



COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON, D.C. 20548

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Dear Mr. Chairman:

In accordance with your request of October 6, 1971, and subsequent discussions with our representatives, we reviewed the rural housing loan program of the Farmers Home Administration (FHA), Department of Agriculture, in five States to determine whether:

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- FHA county office employees had shown favoritism to certain contractors and material suppliers by requiring borrowers to use these contractors and suppliers.
- FHA county office employees had shown favoritism to certain private attorneys in assigning them to assist borrowers in loan settlement proceedings.
- FHA's administration of building specifications had been inadequate because contractors had been required to meet varying building specifications when preparing bids for FHA-financed houses.
- FHA had made loans on a first-come-first-served basis.

The five States--Arkansas, California, Georgia, Indiana, and Oklahoma--selected for review represent a good cross section of States with regard to geographic location and size of the program. About 226,000 rural housing loans totaling \$2.6 billion were made by FHA nationwide during fiscal years 1969-71. Seventeen percent or about 39,000 of these loans, totaling \$421 million, were made in these five States.

We visited the FHA State office in each State, and a total of 15 selected FHA county offices--two or more in each State. Our review covered 22 counties.¹ We reviewed FHA's policies, procedures, and practices and certain reports of the Department's Office of the Inspector General relating to

¹The counties were: Clay, Craighead, Lee, Randolph, and St. Francis Counties in Arkansas; Alameda, Monterey, San Benito, San Francisco, San Mateo, Santa Clara, Santa Cruz, Stanislaus, and Tuolumne Counties in California; Gordon and Walton Counties in Georgia; Lawrence and Monroe Counties in Indiana; and Grady, Noble, Oklahoma, and Okmulgee Counties in Oklahoma.

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the program. We also reviewed State and county office files for complaints about the program and examined county office files on loans made to about 3,400 borrowers during fiscal years 1969-71. We interviewed FHA State and county office employees, 231 borrowers, and certain contractors and material suppliers. Our findings are summarized below.

SELECTION OF CONTRACTORS AND MATERIAL SUPPLIERS

FHA instructions require an applicant for a rural housing loan to select one or more contractors, evaluate their qualifications and bid proposals, and award the contract. Although FHA county office employees are to encourage applicants to obtain competitive bids, FHA instructions allow an applicant to award a contract to a sole bidder. If an applicant has not selected a contractor prior to applying for a loan, he may receive such assistance from FHA county office employees.

FHA does not require its county offices to maintain information in the loan files on the number of bids an applicant obtains or the names of contractors he contacts.

When the contractor is also a material supplier, the above FHA instructions apply. When the contractor is not a material supplier, the contractor selects the material supplier; FHA has not issued instructions about the selection of material suppliers.

Contractors

Of the 230 borrowers we interviewed concerning selection of their contractors, 195 indicated that FHA county office employees had not provided the names of contractors, 24 indicated that FHA employees had provided the names of several contractors, and 11 indicated that FHA employees had provided the name of a particular contractor.

In the counties where borrowers said that FHA county office employees had provided the name of a particular contractor, we did not find any pattern showing that the applicants had been referred to the same contractor or any indications that applications had been rejected because the applicants had not selected the recommended contractor.

In three counties FHA county supervisors said they supplied lists of contractors when applicants had requested

assistance in selecting a contractor. The lists used in two of the counties, however, did not contain the names of all available contractors. Borrowers in these two counties were not limited to using the contractors on the lists, and some of the borrowers had used other contractors.

The highest percentage of FHA-financed houses built by any one contractor in each county ranged from 14 percent in Lawrence County, Indiana, to 45 percent in Okmulgee County, Oklahoma. Generally four or five contractors in each county had built most of the FHA-financed houses.

The files at FHA State and county offices contained a few complaints about favoritism to contractors. We tried to verify or substantiate these complaints through interviews and other means but were unable to do so.

Material suppliers

As mentioned earlier, in those cases where the material suppliers were not the contractors, the contractors selected the material suppliers. We did not find any evidence that FHA county office employees had influenced the contractors' selection of suppliers.

The FHA State and county office employees, contractors, and borrowers whom we interviewed did not have any complaints concerning the practices used in the selection of material suppliers.

SELECTION OF ATTORNEYS

FHA instructions provide that FHA State directors should designate attorneys in each county or area to furnish the legal services required in closing rural housing loans and that only in a rare case should less than two attorneys be designated in a county. The instructions also permit the State directors to approve title insurance companies to perform loan closing services if such companies issue satisfactory title insurance policies and are licensed in the States.

Procedures and practices for designating and using attorneys or title insurance companies differed in each of the States.

Arkansas--Several attorneys had been designated in each county and in some counties title insurance companies

had been approved. All of the designated attorneys and title insurance companies were being used to provide legal services required for loan closings. In some cases borrowers told us that FHA county office employees had selected or suggested the attorney.

California--Title insurance companies had been approved by the FHA State director to provide legal services for all loan closings in the State. Attorneys had not been designated or used for loan closings.

Georgia--Several attorneys had been designated in each of the two counties. Legal services for the majority of loans closed during fiscal years 1969-71, however, were performed by one attorney in each county--97 percent by an attorney in Gordon County and 68 percent by an attorney in Walton County.

Indiana--On September 22, 1969, the FHA State director designated one attorney in each of the two counties to provide legal services for closing rural housing loans. Each of these attorneys replaced an attorney who had been designated prior to the period covered by our review. Both of the designated attorneys were partners in law firms with the previously designated attorneys. The State director told us that only one attorney had been designated in each county because only one attorney had applied.

The designated attorneys provided the legal services for all rural housing loan closings in the two counties.

Oklahoma--In three of the four counties the FHA State director had designated several attorneys to provide the legal services for loan closings. In the other county--Oklahoma County--one attorney and two title insurance companies were designated. All of the designated attorneys and title insurance companies in the four counties were being used for loan closings.

Some borrowers told us the FHA county supervisor had selected the attorneys who provided the legal services for their loan closings.

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FHA State or county office files did not contain any complaints about the designation of attorneys in the counties included in our review.

ADMINISTRATION OF BUILDING SPECIFICATIONS

Our review of FHA's administration of building specifications was limited to determining whether FHA county office employees had required contractors to meet varying building specifications when preparing bids for FHA-financed houses.

Our review indicated that contractors were required to follow the same building specifications when bidding on FHA-financed houses. Prior to October 13, 1971, FHA required that all construction accomplished with rural housing loan funds comply with the minimum construction standards in FHA's "Guide for the Construction of Farm Buildings." On October 13, 1971, FHA announced that, effective on that date, use of FHA's minimum standards was to be discontinued and that the Department of Housing and Urban Development's minimum property standards for single family houses were to be followed.

Contractors who had built FHA-financed housing told us that they were familiar with the building specifications and that, in general, they believed the building specifications were administered uniformly by FHA county supervisors.

The files of the FHA State and county offices did not contain any complaints about FHA's administration of building specifications.

FIRST-COME-FIRST-SERVED SYSTEM OF MAKING LOANS

FHA instructions provide that rural housing loan applications should be considered in the order received.

Applications in the counties included in our review generally were processed on a first-come-first-served basis to the extent practicable. Eligible applicants for rural housing loans generally received their loans within 2 and 5 months after filing their applications.

Some applications were processed more quickly than others because the applicants had completed some or all of the actions required before FHA loans are made. These actions included selecting a contractor or developer, selecting the house wanted, submitting bids and specifications and other required information with the application, and obtaining the land. Applications also were processed more quickly in cases

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in which credit reports and employment verification data had been returned promptly to the FHA county office.

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We did not obtain written comments on these findings from any of the parties discussed in this report; however, the report was based on information available in their files or furnished by them and was discussed informally with them.

We plan to make no further distribution of this report unless copies are specifically requested and then only after your approval has been obtained or public announcement has been made by you concerning the contents. We will be pleased to supply further details on these matters if you desire.

Sincerely yours,



Comptroller General
of the United States

(1) The Honorable Hubert H. Humphrey
Chairman, Rural Development Subcommittee
Committee on Agriculture and Forestry
United States Senate