United States Government Accountability Office

Report to Congressional Requesters

March 2021

HOME FORECLOSURE SALES

FHA, Rural Housing Service, and VA Could Better Align Program Metrics with Their Missions

Accessible Version

A Century of Non-Partisan Fact-Based Work

GAO-21-219

GAO Highlights

Highlights of GAO-21-219, a report to congressional requesters

March 2021

HOME FORECLOSURE SALES

FHA, Rural Housing Service, and VA Could Better Align Program Metrics with Their Missions

Why GAO Did This Study

Poor maintenance of foreclosed properties can negatively affect communities and threaten neighborhood stability. FHA, VA, RHS, and Freddie Mac are among the federal entities owning foreclosed properties through REO programs.

GAO was asked to review how these federal entities monitor REO property conditions. The objectives this report examines include trends in the number of REO properties; oversight of maintenance contractors; and whether metrics used to assess REO program performance align with entities' missions.

GAO reviewed and analyzed reports and data on the number of REO properties and documentation on FHA, Freddie Mac, VA, and RHS oversight of REO property maintenance from 2017 to 2020. GAO also analyzed data on REO reimbursements to contractors for maintenance activities.

What GAO Recommends

GAO recommends that FHA, VA, and RHS consider additional REO program metrics that measure how the programs support their respective missions of strengthening communities and serving veterans and rural homeowners. The entities generally agreed with the recommendation.

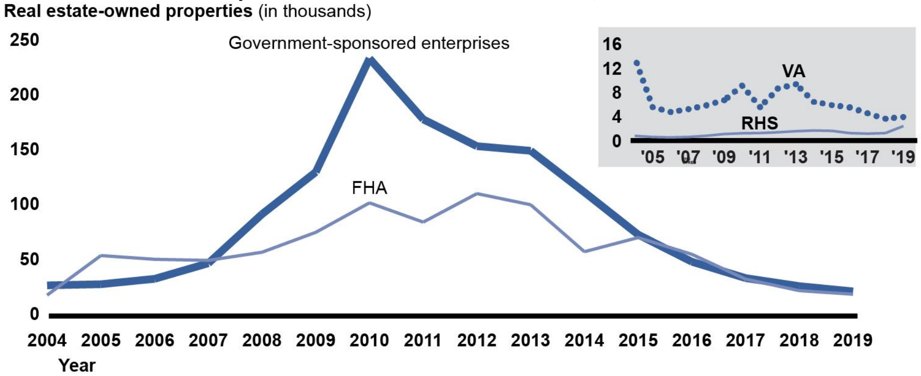
View GAO-21-219. For more information, contact John H. Pendleton at (202) 512-8678 or pendletonj@gao.gov.

What GAO Found

By 2019, the number of foreclosed properties—known as real estate-owned (REO) properties—that federal entities owned declined to historically low levels because of the housing market recovery and the sale of many of the properties (see figure).

Real Estate-Owned Properties of Selected Federal Entities, 2004–2019

Real estate-owned properties (in thousands)



Source: GAO analysis of Federal Housing Administration (FHA), Department of Veterans Affairs (VA), Rural Housing Service (RHS), Freddie Mac, and Fannie Mae data. | GAO-21-219

Data table for Real Estate-Owned Properties of Selected Federal Entities, 2004–2019

Year	FHA REO (calendar year)	Government-Sponsored-Enterprises (calendar year)	VA REO (fiscal year)	RHS REO (Fiscal year)
2004	19,106	27,983	15539	783
2005	55,143	29,021	7,288	587
2006	51,739	33,918	6,490	530
2007	50,761	48,132	6,975	591
2008	58,186	92,913	7,605	800
2009	76,323	131,275	8,464	1,082
2010	103,204	234,804	10835	1,209
2011	85,628	179,343	7,322	1,253
2012	111,625	154,871	10,400	1,375
2013	101,480	150,655	11,100	1,547
2014	58,664	112,893	8,180	1,667
2015	71,523	74,270	7,645	1,607
2016	56,279	49,524	7,273	1,239
2017	33,675	34,623	6,285	1,145
2018	23,158	27,272	5,365	1,238
2019	19,880	22,502	5,680	2,398

Note: Fannie Mae and Freddie Mac are the government-sponsored enterprises shown here. Data for the enterprises and FHA are calendar year; for VA and RHS, fiscal year ending September 30.

The entities GAO reviewed each have processes to oversee their REO maintenance contractors' activities and performance, including internal and external performance reviews and on-site inspections. Entities generally have standardized maintenance policies for REO properties across the country, such as emergency repairs for broken windows and routine maintenance requirements for the frequency of cutting grass. GAO found that the performance of contractors whose documentation GAO reviewed generally met entities' standards and requirements. However, entities' oversight of contractors identified instances of underperformance in maintenance. For instance, the Federal Housing Administration (FHA) recouped almost $3 million from seven property maintenance contractors for work below quality standards from 2017 to 2020.

The REO program metrics of FHA, the Department of Veterans Affairs (VA), and the Rural Housing Service (RHS) focus on required financial goals, such as minimizing losses, but do not always align fully with other program goals or agency missions. For example, FHA does not collect comprehensive information on REO property sales to public-sector homeowners or local nonprofits—missing an opportunity to measure the extent to which its REO program supports its goal to strengthen neighborhoods and communities. Similarly, VA and RHS lack metrics that would show whether their REO programs align with their broader agency missions to serve veterans and rural homebuyers, respectively. Incorporating additional metrics could help FHA, VA, and RHS ensure that their REO programs assist in meeting their agencies' missions.

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Abbreviations

COVID-19	Coronavirus Disease 2019
FHA	Federal Housing Administration
HUD	Department of Housing and Urban Development
NSP	Neighborhood Stabilization Program

OMB	Office of Management and Budget
REO	real estate-owned
RHS	Rural Housing Service
VA	Department of Veterans Affairs

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
A Century of Non-Partisan Fact-Based Work
441 G St. N.W.
Washington, DC 20548

March 5, 2021

The Honorable Carolyn B. Maloney
Chairwoman
Committee on Oversight and Reform
House of Representatives

The Honorable Mark DeSaulnier
House of Representatives

The large increase in foreclosed, abandoned, and vacant homeowner properties in the wake of the 2007–2009 financial crisis had a substantial negative impact on communities.[1] For instance, communities lacked the resources to address blight or had difficulty identifying and communicating with property owners on property conditions. When foreclosed properties are not sold, they often become the possessions of lenders or mortgage guarantors, which can be government or private entities. Such properties are known as real estate-owned (REO). Federal entities with REO properties include the Federal Housing Administration (FHA), Department of Veterans Affairs (VA), the Rural Housing Service (RHS) within the Department of Agriculture, and Fannie Mae and Freddie Mac (government-sponsored enterprises). Private entities include banks and nonbank mortgage servicers. We and others have reported on ways

[1]See GAO, *Mortgage Foreclosures: Additional Mortgage Servicer Actions Could Help Reduce the Frequency and Impact of Abandoned Foreclosures*, GAO-11-93 (Washington, D.C.: Nov. 15, 2010); and *Vacant Properties: Growing Number Increases Communities' Costs and Challenges*, GAO-12-34 (Washington, D.C.: Nov. 4, 2011).

federal entities could improve the oversight and effectiveness of their foreclosure mitigation and REO disposition programs.[2]

More recently, the Coronavirus Disease 2019 (COVID-19) pandemic has affected millions of homeowners with FHA- or VA-insured mortgages—including a large number of homeowners in lower-income communities and communities of color.[3] In recent months, FHA- and VA-insured properties have started to show greater negative impacts from the pandemic or higher rates of mortgage delinquency than other types of mortgages, potentially raising the risk of future increases in foreclosures and REO properties.

You asked us to review how federal entities monitor REO property conditions, including identifying any gaps in the process that could affect communities. This report examines (1) trends in the number of REO properties during 2004–2019 and reasons for the trends; (2) factors that affect federal entities' costs of maintaining REO properties; (3) federal entities' oversight of REO property maintenance; and (4) whether federal entities' performance goals and metrics for their REO programs align with entities' missions. We focused primarily on four federal entities because of the role they play in the mortgage market: FHA, Freddie Mac, VA, and RHS. We included Fannie Mae in our first objective looking at general changes in numbers of foreclosures and REO properties. However, we excluded Fannie Mae from our other three objectives because of active

[2]GAO, *Federal Housing Administration: Opportunities Exist to Improve Defaulted Single-Family Loan Sales*, GAO-19-228 (Washington, D.C.: July 3, 2019); *Federal Housing Administration: Improved Procedures and Assessment Could Increase Efficiency of Foreclosed Property Conveyances*, GAO-19-517 (Washington, D.C.: June 20, 2019); and *Federal Housing Administration: Improving Disposition and Oversight Practices May Increase Returns on Foreclosed Property Sales*, GAO-13-542 (Washington, D.C.: June 20, 2013). Also see Department of Housing and Urban Development, Office of Inspector General, *BLM Companies LLC Failed to Ensure That It Protected and Preserved HUD Properties Under Its Field Service Manager Contract for Area 1D*, 2017-FW-1011 (Fort Worth, Tex.: Aug. 29, 2017); *BLM Companies LLC, Hurricane, UT, Did Not Provide Property Preservation and Protection Services in Accordance with Its Contract with HUD and Its Own Requirements*, 2017-CH-1011 (Chicago, Ill.: Sept. 30, 2017); and *Evaluation of HUD's Management of Real Estate-Owned Properties*, IED-12-001R (Apr. 19, 2012).

[3]In response to the COVID-19 pandemic, Congress and federal entities extended mortgage forbearance and other assistance. Borrowers experiencing a financial hardship that negatively affects their ability to make on-time mortgage payments because of the COVID-19 pandemic may request forbearance from mortgage servicers. Such forbearance can provide more than 1 year of reduced or suspended payments.

litigation between Fannie Mae and the National Fair Housing Alliance on REO issues.[4]

To determine changes in federal entities' foreclosure and property volumes in 2004–2019, we reviewed annual reports to Congress and other public reports. We focused our work on REO single-family residential properties (1–4 unit properties) from 2004 through 2019—the most recent full year for which data were available. We started with 2004 to capture trends for the housing bubble and 2007–2011 housing crisis and for comparison with current conditions.[5]

To understand the causes of the changes observed in entities' foreclosure and property volumes and factors affecting costs, we interviewed agency officials, academics, and representatives of nonprofit organizations; analyzed entity policy and program guidance; and reviewed literature about foreclosures and vacant properties. We also evaluated data from the federal entities on property maintenance spending from 2017 to 2019 and visited the Atlanta metropolitan area to review properties in the entities' REO portfolios.[6] We assessed the reliability of the data by interviewing knowledgeable officials, reviewing related documentation, and performed data tests. In the few instances in which we identified potential errors, we followed up with the data provider to confirm or correct the data. Based on these actions, we determined the data were sufficiently reliable to report information on these reporting objectives.

To evaluate federal entities' oversight of REO property maintenance, we reviewed relevant laws and regulations; entities' contract monitoring requirements, policy, and guidance, and contracts with property maintenance contractors; and we interviewed entity officials and property preservation contractors. We also analyzed nongeneralizable samples of contractors' quality control documents, federal entities' inspection

[4]National Fair Housing Alliance Inc., et al. v. Federal National Mortgage Association, No. 16-cv-06969 (N.D. Cal., filed December 5, 2016).

[5]The housing crisis of 2007–2011 resulted in historic rates of mortgage defaults and foreclosures. We use the 2007–2011 date range to identify the housing crisis based on the S&P/Case Shiller National Home Price Index, according to which average home prices fell each calendar year in that period, for a total decline of almost 27 percent. For more details on our scope and methodology, see app. I.

[6]We selected the 2017–2019 period to reflect the most recent full-year trends in maintenance costs and market conditions. For more information on our site selection process, see app. I.

scorecards and inspection reports, and the inspection reports of other parties, such as third-party inspection companies, real estate brokers, and contractors overseeing subcontractors.

To assess performance goals and metrics of the REO programs, we reviewed relevant laws and regulations and the federal entities' missions, strategic plans, and performance reports. We also reviewed the performance goals and metrics of our four selected federal entities. We compared this information against relevant criteria, such as the Office of Management and Budget (OMB) performance reporting guidance that states that performance goals, indicators, and targets should reflect a program's missions and objectives and that agencies should collect and use program performance data to track performance, make decisions, and improve results.[7] See appendix I for more information on our scope and methodology.

We conducted this performance audit from March 2019 to March 2021 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Overview of Selected Federal Entities' REO Programs

FHA, Freddie Mac, VA, and RHS are federal entities that have mortgage lending or guarantee programs, or purchase mortgages, to promote homeownership among certain populations. Such mortgages sometimes go into foreclosure and if the properties are not sold before or at foreclosure, they enter the entities' REO inventory. The federal entity is then responsible for maintaining and selling the properties. FHA, Freddie Mac, VA, and RHS each have an REO program that works to dispose of these properties (see fig. 1).

[7]Office of Management and Budget, *Preparation, Submission, and Execution of the Budget*, Circular No. A-11 (Washington, D.C.: July 2020).

Figure 1: Overview of Loan and Real Estate-Owned (REO) Programs of Selected Federal Entities

FHA

- The Federal Housing Administration (FHA) helps low- and moderate-income borrowers to obtain home loans by providing guarantees to private lenders.
- If a borrower is unable to pay the FHA-guaranteed mortgage and the loan goes into and completes foreclosure, FHA may take responsibility for maintaining and selling the foreclosed (real estate-owned, or REO) property.
- The REO Program operates out of FHA's four homeownership centers: Atlanta, GA; Santa Ana, CA; Denver, CO; and Philadelphia, PA.

Freddie Mac

- Freddie Mac is a government-sponsored enterprise that purchases mortgage loans from lenders, which provides market liquidity so that lenders can provide more loans to borrowers.
- If those loans are foreclosed, Freddie Mac is responsible for maintaining and selling the properties.
- The REO program—known as HomeSteps—oversees the process of disposing of REO properties.

VA | U.S. Department of Veterans Affairs

- The loan guarantee program of the Department of Veterans Affairs (VA) allows mortgage lenders to extend loans to eligible borrowers (such as veterans and active duty military personnel) on favorable terms and provides lenders with financial protections against losses associated with such mortgages.
- If a borrower is unable to pay the VA-guaranteed mortgage and the loan goes into and completes foreclosure, VA takes responsibility for maintaining and selling the property.
- The REO program is responsible for disposing of VA-guaranteed or VA-financed properties acquired as a result of foreclosure. The REO program is part of VA's Loan Guaranty Service—which manages the VA loan programs.

USDA Rural Housing Service

- The Rural Housing Service (RHS) operates guaranteed and direct loan programs to eligible borrowers in rural areas.
- If mortgages under the direct loan program fall into foreclosure, RHS is responsible for maintaining and selling the REO properties.
- From 2015 through September 2020, the bulk of properties acquired as a result of foreclosure were transferred to VA and managed and marketed through an interagency agreement.

Source: GAO summary of FHA, VA, RHS, and Freddie Mac program documents. | GAO-21-219

Data table for Figure 1: Overview of Loan and Real Estate-Owned (REO) Programs of Selected Federal Entities

Federal Housing Administration (FHA)

- FHA assists low- and moderate-income borrowers obtain home loans by providing guarantees to private lenders.
- If a borrower is unable to pay the FHA-guaranteed mortgage and the loan goes into and completes foreclosure, FHA may take responsibility for maintaining and selling the foreclosed (real estate-owned, or REO) property.
- The REO Program operates out of FHA's four homeownership centers: Atlanta, GA; Santa Ana, CA; Denver, CO; and Philadelphia, PA.

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- Freddie Mac is a government-sponsored enterprise that purchases mortgage loans from lenders, which provides market liquidity so that lenders can provide more loans to borrowers.

- If those loans are foreclosed, Freddie Mac is responsible for maintaining and selling the properties.
- The REO program—known as HomeSteps—oversees the process of disposing of REO properties.

Department of Veterans Affairs (VA)

- VA's loan guarantee program allows mortgage lenders to extend loans to eligible borrowers (such as veterans and active duty military personnel) on favorable terms and provides lenders with financial protections against losses associated with such mortgages.
- If a borrower is unable to pay the VA-guaranteed mortgage and the loan goes into and completes foreclosure, VA takes responsibility for maintaining and selling the property.
- The REO program is responsible for disposing of VA-guaranteed or VA-financed properties acquired as a result of foreclosure. The REO program is part of VA's Loan Guaranty Service—which manages the VA loan programs.

Rural Housing Service (RHS)

- RHS operates guaranteed and direct loan programs to eligible borrowers in rural areas.
- If mortgages under the direct loan program fall into foreclosure, RHS is responsible for maintaining and selling the REO properties.
- From 2015 through September 2020, the bulk of properties acquired as a result of foreclosure were transferred to VA and managed and marketed through an interagency agreement

Source: GAO summary of FHA, VA, RHS, and Freddie Mac program documents. | GAO-21-219.

Disposing of REO properties can involve various activities, including maintaining the property, conducting repairs if necessary, and listing the property for sale. FHA, Freddie Mac, VA, and RHS each use contractors for these activities. Each entity sets up contractor functions in its REO program differently. FHA manages and oversees its REO program through its four homeownership centers, which rely on contractors in each region to maintain REO properties and other contractors to market and sell the properties. Some contractors operate in more than one FHA region. Since 2017, Freddie Mac oversees one national contractor for its REO program that manages a network of regional and local preservation and maintenance vendors.[8] Since 2012, VA has used one national contractor to manage its REO process—including maintaining, marketing, and selling properties.

From October 2015 to September 2020, RHS operated its REO program for 31 states under an interagency agreement with VA, which allowed RHS to use VA's national contractor to manage and provide maintenance and disposition services for a portion of RHS's REO properties.[9] The agreement required that RHS rely on VA's monitoring and oversight processes and procedures. RHS manages more geographically dispersed properties through another contractor and its field offices.[10]

The contractors used by federal entities generally manage REO maintenance and marketing activities by using local subcontractors to provide specific services for the properties, such as cutting the lawn or marketing the property for sale (see fig. 2).

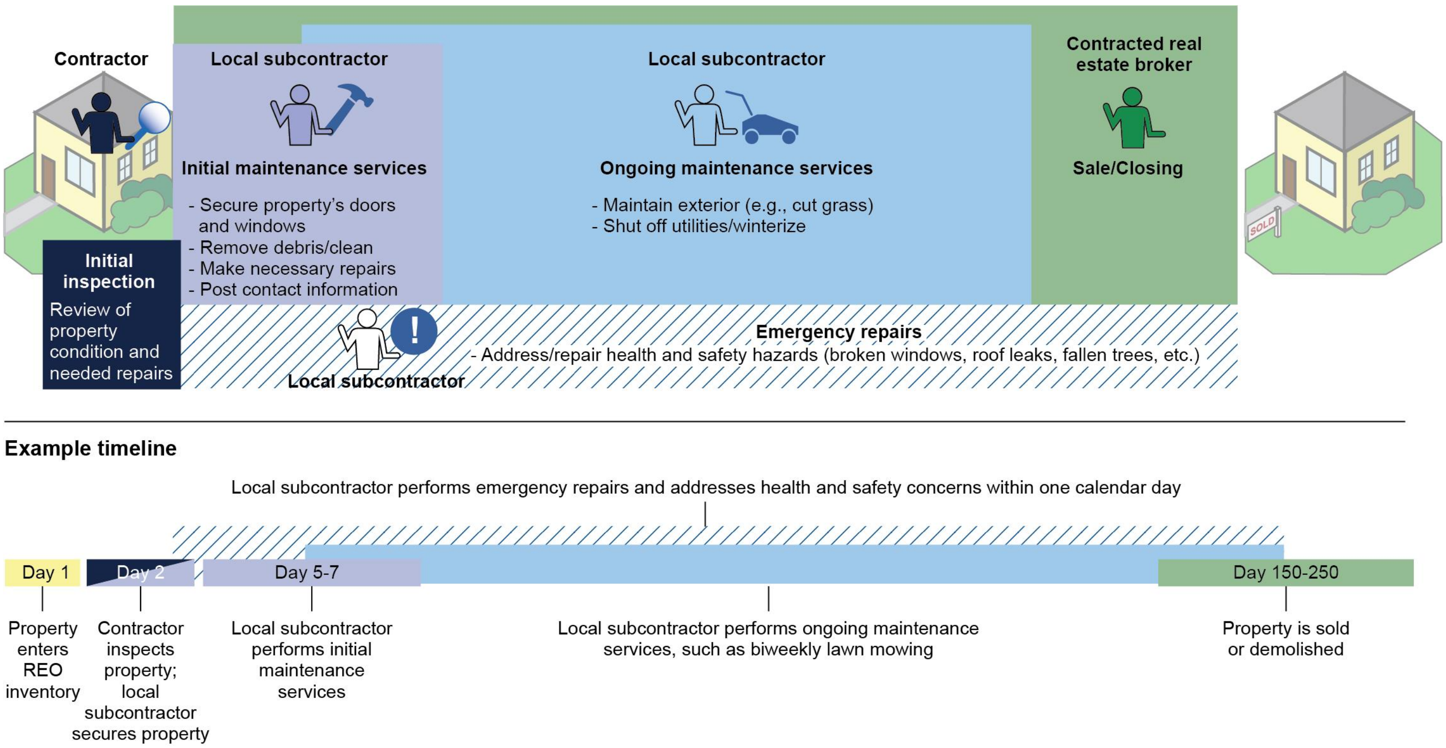
[8]Before 2017, Freddie Mac managed and oversaw maintenance and sales of REO properties using three maintenance contractors and a network of real estate brokers. Freddie Mac moved to its current configuration because the number of REO properties declined, according to Freddie Mac officials.

[9]The interagency agreement was in place from 2015 to 2020. In 2020, RHS began the process of significantly changing its REO program—for example, moving from using VA's national contractor to selecting its own.

[10]At the end of 2019, 83 percent of RHS REO properties were managed through VA and 17 percent of the properties were managed through RHS's 19 field offices.

Figure 2: REO Property Maintenance and Marketing—Contractor Roles and Responsibilities and Example Timeline

Selected federal entities that are responsible for maintaining and selling properties not sold at foreclosure (known as real estate-owned, or REO) use contractors to manage maintenance and marketing activities.



Source: GAO analysis of Federal Housing Administration, Department of Veterans Affairs, Rural Housing Service, and Freddie Mac property maintenance protocols and guidance. | GAO-21-219

Text for Figure 2: REO Property Maintenance and Marketing—Contractor Roles and Responsibilities and Example Timeline

1. Contractor conducts initial inspection, review of property condition, and needed repairs
2. Local subcontractor conducts emergency repairs if needed. Address/repair health and safety hazards (broken windows, roof leaks, fallen trees, etc).
3. Local subcontractor conducts initial maintenance services.

- Secure Property's doors and windows
- Remove debris/clean
- Make necessary repairs
- Post contact information

4. Local subcontractor performs ongoing maintenance services

- Maintain exterior (e.g., cut grass)
- Shut off utilities / winterize

5. Contracted Real Estate broker performs sales/closing

Example of a timeline:

Day 1 – property enters REO inventory

Day 2 – Contractor inspects property; local subcontractor secures property

Day 5-7 – Local contractor performs initial maintenance services, which continues until sale.

Day 150-250 Property is sold or demolished.

Source: GAO analysis of Federal Housing Administration, Dept. of Veterans Affairs, Rural Housing Service, and Freddie mac property maintenance protocols and guidance. | GAO-21-219.

The maintenance requirements that entities must follow may vary by entity or locality. Entities' maintenance requirements can differ from each other (discussed later in the report). However, each of the entities in our review had standard requirements for contractors across the country. Local regulatory codes, state laws and regulations, and homeowner association rules may also guide such things as the frequency of lawn mowing, debris removal, or boarding and securing of properties.

Other Programs and Initiatives That Have Addressed Foreclosed and Vacant Properties

Localities and federal agencies may have other programs, initiatives, or requirements to address abandoned and foreclosure properties (see app. II for more details). For instance, some localities require property owners to register vacant properties to ensure local officials are aware of them. Localities also may have demolition strategies or partnerships with land banks, which acquire vacant or problem properties, rehabilitate them, and sell them to responsible owners.[11]

Other federal programs and initiatives also have helped localities to address foreclosed and vacant property maintenance. For example, the Department of the Treasury's Hardest Hit Fund program assisted homeowners facing foreclosure in areas hardest hit by the housing crisis.[12] Housing finance agencies in 19 states used the funds to help stabilize local housing markets—for example, by demolishing blighted properties.

Congress also appropriated approximately $7 billion in funding in 2008–2010 to the Department of Housing and Urban Development's (HUD) Neighborhood Stabilization Program, which served communities with large numbers of foreclosures or abandoned properties.[13] Program participants used the funding to reduce the number of such properties and restore depressed local markets. The Federal Housing Finance Agency, together with Fannie Mae and Freddie Mac, developed a Neighborhood Stabilization Initiative and First Look programs to facilitate sales of foreclosed properties to community organizations.

[11]For additional information on land banks and other strategies, see app. II and GAO-12-34.

[12]For example, see GAO, *Troubled Asset Relief Program: Treasury Continues Winding Down Housing Programs*, GAO-21-39 (Washington, D.C.: Dec.8, 2020) and GAO, *Troubled Asset Relief Program: Monitoring of the Hardest Hit Fund Program Could Be Strengthened*, GAO-19-100 (Washington, D.C.: Dec. 21, 2018). The Department of the Treasury obligated $9.6 billion in funds to 19 state housing finance agencies, as of the end of 2018. Programs have until the end of 2021 to expend previously committed funds.

[13]See GAO, *Neighborhood Stabilization Program: HUD and Grantees Are Taking Actions to Ensure Program Compliance but Data on Program Outputs Could Be Improved*, GAO-11-48 (Washington, D.C.: Dec. 17, 2010).

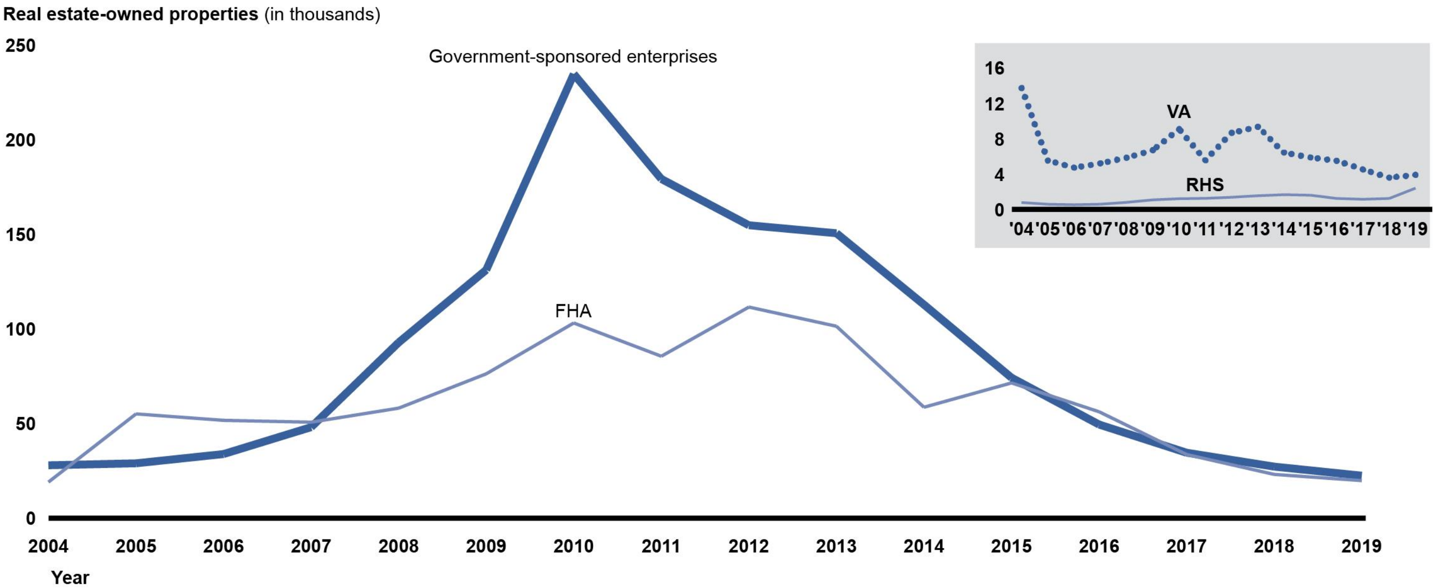
REO Inventories Declined to Relatively Low Levels by 2019

Number of Federal Entities' REO Properties Generally Declined Following Large Spike in 2010–2013

After reaching a peak in 2010–2013, the number of properties in the REO portfolios of FHA, VA, and the government-sponsored enterprises—Fannie Mae and Freddie Mac—declined significantly (see fig. 3). At their peaks, FHA had more than 100,000 REO properties; the government-sponsored enterprises together had more than 234,000; and VA had more than 10,000, according to entity data and public reports. By the end of calendar year 2019, the number of REO properties had decreased by 82 percent to approximately 20,000 at FHA and by 90 percent to approximately 22,000 at the enterprises. By the end of fiscal year 2019 (September 30) the number of REO properties had declined by 49 percent to approximately 5,700 at VA. RHS was an exception to this trend: its REO inventory was 1,667 in 2014 and 2,398 in fiscal year 2019.[14]

[14]RHS's REO portfolio increased by approximately 1,200 properties from 2018 to 2019. RHS officials told us they had a backlog of foreclosed properties dating before 2015, when they entered into an interagency agreement with VA to manage RHS's REO property disposition process.

Figure 3: Real Estate-Owned Properties of Selected Federal Entities, by Number of Properties, 2004–2019



Source: GAO analysis of Federal Housing Administration (FHA), Department of Veterans Affairs (VA), Rural Housing Service (RHS), Freddie Mac, and Fannie Mae data. | GAO-21-219

Data table for Figure 3: Real Estate-Owned Properties of Selected Federal Entities, by Number of Properties, 2004–2019

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2018	23,158	27,272	5,365	1,238
2019	19,880	22,502	5,680	2,398

Note: The government-sponsored enterprises included here are Fannie Mae and Freddie Mac, congressionally chartered for-profit organizations that have been in federal conservatorship since 2008. Data for FHA and the government-sponsored enterprises are calendar year; for VA and RHS, fiscal year (October 1–September 30).

Mortgage lenders—such as banks—also manage REO properties, and their REO properties showed similar trends. We analyzed data on the value of REO portfolios of active banking institutions, such as bank holding companies and savings and loan institutions, and found that the trend line for REO portfolio values also spiked around 2010–2013, followed by a steady and significant decline.[15]

Federal Entities Have Alternatives to Dispose of Properties

From 2013 to 2019, FHA, the government-sponsored enterprises, and VA used several alternatives to dispose of properties with defaulted mortgages—either before or after they entered REO status—which contributed to reducing the number of REO properties in federal inventories. Specifically, the entities used several programs or processes to dispose of properties or mortgages, including the following:

- **Claims without Conveyance of Title Program.** FHA has disposed of the largest share of its distressed assets through this program since 2017.[16] In fiscal year 2020, FHA reported it used the program for 57 percent of all dispositions (about 24,500 properties) and used REO sales for 35 percent (about 15,000 properties). In contrast, in 2013 FHA used the Claims without Conveyance of Title Program to sell just under 11,000 properties and used its REO program to sell more than 100,000 properties.
- **Distressed Asset Stabilization Program.** Under this program, FHA accepts assignment of eligible, defaulted single-family loans from mortgage servicers in exchange for claim payments and sells the loans in competitive auctions. FHA used the program to dispose of

[15]Bank regulatory data we reviewed reflect the value of these REO portfolios rather than the number and exhibited similar trends. We reviewed data on 4,992 active banking institutions with REO properties as of November 2020. The data were derived from S&P Global Market Intelligence bank regulatory data.

[16]Under the Claims without Conveyance of Title Program, the servicer attempts to secure a third-party purchase of an eligible property for an adjusted fair market value that is less than the amount of the servicer’s projected claim.

approximately 30,000 mortgages in fiscal year 2013, although the agency did not use this program after 2016, according to officials.[17]

- **Third-party sales.** The government-sponsored enterprises and VA use sales to third parties, such as investors, to dispose of properties. For example, one enterprise reported that in 2019, its REO inventory declined in part because many of these properties were sold to third parties.
- **First Look programs.** The government-sponsored enterprises' First Look programs offer homebuyers a 20–30 day period to purchase properties before they are offered to investors.[18] In 2017, Freddie Mac disposed of about 30 percent of its foreclosed properties through its First Look program (by 2019, this declined to approximately 22 percent).[19] HUD also developed a First Look program through the Neighborhood Stabilization Program in 2010 that provided eligible purchasers with a preference to acquire FHA REO properties available for purchase in certain areas.[20]

Investors (specifically, those who purchased properties to rent or resell them) also played a role in these programs. Some researchers have found that the number of homes investors purchased increased

[17]See GAO-19-228. Another FHA program, the Pre-foreclosure Sales Program, accounted for a relatively smaller number of dispositions during the 2017–2019 period.

[18]The Federal Housing Finance Agency, Fannie Mae, and Freddie Mac developed First Look programs to stabilize the hardest-hit neighborhoods and reduce the enterprises' inventory of REO properties.

[19]We previously reported on homeownership trends following the 2007–2009 financial crisis. See GAO, *Housing: Preliminary Analysis of Homeownership Trends for Nine Cities*, GAO-20-544R (Washington, D.C.: June 25, 2020).

[20]Federal Housing Administration (FHA) First Look Sales Method for Grantees, Nonprofit Organizations, and Subrecipients Under the Neighborhood Stabilization Programs (NSP), 75 Fed. Reg. 41225 (July 15, 2010). HUD issued a notice creating the First Look Sales Method effective through May 31, 2013. The end date was expanded to go through the conclusion of the Neighborhood Stabilization Program in January 2013. Federal Housing Administration (FHA) First Look Sales Method Under the Neighborhood Stabilization Program (NSP); Increased Discount on Sales Price for Certain Properties and Clarification of Effective Dates, 78 Fed. Reg. 2280 (January 10, 2013).

significantly from 2010 to 2018 in selected housing markets.[21] Some researchers have found investor-owned properties may help stabilize neighborhoods with a large number of foreclosures.[22] However, investor purchases also can produce a larger number of rentals in an area, which may affect property maintenance and conditions.

REO Property Preservation and Maintenance Costs Generally Have Declined but Vary Based on Several Factors

The REO maintenance costs of the selected federal entities we reviewed generally have declined since 2017, with the exception of RHS. A number of factors can affect the cost of property maintenance, such as REO program standards and requirements or the time a property spends in the REO inventory.

REO Maintenance Costs Generally Declined in 2017–2019

Total Maintenance Costs

Total costs for preservation and maintenance of REO properties declined for FHA, Freddie Mac, and VA—by 55, 44, and 8 percent, respectively.[23] In 2017–2019, FHA's REO preservation and maintenance costs decreased by approximately $51 million, Freddie Mac's costs decreased

[21]See Lauren Lambie-Hanson, Wenli Li, and Michael Slonkosky, "Institutional Investors and the U.S. Housing Recovery," Urban Institute (Washington, D.C.: Feb. 5, 2020) and Rohan Ganduri, Steven Chong Xiao, and Serena Wenjing Xiao, "Tracing the Source of Liquidity for Distressed Housing Markets," Urban Institute, (Washington, D.C., Feb. 5, 2020). We have previously reported on the decline of homeownership since the financial crisis. See GAO, *Rental Housing: As More Households Rent, the Poorest Face Affordability and Housing Quality Challenges*, GAO-20-427 (Washington, D.C.: May 27, 2020) and GAO-20-544R.

[22]Lauren Lambie-Hansen, "Foreclosed Property Investors in a Strong Housing Market City: A Case Study of Boston," *Cityscape: A Journal of Policy Development and Research,* vol. 17, no. 2 (2015): 239.

[23]Each federal entity provided data for all U.S. states, Puerto Rico, and other territories for which they had REO properties in 2017–2019. Except, RHS did not provide data for Alaska, Vermont, and the District of Columbia. See app. I for more information.

by approximately $64 million, and VA's decreased by approximately $4 million. In contrast, for RHS, total preservation and maintenance costs increased by about 250 percent (approximately $5 million) in 2017–2019, largely because RHS's REO portfolio doubled during that time.[24]

Per-Property Maintenance Costs

When measured by cost-per-property, maintenance costs rose for VA and RHS and declined for FHA and Freddie Mac in 2017–2019 (see fig. 4). VA staff attributed the increase in per-property costs to contract updates that resulted in higher contractor costs and to increased proficiency in identifying repairs that may have been missed previously.

[24]RHS's REO portfolio increased by approximately 1,200 properties in 2017–2019, which RHS officials told us resulted from the processing of a backlog of foreclosed properties dating before 2015.

Figure 4: Federal Entities' Per-Property Preservation and Maintenance Costs for Their Real Estate-Owned Inventories, 2017–2019

Source: GAO analysis of Federal Housing Administration, Department of Veterans Affairs, Rural Housing Service, and Freddie Mac data. | GAO-21-219

Data tables for Figure 4: Federal Entities' Per-Property Preservation and Maintenance Costs for Their Real Estate-Owned Inventories, 2017–2019

Cost per property (dollars in thousands)

Year	FHA	Freddie Mac	VA	RHS
2017	$2,936.42	$10,249.88	$3,518.49	$1,765.32
2018	$2,601.27	$8,593.70	$3,824.62	$2,033.04
2019	$2,147.81	$8,701.71	$4,224.19	$3,127.49

Property Count

Year	FHA	Freddie Mac	VA	RHS
2017	31,800	14,300	13,900	1,200
2018	21,900	11,100	11,700	1,300
2019	19,400	9,600	10,700	2,400

Source: GAO analysis of FHA, Dept of Veteran Affairs, RHS and Freddie Mac data. | GAO-21-219.

As shown in figure 4, per-property maintenance costs have varied significantly by entity—for example, Freddie Mac spent approximately $8,700 per property in 2019, while FHA, VA, and RHS spent approximately $2,100, $4,200, and $3,100, respectively. As discussed later in this report, the cost differences among entities are related to a number of factors—for example, Freddie Mac's costs may have been higher because its properties spent more time in REO inventory due to eviction or redemption periods, or because of the inclusion of property improvement costs made to the homes.[25]

Maintenance Costs by Activity

The federal entities differ in how they categorize the maintenance activities of their REO properties.[26] For example, FHA separates initial property inspections from initial maintenance activities because the initial inspection is important to FHA's REO conveyance (title transfer)

[25]Improvements to a property can include capital repair spending (improvements to increase the return on sale).

[26]We developed general categories based on common activities across the entities. For more details on our methodology, see app. I.

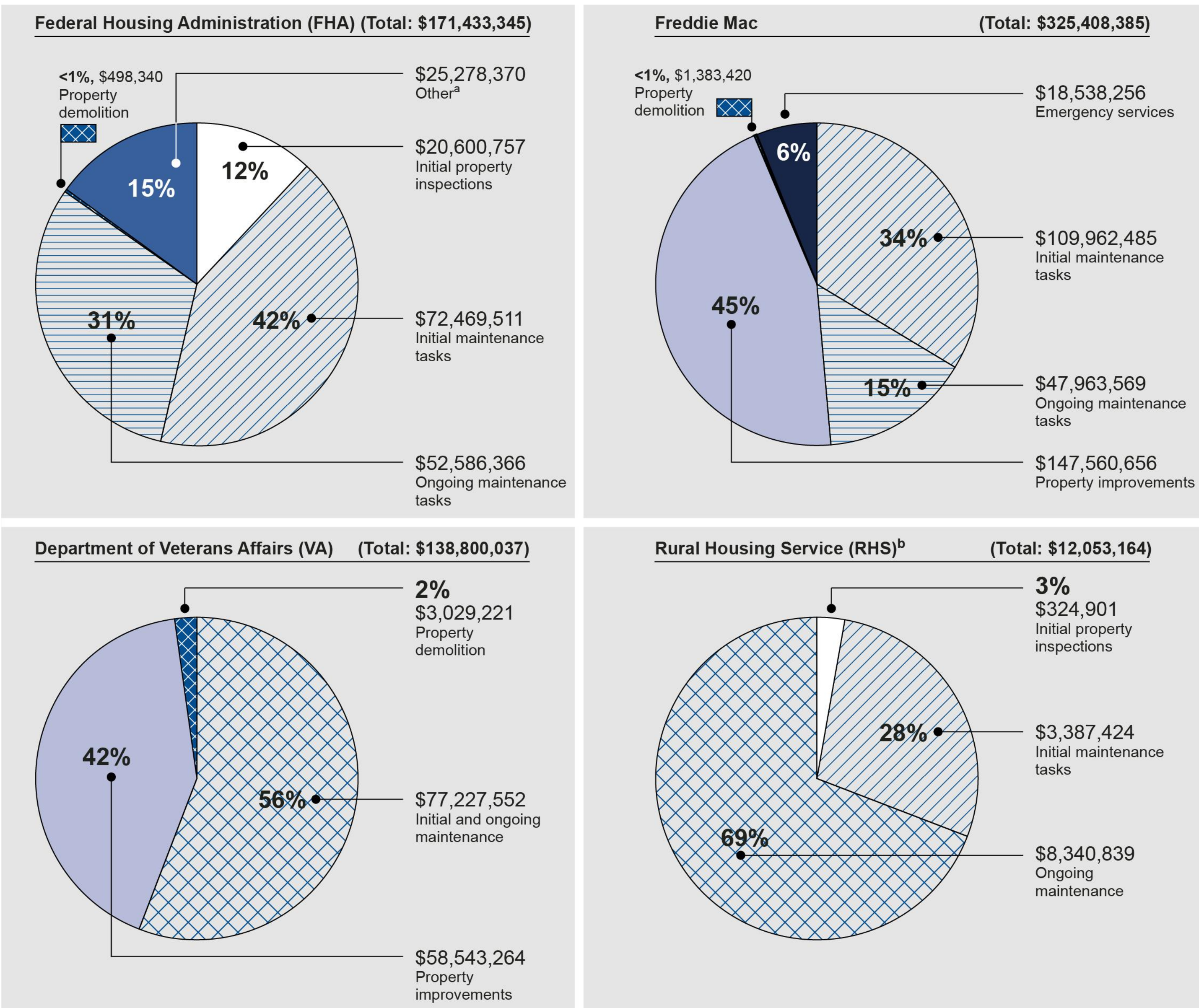
process.[27] By contrast, VA groups the two activities into a single category—initial maintenance—based on terms and payment structures outlined for its national contractor: VA pays the contractor a flat fee for initial maintenance activities. In addition, Freddie Mac, VA, and RHS pay for improvements to the property, while FHA does not.[28]

Initial and ongoing activities generally accounted for at least half of all the entities' maintenance costs in 2017–2019 (see fig. 5). These activities include a contractor's initial inspections and initial maintenance (such as removing debris and securing the property), health- and safety-related repairs, and ongoing services, such as lawn maintenance. Other activities, such as inspections and demolitions, generally accounted for less than 10 percent of maintenance costs. A large portion of Freddie Mac's and VA's maintenance costs was for property improvements—45 and 42 percent, respectively. Improvements to the property may be done to increase the sales value.

[27]At the initial inspection, FHA determines if the property has met all the requirements for conveyance into its REO inventory or whether the mortgage servicer must carry out additional steps. See GAO-19-517.

[28]RHS has a maximum reimbursement through its interagency agreement with VA.

Figure 5: Property Maintenance Costs for Real Estate-Owned Properties, by Activity, 2017–2019



Source: GAO analysis of FHA, VA, RHS, and Freddie Mac data. | GAO-21-219

Data tables for Figure 5: Property Maintenance Costs for Real Estate-Owned Properties, by Activity, 2017–2019

	FHA		Freddie Mac		VA		RHS	
Category:	**$**	**%**	**$**	**%**	**$**	**%**	**$**	**%**
Initial Property Inspections	20600757	12.01673		0	0	0	324901	2.695566
Initial REO Maintenance Tasks (Initial Services)	72469511	42.2726	109962485	33.79215	0	0	3387424	28.10402
Ongoing REO Maintenance Tasks	52586366	30.67442	47963569	14.7395	0	0		0
Initial and Ongoing Maintenance		0		0	77227552	55.63943	8340839	69.20041
Maintenance Above Standard Amounts / Capital Repairs		0	147560656	45.3463	58543264	42.17813		0
REO Property Demolition	498340	0.29069	1383420	0.425133	3029221	2.182435		0
Other (includes pre-conveyance, custodial and vacant lot spending)	25278370	14.74562						
Emergency Service			18538256	5.69692				
TOTAL	171433345	100	325408385	100	138800037	100	12053164	100

Note: The cost categories differ for each of the four entities presented because the entities vary in how they classify their real estate-owned (REO) maintenance activities. FHA, VA, and RHS do not break out emergency services as a separate category and categorize it under initial or ongoing maintenance.

[a]"Other" includes reimbursement to mortgage lenders for costs incurred before FHA took possession of the property and maintenance of reverse mortgage properties and vacant lots.

[b]Maintenance for RHS's REO properties is performed by VA's contractor under an interagency agreement between the two agencies.

Several Factors May Contribute to Variations in Maintenance Costs

We identified several factors that may have contributed to variations in property maintenance costs among the four federal entities included in our review.[29]

REO program standards or requirements. The federal entities have different requirements for their REO programs, which can affect costs they incur for property preservation and maintenance. For example, FHA

[29]We conducted a literature review and interviewed entity staff, academic researchers, and representatives of contractors, local government, and housing and community nonprofit organizations. For more details on our methodology for identifying factors, see app. I.

sells homes "as is," which means that it does not pay for improvements to a property, such as new carpeting or floors.[30] In contrast, Freddie Mac and VA may make such improvements to increase the return on sale.

Time spent in REO inventory. The time a property spends in REO status also can affect how much federal entities spend on maintenance. Key maintenance activities are recurring, such as yard maintenance or inspections of the property to ensure security. In 2019, Freddie Mac properties were in inventory an average of 261 days, FHA properties an average 135 days, and VA an average of 136 days.[31]

Many factors can affect the time a property spends in REO status. For example:

- Some of the variation in average time spent in inventory can be attributed to how the entities measure the REO lifecycle. Each of the four entities we examined measures the REO lifecycle differently. For example, Freddie Mac properties enter REO inventory soon after the foreclosure process is complete, while FHA requires the lender to take a set of steps before transferring the title to the property to FHA. We previously recommended that improved procedures and assessments could improve the efficiency of the FHA transfer process.[32]
- States' legal requirements can affect the amount of time a property remains in foreclosure or REO status before sale. For example, as described in one Federal Housing Finance Agency Office of Inspector General (OIG) report, some states require foreclosures to be processed through courts, which often results in longer foreclosure

[30]FHA will reimburse contractors for repairs in cases of safety or health hazards.

[31]VA does not manage all active RHS REO properties because some RHS properties are managed independently by RHS field offices, according to RHS. We received data showing the average days in inventory per month for VA-managed RHS REO properties. These monthly averages ranged between 263 and 431 days under the VA contractor's management in 2019.

[32]See GAO-19-517.

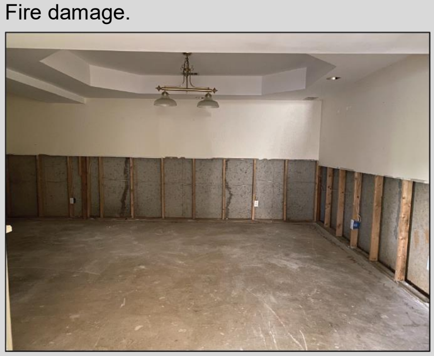
periods than in states with administrative processes.[33] In addition, the OIG report notes that some states have redemption periods, in which mortgage holders have from 10 days to 2 years after a foreclosure to reclaim their property by providing necessary funds.[34] For example, according to Freddie Mac data for 2017–2019, more than one-third of its REO properties experienced a redemption period. The redemption periods increased the time in REO status, with increases ranging from an average of 19 days to an average of 27 days, depending on the year.

[33]A judicial foreclosure is a litigation process in which foreclosure commences by filing a suit against the homeowner. A nonjudicial foreclosure is an administrative process in which the foreclosing party must notify the homeowner of the default and the scheduled sale. Thirty-two states and the District of Columbia have nonjudicial foreclosures, and 18 states and Puerto Rico have judicial foreclosures. See Federal Housing Finance Agency Office of Inspector General (FHFA OIG), *Overview of the Home Foreclosure Process*. Accessed at fhfaoig.gov/Content/Files/SAR%20Home%20Foreclosure%20Process.pdf

[34]In some states, homeowners also have a statutory post-foreclosure “right of redemption,” by which they can reclaim title to the house by paying the remaining debt and foreclosure costs. The redemption period varies considerably among states, from 10 days to 2 years.

Examples of Real Estate-Owned Properties in the Atlanta Metropolitan Region Requiring Significant Maintenance and Repairs

Fire damage.



Water and mold damage to walls.

Exposed wiring and missing drywall.

Source: GAO photos taken of Federal Housing Administration, Department of Veterans Affairs, and Freddie Mac real estate-owned properties. | GAO 21 219

Condition and age of the property. We heard from entity staff that the condition of a property when it enters REO inventory also affects the kind of maintenance needed and can prolong time spent in inventory before sale. Federal entity staff noted that long foreclosure periods, during which properties may remain vacant, can result in deterioration, which may increase costs. Literature we reviewed and federal entity staff we interviewed indicated that older properties are often in poorer condition because of deferred maintenance or the need for health and safety repairs, such as lead paint abatement. In 2019, the average age of VA, FHA, and Freddie Mac REO properties was 42, 56, and 53 years, respectively.

Examples of Real Estate-Owned Properties in the Atlanta Metropolitan Region Not Requiring Significant Maintenance and Repairs

Exterior showing bushes and trees trimmed away from the walls and gutters.

Kitchen that is clean and in good repair.

Kitchen showing no severe maintenance issues.

Source: GAO photos taken of Federal Housing Administration, Department of Veterans Affairs, and Freddie Mac real estate-owned properties. | GAO 21 219

In addition, the condition of certain types of properties in an agency's REO inventory can affect maintenance costs. For example, FHA staff told us that properties for which it acts as custodian—such as those with Home Equity Conversion Mortgages (reverse mortgages)—have recently become a larger share of the properties the agency must maintain through the REO program. These properties can be in poorer condition when entering the REO portfolio because of factors such as a homeowner's deferred maintenance.[35]

We visited 10 REO properties that VA, FHA, and Freddie Mac maintained in the Atlanta metropolitan area to view property conditions (see sidebars).[36] Property conditions for the properties we visited varied widely, ranging from those that required significant repairs to those that required minimal maintenance.

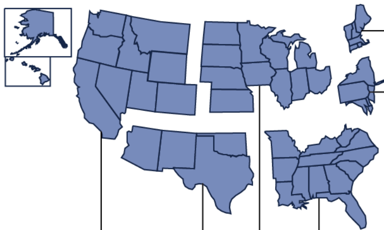
Regional or local labor costs, housing market conditions, and regulations. Maintenance costs for REO properties of the four federal entities we reviewed were higher in certain regions and states, based on data we analyzed for 2017–2019 (see fig. 6).[37]

[35]Home Equity Conversion mortgages are assigned to FHA when the owner passes away or if the property becomes vacant. According to FHA staff, the process to complete foreclosure and handle the deceased's estate can be lengthy. The number of FHA REO properties with reverse mortgages ranged from 3,740 to 4,695 each year between 2017 and 2019. FHA staff informed us that their REO maintenance contractors maintain FHA reverse mortgage properties, but these properties have different maintenance requirements than other properties in FHA's REO portfolio. For example, FHA staff explained that their REO contractors conduct only exterior maintenance, because FHA does not gain access to the interior until the property becomes part of its REO portfolio. See GAO, *Reverse Mortgages: FHA Needs to Improve Monitoring and Oversight of Loan Outcomes and Servicing*, GAO-19-702 (Washington, D.C: Sept. 25, 2019).

[36]We originally selected Santa Ana, California, as part of our site selection process but were unable to carry out this site visit because of the COVID-19 pandemic. See app. I for more information on our scope and methodology.

[37]We excluded RHS from our analysis of geographic variation in maintenance costs because RHS data did not include state-level cost information.

Figure 6: Examples of Regional Variation of Real Estate-Owned (REO) Properties: Maintenance Costs, Time in Inventory, and Number of Properties for FHA, Freddie Mac, and VA for 2017–2019



<table>
<tr><th>Region</th><th>Federal Housing Administration (FHA)</th><th>Freddie Mac</th><th>Veterans Affairs (VA)</th></tr>
<tr><td>New England (CT, ME, MA, NH, RI, VT)</td><td colspan="3">In New England, properties generally spent longer in REO inventory than in other regions.
Connecticut was an outlier, relative to other states in New England, with more REOs and higher costs.</td></tr>
<tr><td>Mid-Atlantic (DE, MD, NJ, NY, PA)</td><td colspan="2">New Jersey had relatively more properties and higher costs than other mid-Atlantic states.</td><td>In New Jersey, properties spent relatively longer in REO status.</td></tr>
<tr><td>South (AL, AR, FL, GA, KY, LA, MS, MO, NC, SC, TN, VA, WV)</td><td colspan="2">Florida had more properties (and total costs) than other southern states in 2017–2019.</td><td>North Carolina and Virginia had more properties than other southern states in 2017–2019.</td></tr>
<tr><td>Midwest (IL, IN, IA, KS, MI, MN, NE, ND, OH, SD, WI)</td><td colspan="2">Ohio, Illinois, and Michigan had relatively more properties (and thus higher costs) than other states in the region.</td><td>Ohio and Illinois had relatively more properties (and thus higher costs) than other states in the region.</td></tr>
<tr><td>Southwest (AZ, NM, OK, TX)</td><td>Texas had more properties (and higher costs) than any other state in the region for 2017–2019.</td><td>The Southwest had relatively consistent numbers of properties and costs per property among states.</td><td>Texas had high levels of REOs and costs for 2017–2019.</td></tr>
<tr><td>West (AK, CA, CO, HI, ID, MT, NV, OR, UT, WA, WY)</td><td>Idaho, Nevada, and California had higher per-property costs in 2019 than other western states.</td><td>California had high total costs relative to other western states.</td><td>The West had fewer REO properties and total costs relative to other regions.</td></tr>
</table>

Sources: GAO analysis of FHA, VA, and Freddie Mac data. | GAO-21-219

Factors that may explain the geographic variations in REO maintenance costs include the following:

- Labor costs, such as for maintenance contractors, vary by region.[38] For example, VA officials attributed the increase from 2017 levels in per-property costs in 2018 and 2019 to an upward adjustment in the flat fee they reimburse for standard maintenance.

[38] We recently reported that factors such as population size, housing stock, and employment conditions influence local markets. See GAO-20-544R.

- Federal entities’ REO staff informed us that local housing market conditions affect how long a property remains in inventory—that is, remains unsold—which, in turn, affects how long a federal entity must pay for routine maintenance.
- The laws, regulations, and rules governing maintenance of vacant properties vary among states, localities, and homeowners associations. For example, costs may be higher in colder states where there are winterization requirements. In addition, New Jersey has costly requirements for debris removal, according to a property maintenance contractor. Moreover, homeowner associations may have additional requirements, such as how windows may be boarded.

In addition, according to entity and contractor staff, the declining number of REO properties in recent years has led to more geographical dispersion, which can increase maintenance costs due to a shortage of available contractors and additional costs when contractors must travel long distances between properties.

Selected Entities’ Oversight Processes Identified REO Property Maintenance Issues

The entities we reviewed—FHA, Freddie Mac, VA, and RHS—each have processes to oversee their contractors’ activities and performance, including internal and external performance reviews and on-site inspections.[39] Entities have specific policies and procedures that standardize property maintenance requirements across the country. Generally, the performance of contractors whose documentation we reviewed met entities’ standards and requirements. However, the entities’ oversight procedures identified instances in which contractors did not meet contract or program requirements and actions were taken. For example, Freddie Mac terminated 36 real estate brokers and three property maintenance and general contractors between January 2017 and October 2019 for poor performance.

[39]We reviewed documentation related to the entities’ contractor oversight, including samples of quantitative and qualitative inspection reports and summary data from 2017 to 2020. See app. I for more information about our methodology.

Federal Housing Administration

FHA's contracts with the property and preservation contractors and asset managers describe performance, quality assurance, and quality control requirements.[40] The contracts detail requirements each contractor must meet, such as the frequency of inspections and maintenance activities.[41] These requirements are generally standard across all four homeownership centers for all contractors. For example, all contractors must address health and safety hazards within 1 day.

The contracts also describe FHA's oversight activities, such as scorecards and frequency of reviews, and the consequences of negative performance results. Scorecard assessments and inspections included whether contractors met requirements likely to be of concern to communities and neighborhoods. For example, contractors are assessed on whether contact information is posted in the window of REO properties, so that it is clear whom to contact if a property-related issue were to arise. Furthermore, an element in the scorecard includes complaints about property conditions (which also factors into neighborhood or community perceptions about the condition of a property).

FHA has a monitoring plan describing the steps FHA staff use to monitor contractor compliance with contract requirements.[42] FHA's monitoring plan requires that staff conduct monthly desktop reviews of random samples of maintenance information on 15 properties per month for each of the topics in the monitoring plan. The plan also includes FHA on-site inspections of properties. In 2018 and 2019, FHA completed on-site inspections of more than its minimum standard of 2 percent of properties—almost 3,600 (about 14 percent) and 2,950 (about 16

[40]During the period of our review (2017–2020), FHA maintained contracts with eight property maintenance contractors and seven asset management contractors. The contracts consisted primarily of a fixed-amount base year with 4 option years. Total base-year obligations for the four HUD homeownership centers totaled approximately $225 million, and the potential total obligations, including option years, exceeded $1 billion.

[41]For example, FHA requires an initial inspection within 2–3 days of a completed foreclosure and completion of initial maintenance activities within 7 days.

[42]FHA implemented the plan in 2015 in response to a recommendation in GAO-13-542. In that report, we identified several issues related to contractor oversight processes and made four recommendations to improve the process, including implementing a contractor performance review system. FHA implemented all four of the report's recommendations.

percent) of REO properties, respectively, across its four homeownership centers.

In general, the performance of FHA contractors whose documentation we reviewed met entities' standards and requirements. However, FHA's oversight processes and procedures identified contractors that did not meet minimum performance requirements.[43] Contractors with scorecards that show they did not meet FHA standards may be required to refund payments received for the substandard activities. After 3 or more consecutive months of performance issues, FHA may send a formal letter describing deficient performance. FHA may take additional actions against contractors for performance issues, including not assigning properties to contractors performing below a satisfactory level or not renewing their contract. Since 2018, REO preservation and maintenance contracts also allow FHA to recoup money for maintenance work found to not meet program standards (liquidated damages clause).[44]

We found instances in which FHA reviews identified that contractors did not post contact information, secure properties, or complete work as required, or that they took excessive time to repair safety hazards. These findings resulted in corrective action or returns of FHA payments, according to documentation we reviewed. In addition, FHA contractors that performed below a satisfactory level had limitations placed on the geographic area they served or were not permitted to extend their contract period.[45]

[43]We reviewed a nongeneralizable sample of scorecards, on-site inspection reviews, or quarterly inspection reports for at least one maintenance contractor and one asset management contractor in each of the four HUD homeownership center regions during the 2017–2020 period of our review (total of seven contractors). We also analyzed a nongeneralizable sample of documentation of instances of substandard performance and how FHA addressed performance issues, including corrective action plans or evidence of liquidated damages assessed.

[44]FHA added such clauses to contracts after HUD Office of Inspector General audits identified FHA contractor oversight and performance issues. See HUD OIG 2017-FW-1011, 2017-CH-1011, and IED-12-001R.

[45]The contract's performance work statement states that the government may unilaterally realign the existing geographic area and increase or reduce the geographic service area through contract modification. A satisfactory year-end performance rating is required for exercise of an option to continue the contract. After exercising an option, contractors must continue to give satisfactory performance for assignments to continue for the entire period.

FHA can address contractor performance issues with actions such as warning letters, non-renewal of contracts, and recoupment of funds. For example, FHA issued a formal letter to a maintenance contractor for a pattern of substandard performance in 2019 in four key areas, including a high percentage of properties with health and safety hazards. The formal letter required the contractor to plan and complete corrective actions to improve performance to an acceptable level within 30 days. According to interviews with FHA staff, the contractor received improved performance ratings following this process. HUD contract officials also told us that FHA did not renew a contract due to unsatisfactory performance. FHA documents we reviewed from 2017–2019 showed that seven property maintenance contractors returned nearly $3 million to FHA for maintenance work found to be below quality standards. The amounts recouped averaged about $91,500 and ranged from about $100 to $261,550.[46]

Freddie Mac

Freddie Mac's REO contract describes criteria for evaluating contractor performance (which is standard across geographic locations, including local communities and neighborhoods).[47] To monitor contractor performance, REO program staff conduct monthly desktop reviews, random file reviews, and 10–12 targeted market inspections each year (based on criteria such as performance issues or real estate market characteristics). According to its guidance, Freddie Mac REO program staff meet with the contractor monthly to review performance scorecards, which measure progress in meeting program objectives—maximizing recovery costs and minimizing property disposition time for the REO portfolio. The on-site inspections review how the property is marketed, maintained and secured. More specifically, these reviews can include

[46]The data reported are not meant to be comprehensive. We received documentation from FHA of instances of liquidated damages in 2017–2020. However, we did not review all of FHA's payments to REO maintenance or asset management contractors.

[47]Freddie Mac's service agreement obligated a maximum total expenditure of $20 million for its contractor. Freddie Mac also publishes a guidebook that defines REO program roles and responsibilities for maintenance contractors and real estate brokers. In 2018, the Federal Housing Finance Agency issued a third-party service provider (contractor) advisory bulletin for regulated federal enterprises that states the enterprises are expected to have ongoing oversight and performance monitoring of third parties to ensure that service levels, performance metrics, and other contractual terms are met. Federal Housing Finance Agency, *Oversight of Third-Party Provider Relationships*, AB 2018-08 (Sept. 28, 2018).

whether yards are maintained and properties are secured, and if there is any visible blight on the property.

In general, the performance of Freddie Mac's contractor whose documentation we reviewed met entities' standards and requirements. Freddie Mac's oversight processes and procedures identified some contractor performance issues that could affect property maintenance.[48] For example:

- The contractor was rated "below target" in the monthly closing goal, a primary indicator, for three quarters of 2019.[49] The contractor informed Freddie Mac of the reasons for and discussed a solution to the underperformance during its monthly review, which included coaching vendors on how to increase the number of early closings.
- The third-party inspection company inspected between 600 and 900 properties per month in fiscal year 2019 on behalf of Freddie Mac. Most inspections met requirements—average monthly grades were 87–93 percent. Some reports identified instances of maintenance subcontractors not meeting minimum performance requirements. For example, one inspection revealed deficiencies relating to marketing signage, cleanliness, and external hazards. Another inspection uncovered a case of fraud, in which a contractor billed for work that was not completed. According to Freddie Mac, the third-party inspections resulted in Freddie Mac terminating 36 real estate brokers and three property maintenance and general contractors between January 2017 and October 2019.

To address performance issues, Freddie Mac may also specify remedial actions for contractors, such as additional coaching or training. Freddie Mac also has a contractor disciplinary committee that can reduce a contractor's territory or capacity, place a contractor on probation with an improvement plan, or permanently remove a contractor from the network (or all of the above).

[48]We reviewed a nongeneralizable sample of Freddie Mac oversight reviews and documentation for the REO contractor.

[49]Monthly closing is calculated as the percentage of retail sales dispositions, or system closings, for the month compared to the closing goal.

Department of Veterans Affairs

VA's REO maintenance and marketing contract outlines contractor requirements and how VA assesses the quality of the contractor's work.[50] These requirements are standard across VA's REO portfolio. Additional contract documentation we reviewed described expected work output and procedures for the contractor to inspect quality, timeliness, responsiveness, and other contract requirements. VA also has an inspection process for monitoring and evaluating contractor performance. On a quarterly basis, VA selects 68 random locations and then inspects 5–10 properties in each location.[51]

The VA contractor performance documentation we reviewed showed that the contractor generally met VA's maintenance standards and requirements—based on our review of a nongeneralizable sample of oversight reviews and documentation conducted from 2017 through 2019. Specifically, we reviewed VA's quarterly performance reviews, which determine the contractor's overall performance evaluation.[52] The reviews included whether doors and windows were secured, contact information was clearly posted, and safety hazards, like missing railings or steps, were promptly repaired. In general, the contractor's overall performance met VA's required performance threshold of 80 percent.

However, VA's oversight processes and procedures identified instances where the contractor's performance did not meet minimum performance thresholds in individual performance categories. In six of the nine quarterly review summaries we examined, the performance category that included clearing debris and yard maintenance had the lowest quarterly

[50]VA entered into a contract with a base year obligation and annual options to renew for 10 years. The base year obligation was about $105 million, with potential obligations for the option years totaling almost $2 billion.

[51]According to VA staff, this sampling methodology results in a 90 percent confidence level with a 10 percent margin of error. In the first quarter of fiscal year 2019, VA completed 90 on-site inspections of REO properties.

[52]The reviews assess the contractor across 11 categories—including properly securing REO properties, keeping them safe and sound, managing maintenance, and assuring VA access to the properties.

ratings—ranging from approximately 48 percent to 84 percent—as well as the largest number of performance issues in eight of the nine reviews.[53]

VA and its contractor have procedures to address poor performance of the contractor and subcontractors, respectively. For instance, VA may issue a report that outlines corrective actions and time allotted to address the actions. The contractor can reduce subcontractor capacity, create a performance improvement plan, or terminate the subcontractor relationship.

Rural Housing Service

Under their 2015–2020 interagency agreement, VA's national contractor maintained RHS properties in 31 states based on VA's standardized REO contractor maintenance and marketing requirements.[54] This agreement included designating VA to oversee contractor performance in maintaining, marketing, and selling RHS properties. RHS met quarterly with VA and VA's contractor to review program results and discuss any issues.[55] RHS also administered a small number of REO properties directly through field offices in 19 states, according to officials.

Although most aspects of VA's contractor oversight were the same for RHS properties, the on-site inspection process differed: VA conducted on-site inspections of RHS properties only if the properties were in an area that VA had randomly selected for inspection of its own properties. VA staff said RHS staff at field offices could conduct on-site inspections for RHS properties. However, RHS officials told us that RHS did not conduct such reviews. As part of the VA–RHS interagency agreement, RHS relied on VA on-site inspections to identify instances of contractor underperformance.

[53]VA reviews its REO contractor's work in the following performance categories: Security, Management, Invoicing, Marketing, Redemption, Repair, Safe and Sound Check, VA Access, Closing, Offer Selection, and Acquiring Title.

[54]We reviewed the 2015–2020 interagency agreement between VA and RHS, but did not review the oversight procedures of the 19 RHS field offices that directly manage REO properties.

[55]For these reviews, VA's contractor provided information on the RHS portfolio by state, invoicing, and subcontractors used to ensure that Department of Agriculture small business contracting goals were considered.

In 2020, RHS began the process of significantly changing its REO program—for example, moving from using VA's national contractor to selecting its own.[56] RHS officials told us that the new program structure was expected to be in place in 2022.[57] RHS staff said the VA oversight procedures, such as performance reviews and on-site inspections, would be included under the new program structure.

REO Program Metrics Do Not Fully Align with Missions to Strengthen Communities or Serve Veteran or Rural Populations

FHA, VA, RHS and Freddie Mac used REO program metrics to assess their REO programs. In general, these metrics focused on financial goals, such as achieving a good return from property sales.[58] FHA did not have specific metrics related to its REO program goal of strengthening neighborhoods and communities. In addition, VA and RHS have not included metrics on how veterans and rural populations are served by the REO programs, even though those are key missions of the agencies. Freddie Mac has metrics related to all three of the goals of its REO program.

FHA Lacks REO Metrics on Strengthening Neighborhoods and Communities

FHA collects and tracks a number of metrics that it uses to evaluate its REO program. Most of these metrics correspond to one of the purposes set out in the regulations of FHA's REO program—to ensure a maximum

[56]RHS staff told us that this was part of a broader set of changes, including foreclosure mitigation.

[57]Until the new program is in place, RHS officials stated a bridge REO contract is expected to be awarded in early 2021.

[58]Across the four entities, we determined which performance information supported the entities' respective program goals or objectives. The general categories we developed were based on a review of metrics across the entities that we determined were financial, promoted homeownership, or were related to the entities' missions.

return to the Mutual Mortgage Insurance Fund.[59] When FHA-insured mortgages enter and complete foreclosure, mortgage lenders file insurance claims with FHA. When FHA sells an REO property, it uses the sales proceeds to recoup some of the losses incurred from these insurance claim payouts.

The metrics that FHA uses primarily are financial (see table 1). For example, one metric—average net return—tracks the REO program's return to FHA from REO sales. Another metric—the recovery rate by cost—measures the percentage of the sales proceeds that covered the maintenance and other costs of the property. According to staff, FHA generally does not set specific targets for these metrics.

Table 1: FHA's Real Estate-Owned (REO) Program: Program Purposes and Associated Metrics

REO program purposes	Selected associated metrics
• Dispose of properties in a manner that ensures a maximum return to FHA's Mutual Mortgage Insurance Fund	• Acquisition cost • Acquisition value rate • Recovery rate by cost • Recovery rate by value • Net return • Days in inventory
• Dispose of properties in a manner that expands homeownership opportunities	• Share of sales to owner-occupants
• Dispose of properties in a manner that strengthens neighborhoods and communities	• None

Source: GAO analysis of Federal Housing Administration (FHA) documentation. | GAO-21-219

In addition, one metric—share of sales to owner-occupants—reflects the regulatory REO program purpose of expanding homeownership opportunities. This metric tracks the extent to which REO properties were sold to people who lived in the homes as their principal residence, rather than renting them out or reselling them as investments.[60]

However, FHA lacks metrics and targets related to the REO program purpose of strengthening neighborhoods and communities, such as

[59]24 C.F.R. § 291.1(a)(2). The purpose of the property disposition program is to dispose of properties in a manner that expands homeownership opportunities, strengthens neighborhoods and communities, and ensures a maximum return to the mortgage insurance fund.

[60]For this metric, FHA has a target that 55 percent of REO sales should be to owner-occupants. Certain individuals have the opportunity to bid on these properties before they are offered to the public. 24 C.F.R. § 291.510(b). These sales are capped at 5 percent of all REO sales. 24 C.F.R. § 291.510(e).

measures of policy outcomes of alternative sales programs. One such program is the Good Neighbor Next Door sales incentive, which permits an eligible owner-occupant borrower who is a full-time law enforcement officer, teacher, firefighter, or emergency medical technician to purchase specifically designated REO properties in certain areas at a 50 percent discount from the sales price and with a minimum down payment of $100 if the purchaser finances the home through an FHA mortgage.[61] FHA also provides opportunities to government entities and nonprofit organizations to purchase REO properties at the same time as individual owner-occupant buyers. The organizations may be eligible for 10–30 percent discounts.

FHA staff said that there were occasional efforts to understand the REO program's use of alternative sales programs and assess the extent to which they aligned with HUD's strategic goals, but the efforts were indirect and not sustained over time. Furthermore, they said that the REO program has prioritized financial goals—and that its REO metrics reflect that. They noted that the REO program plays a relatively small role in strengthening communities relative to FHA's single-family housing function as a whole. However, OMB guidance states that performance goals, indicators, and targets should reflect a program's missions and objectives and that agencies should collect and use program performance data to track performance, make decisions, and improve results.[62] Developing and tracking metrics specific to strengthening communities—such as use of REO in alternative sales programs—would help FHA assess the extent to which its REO program is contributing to that regulatory goal. Such metrics would be useful during economic downturns when FHA needs to carefully weigh both its financial and policy goals, especially in communities that are hard-hit by mortgage foreclosures.

[61]Generally, participants have an opportunity to review the REO properties for a period of time before they are listed for sale to the general public.

[62]For the purposes of our report, we define goals as a statement of the result or achievement toward which effort is directed. Progress against goals should be monitored using a suite of supporting indicators. A performance goal includes a performance indicator, a target, and a time period. A target is a quantifiable or otherwise measurable characteristic typically expressed as a number that tells how well or at what level an agency or one of its components aspires to perform. In setting and communicating targets, where available, agencies should include the baseline value from which the target change is calculated. OMB, Circular No. A-11.

VA Does Not Have REO Metrics Related to Serving Veterans

Consistent with the program goal of disposing of inventory as quickly as possible for the highest net return, VA's REO metrics focus on financial measures such as average sales price, average estimated market value, and return on sale (see table 2). While VA did not have specific targets for these metrics, tracking metrics over time enables organizations to measure REO program changes.

Table 2: Department of Veterans Affairs' Home Loan Guaranty Program and Real Estate-Owned (REO) Program: Program Purposes and Associated Metrics

Program objective or purpose	Selected associated REO metrics
Home Loan Guaranty Program objective: • To help veterans purchase, retain, and adapt homes	• Percentage of REO sales to owner-occupants and investors • No metric to track REO sales to veterans
REO program purpose: • Maximize the return on VA investment • Minimize the time properties are held in inventory	• Average sales price • Average initial list price • Average final list price • Average estimated market value • Net return from sale on VA investment • Days in inventory

Source: GAO analysis of Department of Veterans Affairs (VA) documentation. | GAO-21-219

One of VA's REO metrics—percentage of sales to owner-occupants and investors—helps measure the program's role in promoting homeownership.[63] However, no REO metric helps measure the program's role in promoting homeownership specifically for veterans, or in otherwise supporting veterans. While supporting veterans and supporting veteran homeownership are not expressly goals of the REO program itself, they are goals of the Veterans Benefit Administration Home Loan Guaranty Program, which administers VA's REO program. VA also has a loan program that offers REO properties to qualified borrowers with little to no down payment.[64] However, while VA collects data on program

[63]According to VA officials, compiling information on investor and owner-occupied sales also serves several business needs, such as loan underwriting purposes and other operational requirements.

[64]The VA Vendee Loan Program provides buyers of VA REO properties a seller-financed loan product that VA describes as a competitive and affordable alternative to traditional financing.

participants' veteran status, it does not use that information to measure the extent to which that program is serving veterans.

OMB guidance states that performance goals, indicators, and targets should reflect a program's missions and objectives and that agencies should collect and use program performance data to track performance, make decisions, and improve results.[65] VA officials told us that the statutory purpose of the REO program is fiduciary—namely, to recoup funds paid out in loan guaranty claims as a result of foreclosure. However, they noted that achieving this purpose can also help the community where the property is located—for example, seeking to recoup funds by quickly selling the property reduces the amount of time the property sits vacant or abandoned.

Moreover, VA representatives said that while the agency is statutorily required to track veteran status of participants of its mortgage lending and other benefit programs, it is not required to track the veteran status of those who purchase REO properties. Purchasers of VA REO properties can voluntarily indicate their veteran status, but officials stated that because these data are voluntary, they may not be sufficiently comprehensive and reliable for tracking how many veterans purchase a property from the REO program. However, VA did not analyze the information that was available to determine if it could be useful. Tracking metrics on the extent to which VA's REO program serves veterans—such as by collecting and analyzing information from REO property buyers on veteran status—could help VA assess the extent to which the program supports the Veterans Benefit Administration's goal of supporting veteran homeownership.

RHS Does Not Have REO Metrics Related to Serving Low- and Moderate-Income Rural Homeowners

RHS's performance metrics for its REO program generally focused on two REO program goals—to sell properties quickly and at the best possible price (see table 3). For example, RHS received performance information from VA that included metrics related to days in inventory and

[65]OMB, Circular No. A-11.

average sales price.[66] The VA contractor's performance information also included metrics related to homeowner and investor purchases. In addition, RHS set its own goals of reducing holding times by 50 percent and increasing return on sale by 20 percent.

Table 3: Rural Housing Service's Real Estate-Owned (REO) Program: Program Goals and Associated Metrics

REO program goals	Selected associated metrics
• Sell REO properties quickly and at the best possible price	• Average sales price • Average initial list price • Average final list price • Return on sale • Net recovery value
• Whenever possible, preference to buyers eligible for RHS loan programs	• Homeowner/investor-occupant sales • Closing by finance type (e.g., RHS loan program) • No metric to indicate whether preference given to eligible low- to moderate-income rural homeowners

Source: GAO analysis of Rural Housing Service (RHS) documentation. | GAO-21-219

While not expressly a goal of the REO program itself, RHS's Single Family Housing office administers the REO program and has the goal of providing low- and moderate-income households the opportunity to own a home in rural areas. Furthermore, RHS's REO guidance states that buyers eligible for RHS's direct or guaranteed loan programs should be given preference to purchase REO properties.[67]

However, while RHS had metrics to track purchases of REO properties by owner-occupants or investors and the type of financing used to purchase the properties, RHS did not have metrics, goals, or targets to track REO

[66]As previously stated, from 2015 to 2020, RHS operated its REO program for 31 states under an interagency agreement with VA, which allowed RHS to use VA's national contractor to manage and provide maintenance and disposition services for a portion of RHS's REO properties. The agreement stated that VA-managed RHS REO would rely on VA's monitoring and oversight processes and procedures. RHS manages the remainder of its REO properties through another contractor and its field offices.

[67]Direct loan-eligible buyers must meet income guidelines—at or below the applicable low-income limit at loan approval—for the area where the house is located, demonstrate a willingness and ability to repay debt, and be unable to obtain a loan from other sources on reasonable terms and conditions. The buyers also must use the dwelling as their primary residence.

sales to low- or moderate-income rural households.[68] According to RHS officials, since 2015, its REO program has focused on selling properties quickly and for the best price. RHS officials also said they had a large backlog of REO properties that had accumulated before the VA–RHS interagency agreement.

As of January 2021, RHS was transitioning from using VA's REO maintenance and marketing contractor to selecting its own REO contractor.[69] This shift to direct oversight of its REO inventory provides RHS an opportunity to reassess the metrics, goals, and targets it uses for its REO program. Additional metrics, goals, or targets related to REO sales to low- and moderate-income rural homeowners would help RHS assess the extent to which its REO program helps support the agency mission of serving that population.

Freddie Mac's Metrics Address All of Its REO Program Goals

Freddie Mac has metrics related to each of the three goals of its REO program—to increase financial recoveries, promote homeownership opportunities, and stabilize communities (see table 4). For example, for financial recoveries, Freddie Mac has metrics that track REO sales proceeds and estimated disposition losses.

Table 4: Freddie Mac's Real Estate-Owned (REO) Program: Program Goals and Associated Metrics

REO program goals	Selected associated metrics
Increase financial recoveries	• Sales proceeds • Net proceeds • Valuation accuracy rate • Retail sales recovery rate • Estimated disposition loss rate
Promote homeownership opportunities	• Owner-occupied/investor sales
Stabilize communities	• Sales through alternative sales programs (such as First Look)

[68]Purchasers used cash financing in over 70 percent of sales during this period. USDA, VA, and FHA financing options were used infrequently. In addition, it is not clear from the reports we reviewed to what extent preference was given to owner-occupants. For example, in the fourth quarter of 2019, the share of sales to investors was 76 percent and the share of sales to owner-occupants was 24 percent.

[69]RHS staff told us that this was part of a broader set of changes, including foreclosure mitigation.

Source: GAO analysis of Freddie Mac documentation. | GAO-21-219

Freddie Mac also has metrics related to promoting homeownership opportunities and stabilizing communities, such as sales to owner-occupants and sales made through alternative homeownership sales programs. Specifically, Freddie Mac's REO program management report included the number of properties sold under its First Look program (which provides owner-occupants and nonprofit organizations time to place offers on REO properties before they are offered to investors). While Freddie Mac did not have a specific target, it tracked the data over time.

Conclusions

Foreclosed, abandoned, and vacant properties—including REO properties, which reached historically high levels in 2010–2013—can have negative effects on communities. FHA, VA, and RHS have emphasized financial goals for their REO programs. But these agencies generally lack metrics to measure how their REO programs support their respective missions to strengthen neighborhoods and communities or serve veteran populations or low-income rural homeowners. Developing and using such metrics could help the agencies assess how their REO programs might help stabilize communities experiencing economic stress, and how they might better serve agency missions and goals. Although the future economic impact of the COVID-19 pandemic on the housing market is uncertain, these efforts may become increasingly important if foreclosures rise and federal entities see their REO inventories increase.

Recommendations for Executive Action

We are making the following three recommendations (one each to FHA, VA, and RHS):

The Commissioner of FHA should identify and use metrics that measure how the agency's REO program supports its regulatory goal of strengthening communities. For example, the agency might measure the policy outcomes from the REO property sales made through FHA's alternative sales programs. (Recommendation 1)

The VA Under Secretary for Benefits should identify and use metrics that measure how the agency's REO program contributes to VA's mission to support veterans and veteran homeownership, such as metrics that track veteran purchases of REO properties. (Recommendation 2)

The Administrator of RHS should identify and use metrics that measure how the agency's REO program contributes to RHS's mission of supporting low-income homeowners in rural areas, such as metrics that track this population's purchases of REO properties. (Recommendation 3)

Agency Comments

We provided a draft of this report to HUD, the Department of Agriculture, VA, the Federal Housing Finance Agency, Fannie Mae, and Freddie Mac for review and comment. HUD (Federal Housing Administration) and VA provided written comments, which are reproduced in appendixes III and IV. With regard to our recommendation to HUD, the agency noted that the impacts of HUD's mission programs are not easily quantifiable but stated that FHA would consult with HUD's Office of Policy Development and Research to see if it can update and expand its research on the impact of its mission programs. VA stated it agreed with the recommendation addressed to it, and the agency set a target date for implementing that recommendation. The Department of Agriculture (Rural Housing Service) responded with an email indicating its general agreement with the report. In addition, Freddie Mac, the Rural Housing Service, and VA provided technical comments, which we incorporated as appropriate.

We are sending copies of this report to the appropriate congressional committees, the Secretary Designate of Housing and Urban Development, the Secretary of Agriculture, the Secretary of Veterans Affairs, the Director of the Federal Housing Finance Agency, the Chief Executive Officer of Fannie Mae, the President of Freddie Mac, and other interested parties. In addition, the report will be available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-8678 or pendletonj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix V.

John H. Pendleton
Director, Financial Markets
and Community Investment

Appendix I: Objectives, Scope, and Methodology

Our objectives in this report were to examine (1) trends in the number of real estate-owned (REO) properties during 2004–2019 and reasons for the trends; (2) factors that affect federal entities' costs of maintaining REO properties; (3) federal entities' oversight of REO property maintenance; and (4) whether federal entities' performance goals and metrics for their REO programs align with entities' missions. We focused primarily on four federal entities: the Federal Housing Administration (FHA), Freddie Mac (a government-sponsored enterprise), the Department of Veterans Affairs (VA), and the Department of Agriculture's Rural Housing Service (RHS).[1] We selected these federal entities because of the role they play in the mortgage market.[2] We focused our audit on REO single-family residential properties (1–4 unit properties).

To address our first objective, we reviewed and analyzed federal entities' annual reports to Congress and other public reports issued between 2004 and 2020 that included summary data and analyses of federal entities' foreclosure and REO property portfolios. We started with 2004 to capture trends for the housing bubble and 2007–2011 housing crisis and for comparison with current conditions.[3] We also reviewed federal entity documentation about programs the entities used to dispose of properties in foreclosure and REO status.

To understand the reasons for the changes observed in entities' foreclosure and property volumes, we analyzed federal entity policy and program guidance and conducted a literature review on changes in

[1]The two government-sponsored enterprises that have REO inventories are Fannie Mae and Freddie Mac. We included Fannie Mae in our first objective looking at general changes in numbers of foreclosures and REO properties. Due to active litigation between Fannie Mae and the National Fair Housing Alliance on REO issues, we excluded Fannie Mae from our other three objectives.

[2]FHA and VA loan guarantees support a significant share of mortgage debt, and the government-sponsored enterprises purchase a significant share of mortgages from lenders.

[3]The housing crisis of 2007–2011 resulted in historic rates of mortgage defaults and foreclosures. We use the 2007–2011 date range to identify the housing crisis based on the S&P/Case Shiller National Home Price Index, according to which average home prices fell each calendar year in that period, for a total decline of almost 27 percent.

foreclosures and vacant properties. More specifically, we searched key databases of scholarly articles and working papers, conference papers, and association or nonprofit publications. We collected and reviewed 158 articles related to these topics. We also identified other articles through references and footnotes, and through interviews with organizations. We also interviewed or attended presentations by federal entity staff, academics, and representatives of nonprofit organizations with expertise in housing issues (Atlanta Neighborhood Development Partnership, Center for Community Progress, National Community Stabilization Trust, Mortgage Bankers Association, and the Urban Institute), and companies that conduct maintenance or real estate management services for federal entities. To assess REO property trends among nonfederal entities, we analyzed data on the value of REO portfolios of active banking institutions, such as bank holding companies and savings and loan institutions.

To address our second objective, we analyzed data from our four selected federal entities on property maintenance costs paid to contractors for REO property maintenance activities.[4] We analyzed summary information from the entities on the total number of REO properties maintained during 2017–2019, nationally and by region and state. We selected the 2017–2019 period to reflect the most recent full-year trends in maintenance costs and market conditions. We also analyzed data for this period on the age of the REO properties and the amount of time properties spent in REO inventory.

From each of the four entities included in our audit, we requested information on maintenance costs in the following categories: initial inspection, initial maintenance, ongoing maintenance, emergency services or additional repairs requiring approval, and demolition.[5] We developed the categories based on our analysis of common activities typically performed by the entities based on their program requirements and local government requirements. Because entities varied in how they classified their REO maintenance activities, in some cases cost data the

[4]Each federal entity provided data for all U.S. states, Puerto Rico, and other territories for which they had properties in their REO portfolio during 2017–2019. However, RHS did not provide data for Alaska, Vermont, and the District of Columbia.

[5]The data received from FHA included Home Equity Conversion Mortgages (more commonly referred to as "reverse mortgages"). These properties are maintained to a limited extent by FHA while still occupied by the owner prior to fully entering the REO portfolio.

entities provided were organized by the entities' categories rather than the categories we requested.

We visited the Atlanta metropolitan area to view properties in the federal entities' REO portfolios. We had also selected Santa Ana, California, for a second site visit but were unable to carry out the visit because of the COVID-19 pandemic.[6] Additionally, we attended a conference on property preservation issues and reviewed literature identified during our literature search on factors that affect property conditions. To understand factors affecting property maintenance, we spoke with entity officials, academics, and representatives of nonprofit organizations.

We took various steps to assess the reliability of the data analyzed in the first two objectives, including interviewing knowledgeable officials, reviewing related documentation, and analyzing the data for anomalies or errors. In the few instances in which we identified potential errors, we followed up with the data provider to confirm or correct the data. Based on these actions, we determined the data were sufficiently reliable to report on the REO property volume and value of portfolios, and property preservation costs of our four selected federal entities.

To address our third objective, we reviewed laws and regulations related to entities' REO property disposition programs and policies. We also reviewed the federal entities' property maintenance contracts from 2017 to 2020. In addition, we reviewed contract monitoring requirements and contract policy and guidance. To assess whether agencies had processes in place to ensure contractors performed and achieved the objectives of the contracts, we compared this documentation against relevant contractor oversight criteria, including GAO's federal acquisition framework.[7]

For FHA, we reviewed the contract for eight property maintenance contractors and seven asset management contractors. We reviewed a nongeneralizable sample of inspection scorecards, on-site inspections, or quarterly inspection reports for one maintenance contractor and one asset management contractor in each of the four HUD homeownership

[6]Our site selection originally factored in housing market conditions and the locations of entities' field operations, among other considerations. However, we had to adjust our selection based on travel limitations due to the COVID-19 pandemic.

[7]GAO, *Framework for Assessing the Acquisition Function at Federal Agencies*, GAO-05-218G (Washington, D.C.: Sept. 1, 2005).

center regions during the 2017–2020 period of our review (total of seven contractors).

For Freddie Mac and VA, we reviewed the contracts of each entity's single national contractor. VA entered into a contract with a base year obligation and annual options to renew for 10 years. For RHS, we reviewed the 2015–2020 interagency agreement between VA and RHS, under which VA's contractor maintained RHS properties in 31 states. We also reviewed documentation describing the preservation and maintenance for geographically dispersed properties within 19 RHS field offices.[8]

For each entity, we analyzed nongeneralizable samples of contractors' quality control documents; federal entities' inspection scorecards or inspection reports; documentation of contractors' inspections of subcontractors; and documentation of other entities, such as third-party inspection companies and real estate brokers. We also interviewed entity officials and property preservation contractors. In addition, for FHA specifically, we reviewed a nongeneralizable sample of "scorecards" assessing the performance quality of one property maintenance contractor and one asset management contractor operating in each of the four homeownership center regions, as well as screenshots of the property case management system showing where the system records scorecards for all FHA contractors.

We reviewed reports from FHA's case management system that documented corrective action or returns of FHA payments. In addition, we reviewed one deficiency letter issued to one property maintenance contractor during the 2017–2020 period of our review, as well as the corrective action plan for the contractor, and followed up with FHA staff about performance improvement.

For Freddie Mac, we reviewed third-party inspection reports and examples of deficiencies they identified. We also reviewed a report of contractors terminated for poor performance from 2017 through 2019. We also reviewed four end-of-year contractor scorecards for 2016–2019. For VA, we reviewed nine quarterly review summaries from 2017 through 2019. For RHS, we reviewed four VA contractor quarterly review summaries and monthly performance reports for 2017–2019. We

[8]We reviewed the 2015–2020 interagency agreement between VA and RHS, but did not review the oversight procedures of the 19 RHS field offices that directly manage REO properties.

interviewed entity staff responsible for contract oversight and the REO programs and reviewed property inspection reports.

To address our fourth objective, we assessed the financial, program, and mission-related performance goals and metrics in our four selected federal entities' contract monitoring guidance and program guidance, documentation, and reports. Across the four entities, we determined which performance information supported the entities' respective program goals or objectives. The general categories we developed were based on a review of metrics across the entities that we determined were financial, promoted homeownership, or were related to the entities' missions. For the purposes of our report, we defined goals as a statement of the result or achievement toward which effort is directed. Goals can be long- or short-term and may be expressed specifically or broadly. A performance goal includes a performance indicator, a target, and a time period. An indicator is a measurable value that indicates the state or level of something. A target is a quantifiable or otherwise measurable characteristic typically expressed as a number that tells how well or at what level an agency or one of its components aspires to perform.[9]

For FHA, we reviewed annual reports of financial and program performance for 2017–2020. We also analyzed data on REO sales through other mission-related programs, such as the Good Neighbor Next Door program, the $100 Down program, the nonprofit organization discount program, and the Neighborhood Stabilization Program. We reviewed program guidance, contractor performance work statements, and public reports to assess the extent to which FHA had established goals for its REO disposition program.

For Freddie Mac, we reviewed annual business performance metrics reports for 2017–2019 that included goals and results of REO program performance. For VA, we reviewed quarterly and annual performance reports between January 2017 and December 2019. For RHS, we reviewed VA quarterly and annual performance reports provided to RHS and RHS annual summaries of performance. For all four of our selected federal entities, we assessed whether REO performance goals and metrics aligned with the agency missions and program goals by reviewing agency annual reports, regulatory requirements, and REO program

[9]Office of Management and Budget, *Preparation, Submission and Execution of the Budget*, Circular No. A-11 (Washington, D.C.: July 2020).

guidance and comparing these against each entity's REO program goals and agency missions. We also reviewed Office of Management and Budget performance reporting guidance.[10] In addition, we interviewed each entity's REO program staff.

We conducted this performance audit from March 2019 to March 2021 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[10]OMB, Circular No. A-11.

Appendix II: Strategies and Programs Used to Address Vacant and Abandoned Properties

Foreclosed, abandoned, and vacant properties can have a negative effect on the surrounding community, especially if the property is allowed to fall into disrepair. Local governments and nonprofits use a number of strategies to mitigate these negative effects, and some federal programs target assistance to localities to address this issue.

Local Government and Nonprofit Organization Strategies

Vacant property registration ordinances require vacant properties to be registered with local governments.[1] One purpose is to identify the responsible party for the property, so that local government code-enforcement authorities know whom to contact in case of violations, such as uncut grass, debris, or health and safety hazards.

Land banks are governmental entities or nonprofit corporations that focus on the conversion of vacant, abandoned, and tax-delinquent properties into productive use. They may demolish or develop a property while working with the local community.[2] Land banks often acquire properties that otherwise would be difficult to sell and might remain vacant for prolonged periods.

[1]For more information on vacant property registration systems, see the following: Timothy A. Davis, "A Comparative Analysis of State and Local Government Vacant Property Registration Statutes," *The Urban Lawyer*, vol. 44, no. 2 (Spring 2012); and Arnab Biswas, Chris Cunningham, Kristopher Gerardi, and Daniel Sexton, *Foreclosure Externalities and Vacant Property Registration Ordinances*, Federal Reserve Bank of Atlanta (Atlanta, Ga.: 2019).

[2]For more information on Land Banks, see Payton Heins and Tarik Abdelazim, *Take it to the Bank: How Land Banks Are Strengthening America's Neighborhoods*, Center for Community Progress (2014).

Demolition may be used when the costs to repair a property are greater than the property's value. After demolition, the empty lot can be used for greening strategies (see below), or developed by land banks or other entities. Literature and academic and nonprofit experts with whom we spoke emphasized the importance of demolition in dealing with severely dilapidated properties. Data we examined from federal entities that hold real estate-owned properties indicated that demolition was uncommon—comprising less than 3 percent of their maintenance spending for 2017–2019.[3] One entity representative said demolition was used when required for safety issues. Another said it was not a primary strategy in the Northeast because the process is costly and returns from selling a vacant lot are lower.

Greening strategies allow municipalities to convert vacant lots into parks and green spaces. Greening strategies, such as those used in Philadelphia, Baltimore, or Cleveland, can be effective at repurposing land after demolition of vacant or abandoned properties, according to articles we reviewed and two housing experts we interviewed.[4]

Receivership is an option when property owners are not responsive to local governments. A receiver can be a nonprofit or other entity chosen by the locality to sell, renovate, or destroy a property. If the property owner cannot prove in court the financial capability to renovate the property, the receiver can market and sell the property. Buyers of properties in receivership generally agree to renovate the property.

Reforms to the foreclosure process. A prolonged foreclosure process may increase the maintenance costs of vacant properties for the entity that takes ownership after foreclosure. Eighteen states and Puerto Rico require foreclosures to go through judicial proceedings, which typically take longer than the foreclosure process in states with nonjudicial,

[3]The Department of Veterans Affairs, the Federal Housing Administration (within the Department of Housing and Urban Development), the Rural Housing Service (within the Department of Agriculture), and Freddie Mac all hold real estate-owned property as a result of mortgage purchase, guarantee, or insurance programs.

[4]For example, see Alan Mallach, *The Empty House Next Door: Understanding and Reducing Vacancy and Hypervacancy in the United States*, Center for Community Progress, Lincoln Institute of Land Policy (2018).

administrative procedures.[5] To address the issue of prolonged foreclosure proceedings, some states have enacted laws or taken other steps to streamline or expedite the foreclosure process. One analysis we reviewed cautioned that the success of strategies that try to speed up foreclosures—so-called "fast track" foreclosure legislation—depends on the design of the legislation and how it is implemented.[6]

Selling tax liens. Localities often find it difficult to identify the responsible parties for a vacant property. When these parties cannot be identified, property taxes go unpaid and the locality may set a tax lien against the property. Some regions have experimented with selling tax liens to third-party collectors to recoup some of the lost property income while increasing the probability that the property owners will be identified and maintenance issues will be remedied. One expert we interviewed said that selling tax liens to third parties can be an effective method of getting properties back into the private market—as was the case with the Third Party Transfer system in New York City.[7] However, local governments may have difficulty ensuring that purchasers of the liens adequately maintain the properties.

Federal Assistance for Local Strategies to Manage Foreclosed and Vacant Properties

Hardest Hit Fund. The Department of the Treasury established the Hardest Hit Fund program in 2010 as part of the Troubled Asset Relief Program to help stabilize the housing market and assist homeowners

[5]See Federal Housing Finance Agency Office of Inspector General, *Overview of the Home Foreclosure Process*. Accessed at fhfaoig.gov/Content/Files/SAR%20Home%20Foreclosure%20Process.pdf.

[6]For more information on the effects of fast-tracking foreclosures, see Robert Finn and Julia Gordon, *Fast Track Foreclosure Laws: Not a Silver Bullet for Fighting Blight*, National Community Stabilization Trust (August 2018); and Kyle Fee and Thomas J. Fitzpatrick IV, "Estimating the Impact of Fast-Tracking Foreclosures in Ohio and Pennsylvania," *Economic Commentary* (March 2014).

[7]Under the Third Party Transfer program, according to the New York City Department of Finance, the department and the Department of Housing Preservation and Development work together to resolve a property's outstanding charges and violations. If the charges cannot be resolved, the property is subject to foreclosure, after which ownership is transferred directly to a nonprofit organization and an affordable housing developer is identified. See https://www1.nyc.gov/site/finance/taxes/property-in-rem-forclosure.page, accessed December 18, 2020.

facing foreclosure in the states hardest hit by the housing crisis.[8] The Department of the Treasury had obligated a total of $9.6 billion in Troubled Asset Relief Program funds to 19 state housing finance agencies as of the end of 2018. Housing finance agencies used funds to implement programs that address foreclosure and help stabilize local housing markets—for example, by demolishing blighted properties.

Neighborhood Stabilization Program (NSP). This program provided three rounds of funding between 2008 and 2010 to more than 300 state and local governments.[9] NSP participants used the funding to reduce the number of foreclosed and vacant properties and restore depressed local markets. Municipalities used NSP funds to finance demolitions and mitigate blight caused by foreclosed or vacant properties. Some municipalities used NSP funding to improve thousands of properties. Municipalities also said technical assistance, such as web-based resources, had been beneficial to municipal staff.[10]

Federal-local partnerships. Partnerships between federal agencies and local organizations can enable local organizations with expertise and community buy-in to utilize federal resources and structures to help communities. An example of a federal-local partnership is the relationship the Federal Housing Administration (FHA) Philadelphia homeownership center had with the Cuyahoga Land Reutilization Corporation. Under the agreement, the corporation was eligible to purchase real estate in Cuyahoga County, Ohio, at reduced prices to rehabilitate the properties and prevent blight in local communities. In fiscal year 2019, the

[8]For more information on the Hardest Hit Fund, see GAO, *Troubled Asset Relief Program: Treasury Continues Winding Down Housing Programs*, GAO-21-39 (Washington, D.C.: Dec. 8, 2020) and GAO *Troubled Asset Relief Program: Monitoring of the Hardest Hit Fund Program Could Be Strengthened*, GAO-19-100 (Washington, D.C.: Dec. 21, 2018).

[9]The first phase of this program, NSP 1, was authorized by the Housing and Economic Recovery Act of 2008, which provided $3.92 billion in grant funds. Pub. L. No. 110-289, § 2305, 122 Stat. 2654, 2854. The American Recovery and Reinvestment Act of 2009 provided an additional $2 billion in NSP funds (referred to as NSP 2) and changed several aspects of the program. Pub. L. No. 111-5, 123 Stat. 115, 217. Later, the Dodd-Frank Wall Street Reform and Consumer Protection Act provided an additional $1 billion in funding for the program (referred to as NSP 3). Pub. L. No. 111-203, § 1497 124 Stat. 1376, 2209 (2010).

[10]See GAO, *Neighborhood Stabilization Program: HUD and Grantees Are Taking Actions to Ensure Program Compliance but Data on Program Outputs Could Be Improved*, GAO-11-48 (Washington, D.C.: Dec. 17, 2010); and *Vacant Properties: Growing Number Increases Communities' Costs and Challenges*, GAO-12-34 (Washington, D.C.: Nov. 4, 2011).

corporation purchased 15 properties from FHA (out of a total of about 285 FHA-owned properties in Ohio) and was expected to purchase 20 properties in fiscal year 2020.

CARES Act Funding. In response to the Coronavirus Disease 2019 (COVID-19) pandemic, Congress and federal entities extended mortgage forbearance and other assistance that may affect REO and vacant property trends in coming years.[11] Following the COVID-19 outbreak, Congress appropriated an additional $5 billion to the Community Development Block Grant (CDBG) program as part of the CARES Act. The combination of CARES Act appropriation language and authority granted to the Department of Housing and Urban Development have expanded the range of activities for which the funds could be used to mitigate negative effects of the pandemic on local housing communities.

[11]The CARES Act permitted borrowers with a federally backed mortgage loan experiencing a financial hardship due to COVID-19 to request forbearance on the mortgage for up to 180 days with an extension of another 180 days possible and prohibited servicers from initiating foreclosure for not less than 60 days beginning on March 18, 2020. CARES Act, Pub. L. No. 116-136, § 4022, 134 Stat. 281, 490 (2020). Several federal agencies provided additional protection.

Appendix III: Comments from the Department of Housing and Urban Development

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

January 25, 2021

John Pendleton
Director, Financial Markets and Community Investment
Government Accountability Office
441 G Street NW
Washington, DC 20548

Dear Mr. Pendleton:

The Department of Housing and Urban Development (HUD) appreciates the opportunity to respond to the draft report GAO-21-219 dated December 21, 2020, and entitled "FHA, Rural Housing Service, and VA Could Better Align Program Metrics with Their Missions". This letter responds to GAO recommendation for HUD for executive action.

Recommendation 1:

The Commissioner of FHA should identify and use metrics that measure how the agency's REO program supports its statutory goal of strengthening communities. For example, the agency might measure the policy outcomes from the REO property sales made through FHA's alternative sales programs.

HUD Response:

FHA agrees that foreclosed, abandoned, and vacant properties can have negative impacts on communities. As described in 24 CFR 291.1(a)(2), FHA is fully dedicated to selling HUD Real Estate Owned (REO) properties with the expectation of expanding homeownership opportunities, strengthening neighborhoods and communities, all while ensuring a maximum return to the Mutual Mortgage Insurance Fund.

To achieve these goals, FHA has been committed to its longstanding programs that not only include the initial exclusive sales preference to owner-occupants through its standard sales program, but also through its alternative sales programs. These alternative programs, also known as mission programs, primarily consist of the Good Neighbor Next Door (GNND), HUD-approved Nonprofits and Asset Control Area participants. With the decline in the REO inventory over the last few years, the properties eligible for these programs has also diminished. This reduction in overall sales also influences the impact that these programs have on communities.

The impacts of HUD's mission programs are not easily quantifiable. The last study that focused on the impact of the programs was performed by HUD's Office of Policy Development and Research (PD&R) in 2002. This study focused on the officer and teacher components of the current

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GNND program. This study did show that the sale to officers and teachers had a positive impact on the communities with the most quantifiable metrics being the reduction in crime due to more officers living in the neighborhoods. Because this study was performed so long ago and only covered two eligible participants of the mission programs, FHA will consult with PD&R to see if they are able to update and expand their research.

We appreciate GAO's review and discussions regarding metrics that measure how HUD's REO program supports its statutory goal of strengthening communities.

Sincerely,

John L. Garvin
General Deputy Assistant Secretary for Housing

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Text of Appendix III: Comments from the Department of Housing and Urban Development

Page 1

January 25, 2021

John Pendleton

Director, Financial Markets and Community Investment Government Accountability Office

441 G Street NW Washington, DC 20548

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Sincerely,

John L. Garvin

General Deputy Assistant Secretary for Housing

Appendix IV: Comments from the Department of Veterans Affairs

THE SECRETARY OF VETERANS AFFAIRS
WASHINGTON

January 26, 2021

Mr. John E. Pendleton
Director
Financial Markets and
Community Investment
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Pendleton:

The Department of Veterans Affairs (VA) has reviewed the Government Accountability Office (GAO) draft report ***HOME FORECLOSURE SALES: FHA, Rural Housing Service, and VA Could Better Align Program Metrics with Their Missions*** (GAO-21-219).

The enclosure provides a technical comment and the action plan to implement the recommendation to VA in the draft report.

VA appreciates the opportunity to comment on your draft report.

Sincerely,

Dat Tran

Dat P. Tran
Acting

Enclosure

Enclosure

The Department of Veterans Affairs (VA) Response to the
Government Accountability Office (GAO) Draft Report
HOME FORECLOSURE SALES: FHA, Rural Housing Service, and VA Could Better Align Program Metrics with Their Missions
(GAO-21-219)

Recommendation 2: The VA Under Secretary for Benefits should identify and use metrics that measure how the agency's REO program contributes to VA's mission to support veterans and veteran homeownership, such as metrics that track veteran purchases of REO properties.

VA Response: Concur. The Veterans Benefits Administration (VBA) has reviewed data collected on Veteran purchases of real estate-owned (REO) properties, including the Department of Veterans Affairs (VA) REO loan program, and determined that the data is useful to measure how the agency's REO programs contribute to VA's mission to support Veterans and Veteran homeownership. VBA is adding these metrics to monthly performance data reports to track this data over time.

Target Completion Date: February 28, 2021

Text of Appendix IV: Comments from the Department of Veterans Affairs

Page 1

January 26, 2021

Mr. John E. Pendleton Director

Financial Markets and Community Investment

U.S. Government Accountability Office 441 G Street, NW

Washington, DC 20548

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Sincerely,

Dat P. Tran

Acting

Enclosure

Page 2

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Target Completion Date: February 28, 2021

Appendix V: GAO Contacts and Staff Acknowledgments

GAO Contact

John H. Pendleton at (202) 512-8678 or pendletonj@gao.gov

Staff Acknowledgments

In addition to the contact named above, Nadine Garrick Raidbard (Assistant Director), Catherine Gelb (Analyst in Charge), Stephen M. Brown, Travis Hill, Jill Lacey, Kathryn B. Lenart, Brenda Mittelbuscher, Marc Molino, Barbara Roesmann, Jessica Sandler, and Sara Younes made key contributions to this report.

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Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, DC 20548

Strategic Planning and External Liaison

Stephen J. Sanford, Acting Managing Director, spel@gao.gov, (202) 512-4707
U.S. Government Accountability Office, 441 G Street NW, Room 7814,
Washington, DC 20548