \$580,000 during fiscal year 1970. These six offices acquired only 24 percent of all the properties VA acquired under the guaranty program during fiscal year 1970; therefore, nationwide, VA could realize substantial savings by adopting HUD's policy for paying mortgagees' claims.

DIFFERENCES IN HUD AND VA POLICIES FOR PAYING CLAIMS

HUD loan insurance and VA loan guaranty programs are similar in that each protects mortgagees against losses arising from mortgagors' defaults on loans. When a mortgagor defaults on either a HUD-insured or VA-guaranteed loan, the mortgagee acquires the property securing the loan and usually conveys the property title to the insuring or guaranteeing agency in exchange for settlement of the mortgagee's claim.

Following is a comparison of the two agencies' policies for claim payments to mortgagees.

VA

HUD¹

- Pays the unpaid loan balance, including funds advanced by the mortgagee for taxes and insurance, in exchange for title to the property. However, if the property securing the loan has declined in value to the extent that it would be to the Government's financial advantage, VA can pay 60 percent of the unpaid loan balance, not to exceed \$12,500, and allow the mortgagee to retain the property.
 - Pays the mortgagee for all "reasonable costs" incurred in terminating the loan and in conveying the mortgaged property to VA except that attorney fees are limited to the lesser of \$250 or 10 percent of the amount of the outstanding debt.
 - Pays interest at the loan contract rate
 - on the unpaid loan balance from the effective date of the mortgagor's last payment to the end of the foreclosure period,
 - on funds advanced for taxes and insurance from the date of the advance to the end of the foreclosure period, but
 - not on costs incurred in terminating the loan and in conveying the mortgaged property to VA
 - Pays the claim after the loan has been terminated and after the mortgagee's claim has been submitted to, and approved by, VA
 - Accepts title to property that is occupied or damaged and will accept title at the end of the foreclosure period even though the redemption period has not expired
- Pays the unpaid loan balance, including funds advanced by the mortgagee for taxes and insurance, in exchange for title to the property.
 - Pays the mortgagee the greater of \$75 or two-thirds of the actual costs incurred, including reasonable attorney fees in terminating the loan and conveying the mortgaged property to HUD
 - Pays interest, at the debenture interest rate² in effect at the time the loan was made, on
 - the unpaid loan balance from the loan default date, which is 60 days after the effective date of the last payment, through the claim settlement date,
 - funds advanced for taxes and insurance from the loan default date through the claim settlement date, and
 - costs incurred in terminating the loan and in conveying the mortgaged property to HUD from loan default date through the claim settlement date
 - Pays 90 percent of the unpaid loan balance, plus interest thereon, immediately upon receipt of the claim which is submitted when the deed to HUD is recorded. The remaining claim payment is made after the mortgagee's final claim has been submitted to, and approved by, HUD
 - Does not accept title to property unless it is vacant and free from fire, earthquake, flood, and tornado damages, and will not accept title until the redemption period has expired, except in Alabama

¹Claim payment policy applicable to HUD's basic home loan insurance program (section 203)

²The debenture interest rate is computed by the Treasury Department and is about the same rate as that paid on Government bonds

The following example shows the amount paid by VA's Florida office on a mortgagee's claim and the amount it would have paid under the HUD policy.

| | <u>Paid under VA</u> | <u>Payable under HUD</u> |
|----------------------------------|---------------------------|------------------------------|
| Unpaid loan balance | \$ 9,969.46 | \$ 9,969.46 |
| Advances for taxes and insurance | 67.72 | 67.72 |
| Foreclosure costs | 338.80 | 225.87 ^b |
| Interest | <u>482.72^a</u> | <u>242.06^b</u> |
| | <u>\$10,858.70</u> | <u>\$10,505.11</u> |

^aComputed at loan interest rate of 5-1/4 percent.

^bComputation of interest (at debenture rate of 4 percent) was based on the average time between default date and partial settlement date for 90 percent of the unpaid loan balance and between default date and final settlement date for the remaining balance and termination costs.

BENEFITS AVAILABLE TO VA AND MORTGAGEES
BY ADOPTING HUD'S POLICY FOR PAYING CLAIMS

Our review at the six VA offices showed that if the VA offices had paid mortgagees only two-thirds of their loan termination and property conveyance costs--the HUD payment basis--the office could have saved about \$271,000 during fiscal year 1970. In addition, if the VA offices had paid mortgagees interest on the unpaid loan balance, on funds advanced for payment of taxes and insurance, and on costs incurred to terminate the loan and to convey title to the mortgaged property to VA at the same rates and for the same periods as HUD, the offices could have additionally saved about \$380,000.

These estimated savings of about \$651,000 in loan termination and property conveyance costs and in interest would have been reduced by about \$71,000 because, under HUD's policy, VA would have paid mortgagees the total unpaid loan balances, whereas, under VA's policy, some mortgagees would have been paid less than the full amount of the unpaid loan balance. For example, due to a severe decline in real estate values in some areas of Philadelphia during fiscal year 1970, VA settled about 33 percent of its mortgagees' claims under the 60-percent-guaranty option. Our review showed, however, that, although severe declines in real estate values had resulted in a large number of claims being settled under the 60-percent-guaranty option in certain areas of the country, this option was not of particular significance on a nationwide basis: VA has exercised the 60-percent-guaranty option for less than 3 percent of the claims paid under the loan guaranty program.

Property acquisitions by the six VA offices included in our review totaled only about 24 percent of all VA property acquisitions during fiscal year 1970. Therefore, on a nationwide basis, VA could realize substantial savings by adopting HUD's policy for paying mortgagees' claims.

We discussed the differences between the HUD and VA claim payment policies with representatives of 16 mortgagees, located in five States, which were active in servicing HUD-insured and VA-guaranteed loans. The representatives were of the general opinion that a uniform policy similar to

HUD's would benefit mortgagees because VA's procedures for preparing and processing claims were more complicated and more time consuming than were HUD's procedures. Representatives of four mortgagees indicated that the disadvantages of VA's policy outweighed the financial advantages it offered mortgagees. Representatives of nine mortgagees did not express a preference for either policy but said that each policy had certain advantages and disadvantages.

Representatives of three mortgagees indicated a preference for VA's policy mainly because it provided for full payment of loan termination and property conveyance costs and for payment of interest at the loan contract rate for the entire foreclosure period.

We asked representatives of 11 mortgagees what effect a change in VA's policy would have on the participation of lenders in VA's loan guaranty program. None of the representatives thought that a change would have any effect on VA's loan guaranty program because the number of VA-guaranteed loans terminated for default is insignificant when compared with the number of VA-guaranteed loans. Representatives of several of the mortgagees said that when a mortgagee makes a loan it does not anticipate that the loan will be terminated for default; therefore mortgagees give little consideration, if any, to the policy under which their claims would be paid if the loans were terminated for default.

Our review showed that, of the more than 8 million home loans guaranteed by VA as of December 31, 1970, only about 3.6 percent had been terminated for default. This compares with HUD's basic loan insurance program (section 203) under which about 8.2 million home loans had been insured as of June 30, 1970, of which only 3.5 percent had been terminated for default.

CONCLUSIONS

HUD loan insurance and VA loan guaranty programs are similar, in that each protects mortgagees against losses on defaulted loans. The HUD and VA policies for paying mortgagees' claims for loan termination and property conveyance costs are, however, significantly different. By adopting

HUD's policy for paying mortgagees' claims, VA could reduce the costs under its guaranty program and could provide for uniformity in claim payment policies for insured and guaranteed home loan programs.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on our draft report, VA objected to adopting HUD's claim payment policy (see app. IV) because it believed that its claim payment and property acquisition arrangements made the VA-guaranteed loans an attractive investment. VA stated that its policy of allowing interest at the loan rate to the date of foreclosure also encouraged mortgagees to extend indulgence and forbearance to defaulting mortgagors.

HUD encourages mortgagees to extend indulgence and forbearance to mortgagors by requiring mortgagees to service HUD-insured loans in accordance with the accepted practices of prudent lending institutions and to foreclose loans only as a last resort. Mortgagees who do not properly service HUD-insured loans can be barred by HUD from further participation in the loan insurance programs. HUD's reimbursement policy, which requires mortgagees to pay one-third of the foreclosure costs, has had no apparent effect on mortgagee participation in the HUD loan insurance programs.

As pointed out on page 28, mortgagees' representatives informed us that a uniform policy similar to HUD's would benefit mortgagees because VA's procedures were more complicated and more time consuming than were HUD's. In addition, none of the mortgagees' representatives interviewed thought that VA's loan guaranty program would be affected by adopting HUD's policy, because the number of VA-guaranteed loans terminated for default was insignificant when compared with the total number of VA-guaranteed loans.

RECOMMENDATION TO THE ADMINISTRATOR OF VETERANS AFFAIRS

We recommend that VA adopt HUD's policy for paying mortgagees for costs involved in terminating defaulted loans and in conveying the mortgaged properties to VA.

CHAPTER 5

SAVINGS AVAILABLE TO HUD AND MORTGAGEES

BY NOT REQUIRING TITLE EVIDENCE

HUD could realize savings if it stopped requiring mortgagees to obtain title evidence--such as title insurance--to assure marketable titles to properties acquired by foreclosure. Our review showed that this practice could be stopped because HUD already obtains reasonable assurance of good and marketable titles to properties conveyed to them by mortgagees in exchange for insurance payments. Also, mortgagees would realize savings if HUD discontinued its requirement for additional title evidence, because mortgagees incur one-third of the title evidence costs under HUD's policy for paying claims.

If the seven HUD offices included in our review had not required the purchase of additional title evidence, we estimate that, during fiscal year 1970, HUD and the mortgagees could have saved about \$273,000. Property acquisitions by the seven HUD offices amounted to about 24 percent of all properties acquired by HUD during fiscal year 1970; therefore, on a nationwide basis, the savings to HUD and to mortgagees could be substantial.

GOOD MARKETABLE TITLE IS ASSURED WITHOUT ADDITIONAL TITLE EVIDENCE

At the time a HUD-insured or VA-guaranteed loan is made, the mortgagee obtains a title insurance policy for the property which secures the loan. This policy assures the mortgagee and HUD or VA that the title to the property was good and marketable at that time. Therefore, if HUD or VA should subsequently acquire the property because of default on the loan, a determination that the title is free of defects should be limited to the period between the date of the loan and the date of the termination of the loan by foreclosure. A foreclosure conducted properly in accordance with the laws of the State in which the property is located eliminates the interests of all parties who have recorded interests in the property during the mortgagor's ownership.

Under the judicial foreclosure method, each party who has an interest in the property must be named as a defendant in the foreclosure suit in order to be divested of his interest. To identify the interested parties, the mortgagee's attorney, depending on the State and the attorney's preference, may search the public records, review an abstract of the public records, or employ a title company to make the search and render a title or foreclosure report. The title search usually covers the period from the date of the original title insurance policy through completion of the foreclosure.

When a mortgaged property is acquired by the power-of-sale foreclosure method, the mortgagee's attorney does not have to identify each party with an interest in the property. To eliminate the title interest of all concerned parties, the mortgagee needs only to advertise and conduct the foreclosure sale in accordance with requirements established by State law. The foreclosure notice, which is usually advertised in the local newspaper or posted in a public place, gives the names of the mortgagor and mortgagee, describes the property and its location, and shows the amount of the unpaid loan and the date of the foreclosure sale.

Federal, State, and local tax liens and assessments may not be eliminated by foreclosure action; however, our review showed that HUD did not need to incur additional costs to determine if such liens or assessments existed. Some VA offices require the mortgagee, who is responsible for maintaining the tax account and paying the taxes, to furnish evidence that taxes are paid and that there are no State or local liens or assessments on the property. Also the Internal Revenue Service and VA have agreed that a search for Federal tax liens on a property at time of foreclosure is not necessary because VA has agreed to pay for any Federal tax lien against the property up to the amount that the value of the property exceeded the mortgagor's indebtedness.

Under HUD and VA regulations, mortgagees are responsible for providing HUD and VA with good and marketable titles to properties acquired by foreclosure and conveyed to them in exchange for the insurance or guaranty payments. If a mortgagee has conducted a proper foreclosure, including the identification of all parties with an interest in the

property in judicial foreclosure States, the successful bidder at the foreclosure sale, generally the mortgagee, is vested with a good and marketable title to the foreclosed property. When the mortgagee subsequently conveys the property to HUD or to VA, all the title evidence obtained for the property since the loan was originated is made available to HUD or to VA.

PURCHASE OF ADDITIONAL TITLE EVIDENCE
UNNECESSARY

Before title to an acquired property is accepted, HUD requires the mortgagee to obtain additional title evidence-- usually title insurance or an attorney's certificate of title--to insure that the foreclosure was properly executed and that all interests in the property were extinguished. Our review showed, however, that additional title evidence was unnecessary because the number of title defects in acquired properties was negligible.

In a report to the Congress¹ in June 1966, we pointed out that our examination into the need for VA to purchase title insurance before accepting titles to properties acquired in Florida showed that (1) title companies reported only 15 defects as a result of their title examinations on 343 selected properties acquired by VA, (2) none of the defects seriously affected titles to the properties, and (3) all of the defects were easily corrected by the mortgagees. VA stopped requiring title insurance for all its acquired properties and made the following statement concerning the risk it assumed.

"*** two decades of experience have clearly demonstrated that the number of titles found defective can be considered negligible when viewed in the light of the number of properties acquired during the same period. For this reason, and in view of the appreciable savings to be realized, assumption of the risk is warranted."

¹Report to the Congress on "Review of the Purchase of Title Insurance on Properties Acquired in the State of Florida Under the Loan Guaranty Program" (B-118660, June 1966).

SAVINGS BY NOT REQUIRING TITLE EVIDENCE

We estimate that, during fiscal year 1970, HUD and mortgagees could have saved about \$273,000 on properties acquired by the HUD offices included in our review if HUD had stopped requiring the purchase of additional title evidence on acquired properties. Because mortgagees pay one-third of the total cost of title evidence, HUD could have saved about \$182,000, and the mortgagees could have saved about \$91,000.

In Alabama, Michigan, Ohio, and Pennsylvania, mortgagees generally purchased title insurance policies on mortgaged properties acquired and conveyed to HUD. We estimate that the cost of the title insurance obtained in these four States during fiscal year 1970 was about \$194,000, of which \$129,000 was borne by HUD and \$65,000 by mortgagees.

In Florida and New Jersey, mortgagees generally obtained an attorney's certificate of title from the foreclosing attorney. Although the costs of the attorneys' certifications could not be determined because some attorney fees included charges for foreclosing the loan, we noted that, on the average, attorney fees in both of these States were more for HUD foreclosures than for VA foreclosures. We could not, however, determine how much of the difference was applicable to the purchase of additional title evidence because VA limits its payments for attorney fees to \$250 a property, whereas HUD does not limit attorney fees to specific amounts. However, if HUD had paid the same fees as VA for title evidence, the three HUD offices visited in these two States would have borne costs of about \$53,000 for title certifications, and the mortgagees would have borne costs of about \$26,000.

CONCLUSIONS

The purchase of additional title evidence on defaulted insured loans could be stopped because HUD receives from mortgagees reasonable assurance of good and marketable titles to the properties.

AGENCY COMMENTS AND OUR EVALUATION

HUD strongly objected (see app. III) to not requiring mortgagees to purchase title evidence for properties acquired by foreclosure because

- HUD would lack a proper foundation for conveying good and marketable titles to purchasers of HUD-acquired properties;
- there are many cases when foreclosures are faulty;
- title defects could be difficult and expensive to eliminate after the property has been sold by HUD and could delay subsequent sale of the property by the purchaser of the HUD-acquired property; and
- any defect, regardless of its significance, is a cloud on the title.

HUD stated that our reasoning that title evidence for acquired properties need not be obtained at the time of a mortgage foreclosure seemed to be based on the assumption that earlier title evidence, obtained by a mortgagee at the time the mortgage loan was made, would suffice as satisfactory title evidence at the time the mortgage was foreclosed and the property title was conveyed to HUD. HUD stated that there were many occurrences between the time a mortgage loan was made and the initiation of the mortgage foreclosure which could affect the validity of a foreclosure.

HUD said that the purchase of title evidence afforded HUD the best proof that the foreclosure of a mortgage was valid and that it had received a good and marketable title to the mortgaged property. Although HUD implied that additional title evidence on mortgaged properties acquired through the power-of-sale foreclosure method was not needed, HUD pays for two-thirds of the additional title evidence purchased by the mortgagee in all foreclosures, including power-of-sale foreclosures.

Our proposal that HUD stop requiring mortgagees to purchase additional title evidence at the time of a mortgage foreclosure was not based on the fact that the mortgagor had obtained title insurance when the mortgage loan was made but

rather on the requirement, similar to VA's, that mortgagees be responsible for conveying to HUD good and marketable titles to properties acquired by foreclosure. VA stopped obtaining title insurance several years ago because its experience showed that it generally received good titles to properties from mortgagees. We can perceive no reason why HUD should not expect the same quality of titles from mortgagees.

The risks of title defects in properties acquired as a result of mortgage foreclosures are minimal and the costs HUD is incurring for additional title evidence are unnecessary. The mortgagees should be held accountable for conducting proper mortgage foreclosures and for providing HUD with good and marketable titles to conveyed properties.

RECOMMENDATION TO THE SECRETARY OF HUD

We recommend that HUD stop requiring mortgagees to purchase additional title evidence for properties acquired by foreclosure and conveyed to HUD.

CHAPTER 6

SCOPE OF REVIEW

Our review was directed primarily toward identifying actions HUD and VA could take to minimize the cost, and reduce the time, of acquiring titles to properties securing defaulted home loans. The review was made at HUD headquarters and at the VA central office in Washington, D.C.; at the U.S. Attorney's Office in Jacksonville, Florida; and at 13 HUD and VA field offices in the following States.

| <u>States</u> | <u>HUD offices</u> | <u>VA offices</u> |
|---------------|-----------------------|-------------------|
| Alabama | Birmingham | Montgomery |
| Florida | Jacksonville Tampa | Jacksonville |
| Michigan | Detroit | Detroit |
| New Jersey | Camden | Newark |
| Ohio | Cleveland | Cleveland |
| Pennsylvania | Philadelphia | Philadelphia |

Our selection of field offices was based on a consideration of the types of foreclosure proceedings being used in the area served by the office, the amounts of foreclosure costs incurred, and the number of properties acquired. During the period of our review (fiscal year 1970), these offices acquired about 9,900, or 24 percent, of the 40,800 properties which HUD and VA acquired nationwide.

We reviewed applicable Federal and State laws and the HUD and VA policies and practices relating to (1) the termination of defaulted loans, (2) the transfer of property titles to the Government, and (3) the payment of mortgagees' claims under the VA guaranty and HUD insurance loan programs. We examined home loan statistics and various reports on loan termination costs at HUD headquarters and at the VA central office, and we obtained loan termination costs for at least 30 acquired properties in each field office visited.

We discussed with various HUD and VA officials the policies and practices for acquiring properties and for reimbursing mortgagees for claims made under the insurance

and guaranty programs. We also interviewed representatives of 27 mortgagees concerning their policies and practices for terminating HUD-insured and VA-guaranteed loans and for preparing and submitting claims under the two programs. In addition, we interviewed five private attorneys concerning State foreclosure laws and local practices.

APPENDIX I

COMPARISON OF AVERAGE COST TO TERMINATE DEFAULTED HUD- INSURED LOANS
BY FORECLOSURE AND VOLUNTARY DEED AND OF TIME REQUIRED BY HUD AND VA
TO OBTAIN TITLE TO PROPERTIES ACQUIRED BY FORECLOSURE

| Method of foreclosure | State | Average cost by (note a) | | Amount by which foreclosure cost exceeds voluntary deed cost | Time required to obtain title to property (in months) (note b) | |
|--------------------------|----------------------|-----------------------------|-------------------|---|---|----|
| | | Foreclosure | Voluntary deed | | HUD | VA |
| | | | | | | |
| Judicial | Arizona (d) | \$499 | \$213 | \$286 | 11 | 5 |
| | Delaware | 536 | 177 | 359 | 7 | 7 |
| | Florida | 418 | 176 | 242 | 6 | 6 |
| | Illinois (d) | 738 | 223 | 515 | 16 | 8 |
| | Indiana (d) | 526 | 216 | 310 | 11 | 11 |
| | Iowa (d) | 528 | 269 | 259 | 14 | 8 |
| | Kansas (d) | 468 | 51 | 417 | 23 | 5 |
| | Kentucky | 559 | 204 | 355 | 7 | 7 |
| | Louisiana | 323 | 298 | 25 | 4 | 4 |
| | Montana (d) | 718 | 166 | 555 | 19 | 5 |
| | Nebraska (d) | 399 | 140 | 259 | 18 | 18 |
| | New Jersey | 694 | 332 | 361 | 7 | 7 |
| | New Mexico (d) | 491 | 135 | 526 | 8 | 7 |
| | New York | 853 | 285 | 568 | 9 | 9 |
| | North Dakota (d) | 381 | (c) | | 17 | 5 |
| | Ohio | 517 | 177 | 340 | 9 | 9 |
| | Oklahoma | 455 | 137 | 318 | 7 | 7 |
| | Pennsylvania | 505 | 195 | 310 | 6 | 6 |
| | South Carolina | 382 | 113 | 270 | 6 | 6 |
| | Utah (d) | 430 | 118 | 312 | 10 | 4 |
| | Washington (d) | 559 | 133 | 426 | 19 | 7 |
| Power of sale | Alabama (d) | 196 | 190 | 6 | 2 | 2 |
| | Alaska | 530 | (c) | | 4 | 4 |
| | Arkansas | 355 | 117 | 238 | 6 | 6 |
| | California | 449 | 178 | 272 | 5 | 5 |
| | Colorado (d) | 497 | 114 | 383 | 5 | 3 |
| | District of Columbia | (c) | (c) | | 2 | 2 |
| | Georgia | 207 | 55 | 152 | 2 | 2 |
| | Hawaii | 627 | (c) | | 4 | 4 |
| | Idaho | 401 | 170 | 231 | 5 | 5 |
| | Maryland | 570 | (c) | | 4 | 4 |
| | Massachusetts | 528 | 117 | 411 | 7 | 7 |
| | Michigan (d) | 339 | 69 | 270 | 11 | 5 |
| | Minnesota (d) | 431 | 241 | 190 | 16 | 4 |
| | Mississippi | 204 | 69 | 135 | ? | 2 |
| | Missouri | 304 | 190 | 114 | 3 | 3 |
| | Nevada | 331 | 189 | 142 | 5 | 5 |
| | New Hampshire | 241 | (c) | | 3 | 3 |
| | North Carolina | 204 | (c) | | 3 | 3 |
| | Oregon | 580 | 222 | 358 | 5 | 5 |
| | Rhode Island | (c) | (c) | | 2 | 2 |
| | South Dakota (d) | 655 | 122 | 534 | 19 | 7 |
| | Tennessee | 266 | (c) | | 2 | 2 |
| | Texas | 165 | 117 | 48 | 2 | 2 |
| Virginia | 324 | (c) | | 3 | 3 | |
| West Virginia | 320 | 294 | 26 | 3 | 3 | |
| Wisconsin (d) | 612 | 195 | 418 | 16 | 4 | |
| Wyoming (d) | 500 | 77 | 423 | 11 | 2 | |
| Other | Connecticut | 760 | (c) | | 5 | 5 |
| | Maine (d) | 188 | 107 | 81 | 13 | 1 |
| | Vermont (d) | 503 | (c) | | 14 | 2 |

^aBased on a 1968 HUD analysis of mortgagees' costs which excluded HUD's payment for interest on these costs

^bThe time required represents the period from initiation of foreclosure to transfer of title to the Government and is based on a manual entitled "FHA-VA Foreclosure and Claim Procedures," published in 1967 by The Loan Administration Committee of the Mortgage Bankers Association of America

^cThese States were not included in HUD's analysis

^dThese States have redemption periods

APPENDIX II

PROPERTIES ACQUIRED BY FORECLOSURE AND VOLUNTARY DEED DURING FISCAL YEAR 1970

| State | Office | Properties acquired as a result of | | | | | | | | |
|--------------|---|---------------------------------------|--|--|---------------------------------------|-------------------|-----------------|---------------------------------------|-------------------|-----------------|
| | | Defaulted HUD-insured loans | | | Defaulted VA-guaranteed loans | | | Defaulted VA loans (note a) | | |
| | | By fore-closure and by voluntary deed | By voluntary deed | Percent by deed | By fore-closure and by voluntary deed | By voluntary deed | Percent by deed | By fore-closure and by voluntary deed | By voluntary deed | Percent by deed |
| Alabama | HUD, Birmingham VA, Montgomery | 550 - | 7 ^b - | 1 2 ^b - | - 265 | - - | - - | - 137 | - - | - - |
| Florida | HUD, Jacksonville HUD, Tampa VA, Jacksonville | 847 1,380 - | 21 ^c 160 ^c - | 2 5 ^c 11 6 ^c - | - - 427 | - - 22 | - - 5 2 | - - 481 | - 92 | - 18 9 |
| Michigan | HUD Detroit VA Detroit | 1,662 - | 63 ^c - | 3 8 ^c - | - 277 | - 15 | - 5 4 | - 26 | - 11 | - 44 0 |
| New Jersey | HUD, Camden VA, Newark | 328 - | 21 ^c - | 6 3 ^c - | - 586 | - 50 | - 8 5 | - 18 | - 10 | - 55 5 |
| Ohio | HUD, Cleveland VA Cleveland | 336 - | 32 ^c - | 9 4 ^c - | - 583 | - 116 | - 19 9 | - 249 | - 91 | - 36 6 |
| Pennsylvania | HUD, Philadelphia VA, Philadelphia | 1,073 - | 34 ^b - | 3 2 ^b - | - 178 | - - | - - | - 19 | - 9 | - 47 4 |

^a Does not include acquisition of 430 properties sold by VA under installment contracts

^b Based on the upper limits of confidence developed by statistical sampling

^c Based on statistical sampling at 95 percent confidence

BEST DOCUMENT AVAILABLE



DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D C 20413

APR 20 1972

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING MANAGEMENT

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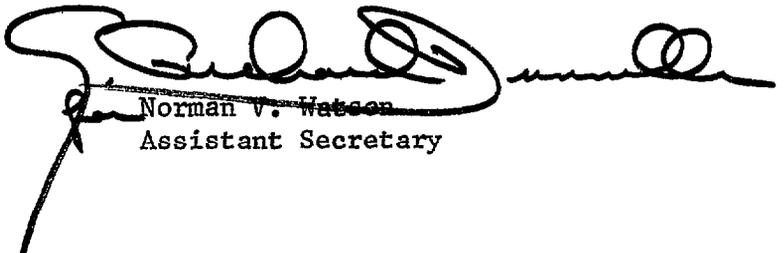
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Mr. B. E. Birkle
Associate Director, Resources &
Economic Development Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Birkle

The Secretary has asked me to respond to your letter of February 14, 1972, requesting the Department's comments on your draft of a proposed report to the Congress entitled "Opportunities to Reduce Acquisition Costs for Properties Acquired as a Result of Defaults on Home Loans."

The enclosed statement contains our comments on the material presented in the proposed report. We appreciate the opportunity to review the proposed report before it is presented to Congress.

Sincerely,



Norman V. Watson
Assistant Secretary

Enclosure

Copy

Statement By The
Department of Housing and Urban Development

GAO Draft Report to Congress

"Opportunities to Reduce Acquisition Costs for
Properties Acquired as a Result of Defaults on
Home Loans"

The GAO Draft Report contains two findings and conclusions which are applicable to HUD activities. The third finding and conclusion applies to the Veterans Administration adoption of HUD's policy of paying Mortgage Claims on defaulted loans.

Finding No. 1

Substantial savings could be achieved by HUD and VA from the increased use of the "power of sale" method of foreclosure or "voluntary deed" method of terminating HUD-insured, VA-guaranteed, and VA-financed loans.

The findings and conclusions recommend that HUD and VA propose legislation to preempt local foreclosure laws with a Federal power of sale foreclosure law for federally financed, insured and guaranteed loans. This poses problems which have been the subject of much discussion over the years. The Civil Division of the Department of Justice has currently under consideration a federal type foreclosure law which could accomplish, if passed by Congress, the objectives set forth in the report. It is agreed that HUD and VA could recommend that the Department proceed as expeditiously as possible in attempting to get legislation passed. In addition, HUD and VA could proceed on their own to attempt such legislation. It must be noted that if legislation is passed it could only be prospective in nature because of the fact that the provisions of mortgage contracts which have been entered into prior to the passing of legislation could not be negated by legislation on a retroactive basis. The HUD mortgages and mortgage notes for use in various states are currently developed so as to comply with the applicable laws of the individual states and these documents constitute the obligations of the mortgagors and mortgagees with respect to payment and foreclosure and all other rights surrounding the transaction. With this in mind, it would be necessary that new mortgages and mortgage notes be drawn by HUD to accomplish the objectives of any new law which would be passed by Congress.

It must also be pointed out that the pitfalls of such legislation would stem from the Congressional representatives of states which have consistently retained redemption rights on behalf of the mortgagors and states and localities wherein the courts are overwhelmingly solicitous of mortgagors' rights insofar as mortgage

APPENDIX III

foreclosures are concerned. For example, in the State of Florida the courts require that a mortgagor be fully protected in mortgage foreclosures. The Department has no objections and, in fact, welcomes complete protection of the mortgagor, however, a power of sale foreclosure obviously does not afford this type of protection since foreclosure is by publication and does not necessarily include direct written advice to the mortgagor that foreclosure is being instituted.

When HUD institutes foreclosure in the power of sale states, we forward a letter to the mortgagor at his last known address advising him of the initiation of foreclosure and of his right to bring the mortgage current within a certain period of time. We have found that this procedure is questioned by some Judges in many strict foreclosure states and they require an actual contact with the mortgagor and an appraisal of the property which will reflect whether or not a mortgagor has obtained any equity as a result of an enhancement in value. This demand on the part of the courts is made even though a deficiency judgment is not requested in the foreclosure proceeding.

The main purpose of this discussion is, of course, to advise of the possible deterring factors which would occur in obtaining Congressional approval of the suggested legislation. The Department is in general accord with the suggestion concerning the proposal of the federal power of sale type foreclosure law subject to the knowledge that the foregoing matters must be dealt with in obtaining such legislation.

The second part of this finding pertains to the issuance of appropriate guidelines and instructions which would encourage greater use of the deed in lieu of foreclosure activity with respect to acquisition of properties after default has occurred. The Department has published numerous circulars and mortgagee letters advising mortgagees that it is their responsibility to attempt to obtain a deed in lieu of foreclosure rather than accomplish a foreclosure action in cases involving defaulted mortgages. These circulars have advised mortgagees that the obtaining of a deed in lieu of foreclosure would minimize the acquisition costs of the mortgagee and HUD.

It has been pointed out to mortgagees that the costs of a deed in lieu of foreclosure are generally lower and the acceptance of the property by deed requires much less time to complete property acquisition than that consummed by a foreclosure action. The mortgagees are aware that two-thirds of the acquisition and conveyance costs are paid for by HUD under the mortgage insurance contract and one-third of such costs must be borne by the mortgagee.

APPENDIX III

A deed in lieu of foreclosure lowers the overall cost structure of property acquisition and, therefore, lowers the cost which must be borne by a mortgagee in any specific case. The main time savings to the Secretary is, of course, in the length of time the property has to be held by HUD prior to a sale by the Secretary. This retention is costly and the cost approximation per property is in the vicinity of \$4 per day.

We support new initiatives to encourage mortgagees to accept voluntary deeds in lieu of foreclosure. We could modify our existing regulations to pay full interest at the contract rate of the mortgage from the time of default until the time the deed is executed and the title is transferred to the mortgagee. We can also pay all of the costs incurred by the mortgagee for this process instead of the current two-thirds. To the extent these financial incentives would be less than our acquisition and resale costs, then, the insurance funds would benefit. By statutory change, we could also offer a negative incentive by decreasing the two-thirds share of foreclosure costs which HUD now pays to one-half. This package of incentives would discourage foreclosure and encourage voluntary deeds. Whether or not we take these steps depends upon the cost benefits they would produce.

We must also be cognizant of possible counterproductive effects of a liberal deed-in-lieu policy. Many mortgagees believe that increased emphasis on voluntary deeds encourages mortgagors to prematurely bail out of their contractual obligations resulting in unnecessary defaults and increased acquisitions. There can be little doubt that many mortgagors capable of overcoming temporary financial difficulties tend to try a little harder if faced with a real threat of foreclosure. Dollar savings on individual cases should not be permitted to over-shadow the possible long-range effects on costs due to increased acquisitions resulting from an easy deed-in-lieu policy.

[See GAO note]

It is our opinion that adequate attempts have been made to encourage greater use of the deed in lieu of foreclosure proceeding in deserving cases. Additional attempts will be made along the lines discussed herein.

[See GAO note.]

GAO note Deleted comments relate to matters which were presented in the draft report but which have been revised or omitted from the final report.

[See GAO note, p. 44.]

Finding No. 2.

HUD and VA relying on title evidence provided by mortgagees for properties acquired as a result of foreclosure of defaulted loans.

A review of the material set forth in the report consistently reflects the statement that "the purchase of additional title evidence and the making of title reviews could be discontinued because HUD and VA obtain reasonable assurances of a good and marketable title from mortgagees when property is conveyed to them in exchange for insurance or guaranty payments " The underlying factor mentioned in this part of the report erroneously assumes that foreclosure action will insure that good and marketable title can be conveyed to the Secretary by the mortgagee and submission of the mortgagee's title evidence obtained at the initiation of the mortgage will suffice as satisfactory evidence of title when the property is conveyed to the Secretary It is our opinion that there is a misunderstanding on the part of GAO with respect to the legal implications of title evidence obtained by the mortgagee at time of loan closing and title evidence obtained by the Secretary at the time the property is conveyed to the Secretary in exchange for insurance benefits.

The title evidence obtained by the mortgagee at loan closing generally consists of a mortgagee's title policy or attorney's certificate of title. This evidence guarantees that the mortgage entered into between the mortgagor and mortgagee is a good and valid first mortgage on the property and that there are no prior liens which could prime the mortgage. It is on this basis that the mortgagee is assured that it is completely protected insofar as the mortgage funds are concerned. They have a right to rely on protection in this regard since title to the property is in the mortgagor and the mortgagee can only acquire title through foreclosure or deed in lieu of foreclosure and must look to the repayment in accordance with the terms of the mortgage to recover its investment in the mortgage.

Between the period of time of loan closing and the initiation of foreclosure, there are numerous occurrences which could affect the validity of a foreclosure It is with this in mind that the mortgagee must ascertain that all proper defendants have been named in a foreclosure action not involving power of sale foreclosures This requires a foreclosure search of existing land records prior to the initiation of foreclosure. Any errors in this search will result in a foreclosure which does not result in acquiring good and marketable title in the property. The foreclosure search must be accomplished in any event and the resulting

APPENDIX III

owner's title policy or attorney's certificate which is issued to the Secretary is issued after the foreclosure has been completed and guarantees that the foreclosure is valid and that the Secretary acquires good and marketable title to the property that is being conveyed in exchange for insurance benefits. In view of this, it is obviously erroneous to assert that the title evidence in possession of the mortgagee reflecting the status of title at the time of loan closing would sufficiently protect the Secretary at the time he acquires the property pursuant to the insurance contract. Practical experience has shown that there are many cases where foreclosure has been faulty and to have accepted the property without adequate title evidence would have obviously embarrassed the Secretary and would have necessitated unnecessary expenditures of government funds to resolve the problems, in connection with such conveyance.

An additional problem, and not the least important problem, posed by the procedure suggested in the report is the matter of disposal of Secretary-acquired properties. As you know, the Secretary now assumes the responsibility under Section 203.390 of the HUD regulations of guaranteeing good and marketable title in the purchaser and guaranteeing a good and valid first mortgage in the mortgagee at the time the property is conveyed to a new purchaser. At the closing of this sale, there is no run-down of title evidence and the Secretary relies on the title evidence submitted by the mortgagee, which forms the basis for the Secretary's guarantee to the new mortgagee and new owner. Without the obtaining of this title evidence from the mortgagee guaranteeing title up to and including the deed into the Secretary, the Secretary would not have a proper foundation for his assumption of responsibility to the new mortgagee and new property owner. Without such title evidence a resulting crucial problem would arise when the new property owner later sells the property. It would be at that time, that title defects could be uncovered and the Secretary would then be called upon to eliminate such defects, with months or possibly years intervening between the sale to the Secretary's buyer and that buyer's sale to his purchaser. In addition, additional liens could be placed of record which would further complicate the title problem.

The major point, however, is that the purchaser of the property from the Secretary is precluded from selling the property because of a defect in title which should have been discovered at the time the Secretary acquired the property from the mortgagee as a result of the original HUD insurance transaction. There have been very few cases of this nature and it is only because of the fact that the title evidence has been obtained insuring good and marketable title in the Secretary that we have been able to surmount the

problems caused by the irate mortgagor unable to dispose of his property. We have received superior assistance from title companies and attorneys in this regard and it is only through their efforts that we have been successful in our endeavors to assist the purchasers of HUD-acquired properties in these matters.

The above discussion reflects that the problems do not only apply to the acquisition of the property by the Secretary pursuant to the terms of the insurance contract but apply equally to the acquisition of the property by the purchasers from the Secretary and by any subsequent purchasers. It is in this area that the problems are compounded and become extremely complex and it is also in this area that the necessity of title evidence guaranteeing good and marketable title in the Secretary becomes equally mandatory.

The question concerning the necessity for the review of submitted title evidence to the Secretary is founded on an erroneous assumption that there must be a significant defect in order to have an impact on the examining attorneys' opinion of the submitted title evidence. This is in error for the same basic reasons given in the preceding paragraphs. Any defect in title is by its very nature a cloud on the title and should be removed, especially so when the Secretary of Housing and Urban Development is responsible for the conveyance of good and marketable title at the time the property is sold. Any attorney representing a future buyer of the property can raise a title defect question, no matter how insignificant, which will preclude the sale of the property unless this question is resolved. The postponing of sales closing obviously places the seller in the position of being unable to obtain sales proceeds in an expeditious manner.

The preventive action accomplished by the review of title evidence has indeed had a salutary effect on the Government's reputation and especially the reputation of the Secretary, in being able to represent that the Secretary in conveying a Secretary-owned property will convey good and marketable title. The review of submitted title evidence also has afforded the Secretary the protection of minimizing any problems confronting him with respect to such defects. The necessity of title review is unquestionable in our mind.

In this connection, even without waiver of the title requirement, we expect that title transfers to HUD will be less expensive as a result of the maximum settlement costs we will be establishing for houses purchased under HUD insured programs. The maximums should also be applied to costs incurred by mortgagees for gathering evidence of clear and marketable title before transferring it to HUD. Currently, two-thirds of these costs are paid by HUD and hence our costs will be reduced.

APPENDIX III

The long run solution to all of these costly processes is the simplification of the title registration and title conveyance processes themselves. It seems to us that the GAO report to Congress, as well as our own support of legislative initiatives, should address itself to the root causes of these costs. In this way, not only will necessary acquisition costs to HUD be reduced, but also the initial financial burden of buying a house will be alleviated for all families.

[See GAO note, p. 44.]



VETERANS ADMINISTRATION
 OFFICE OF THE ADMINISTRATOR OF VETERANS AFFAIRS
 WASHINGTON, D C 20420

APRIL 7 - 1972

Mr. Frank M. Mikus
 Assistant Director, Civil Division
 U. S. General Accounting Office
 Room 137, Lafayette Building
 Washington, D. C. 20420

Dear Mr. Mikus:

We have reviewed your draft report entitled "Opportunities to Reduce Acquisition Costs for Properties Acquired as a Result of Defaults on Home Loans," and have also had the opportunity to discuss the draft with your staff representatives.

We agree with the intent of the first recommendation "that HUD and VA propose legislation to preempt state foreclosure laws with Federal power of sale foreclosure law for federally financed, insured, and guaranteed loans,..", however, take exception to the agencies to which it is directed. It is our contention that such legislation should be recommended by the Department of Justice, since departments and agencies of the Government other than HUD and VA make, guarantee or insure, loans to private individuals where such loans are secured by mortgages on real estate.

In regard to the second recommendation to revise "applicable regulations and issue appropriate guidelines and instructions to encourage greater use of voluntary deed method of terminating loans and acquiring property securing defaulted loans," VA policy presently provides for the acceptance of voluntary deed method of terminating loans when it is in the interest of the Government to do so. Also, the Lenders Handbook (VA Pamphlet 26-7) contains an extensive and substantial explanation of the policy of the VA concerning the acceptance of deeds in lieu of foreclosure, and has been widely distributed to lenders and holders participating in the program.

We do not agree with the third recommendation "that VA adopt HUD's policies for paying mortgagees for (1) costs incurred in terminating defaulted loans and conveying the property securing the loans to the Government and (2) interest on these costs, on funds advanced for payment

APPENDIX IV

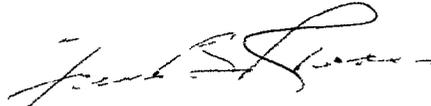
Mr. Frank M. Mikus
Assistant Director, Civil Division
U. S. General Accounting Office

of taxes and insurance, and on the unpaid loan balances." Our objection is based primarily on the intent and objectives behind the VA program as opposed to HUD's program. VA claim payment and property acquisition arrangements have been designed to make GI loans as attractive an investment as possible. Further, we encourage holders to extend indulgence and forbearance in defaulting obligees by allowing interest at the contract rate to the date of the foreclosure sale. We believe the GI Loan is a benefit to which the veteran is entitled and we are trusted with the responsibility of keeping him in his home if at all possible.

[See GAO note.]

Thank you for the opportunity to review this draft, and if you have any questions concerning our comments my staff will be available.

Sincerely,



FRED B. RHODES
Deputy Administrator

GAO note: Deleted comments relate to matters which were presented in the draft report but which have been revised or omitted from the final report.

PRINCIPAL OFFICIALS
RESPONSIBLE FOR THE ADMINISTRATION
OF ACTIVITIES DISCUSSED IN THIS REPORT

| | Tenure of office | |
|--|------------------|------------|
| | From | To |
| <u>DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</u> | | |
| SECRETARY OF HOUSING AND URBAN DEVELOPMENT: | | |
| George W. Romney | Jan. 1969 | Present |
| GENERAL COUNSEL: | | |
| Sherman Unger | June 1969 | Oct. 1970 |
| Norman C. Roettger, Jr. (acting) | Oct. 1970 | Nov. 1970 |
| David O. Maxwell | Nov. 1970 | Present |
| ASSISTANT SECRETARY FOR HOUSING PRODUCTION AND MORTGAGE CREDIT (formerly Assistant Secretary-Commissioner, Federal Housing Administration) (note a): | | |
| William B. Ross (acting) | Feb. 1969 | Sept. 1969 |
| Eugene Gullledge | Oct. 1969 | Feb. 1970 |
| ASSISTANT SECRETARY FOR HOUSING MANAGEMENT (formerly Assistant Secretary for Renewal and Housing Management): | | |
| Lawrence M. Cox | Feb. 1970 | July 1970 |
| Norman V. Watson | July 1970 | Present |
| ASSISTANT SECRETARY FOR ADMINISTRATION: | | |
| Lester P. Condon | Mar. 1969 | Jan. 1972 |
| Vincent J. Hearing (acting) | Jan. 1972 | Mar. 1972 |
| Harry T. Morley | Mar. 1972 | Present |

APPENDIX V

VETERANS ADMINISTRATIONADMINISTRATOR OF VETERANS AF-
FAIRS

| | | |
|--------------|-----------|---------|
| D C. Johnson | June 1969 | Present |
|--------------|-----------|---------|

DEPUTY ADMINISTRATOR OF VETERANS
AFFAIRS.

| | | |
|--------------|----------|---------|
| F. B. Rhodes | May 1969 | Present |
|--------------|----------|---------|

CHIEF BENEFITS DIRECTOR:

| | | |
|--------------|-----------|-----------|
| A. W. Farmer | Nov. 1967 | July 1969 |
| R. H. Wilson | July 1969 | Feb. 1970 |
| O. B. Owen | Feb. 1970 | Present |

DIRECTOR, LOAN GUARANTY SERVICE:

| | | |
|--------------|-----------|-----------|
| J. M. Dervan | Mar 1961 | Jan. 1972 |
| E. A. Echols | Jan. 1972 | Present |

^aEffective February 1970, the responsibility for acquisition of home properties securing defaulted mortgage loans was transferred to the Assistant Secretary for Housing Management.

Copies of this report are available from the U S General Accounting Office, Room 6417, 441 G Street, N W , Washington, D C , 20548

Copies are provided without charge to Members of Congress, congressional committee staff members, Government officials, members of the press, college libraries, faculty members and students. The price to the general public is \$1.00 a copy. Orders should be accompanied by cash or check.