

units—far below the requirements of such a fast-growing state with so many low-wage jobs.

Nonprofit organizations offer even more hope. New York's East Harlem helps illustrate why. On East 105th Street, a solid rectangular apartment building with newly planted trees houses 101 elderly people. A few blocks away, on East 106th Street, fresh paint and new windows mark the apartment building as recently rehabilitated. More new paint and a sign, "Affordable Housing for New Yorkers," decorate a narrow building on 117th Street. The three buildings are the handiwork of Hope Community, which gets its funding from a complicated mix of HUD's Home Program, Community Development Block Grants, low-income-housing tax credits, city money and other sources. Executive Director Mark Alexander describes an endless maze of arcane regulations—some imposed by Congress to prevent waste and abuse. Whatever their intent, Alexander says it took him three years to win approval to build a housing project for the elderly. "The housing industry needs a few programs that are consistent and stable," he says, "so we can learn how to use them."

**Limited resources.** Even so, there's only so much a more streamlined federal housing agency can accomplish working through local governments and nonprofits. Daniel Leibsohn, president of the Low Income Housing Fund in San Francisco, has provided loans for nearly 15,000 units of nonprofit low-income housing since 1984. "I think nonprofits could do more housing, but only up to a point with existing resources," he says. "I think it's a longer-term project of trying to build up nonprofits."

There are no magic fixes, but any solution involves more money. Leibsohn would provide more attractive subsidies in order to involve more private developers. They could receive support to build turnkey projects, for example, to be handed over to tenants or nonprofits to manage. Kathryn Wylde, who recently left her longtime position as president of the New York City Housing Partnership, which created and renovated 15,000 units in New York City, believes that the federal government has to play a continued role but that the agency must be fixed first. "The tax base of New York City can't begin to address the needs of the people here," Wylde says. "We have to have federal participation and federal funding for these needs."

BY PENNY LOEB WITH WARREN COHEN IN CHICAGO, EDWARD T. POUND, TIMOTHY M. ITO AND DANA COLEMAN

## U.S. NEWS

# Of contacts and confidence

### Asking questions about billion-dollar deals

In 1994, officials at the Department of Housing and Urban Development launched an ambitious new program to sell off billions of dollars in troubled real-estate mortgages to private investors. The HUD-insured loans, on which borrowers had defaulted, were proving a drag on efforts to streamline the agency. The way the officials figured it, everybody would win. HUD would rid itself of unwanted baggage. Proceeds generated from the sales would be used against the deficit or for housing initiatives. And private investors would make a buck, reselling the mortgages at higher prices or foreclosing on deadbeats who hadn't made a mortgage payment in years.

In most ways the system has seemed to work as planned. Investors, with Wall Street firms taking the lead, eagerly

snapped up the troubled paper in 15 separate sales, the last one this past September. HUD removed 79,700 problem mortgages from its books, and the agency says it netted even more money than expected: \$1.3 billion for taxpayers.

**Questions.** The program has had a troubling underside, however. Based on a federal lawsuit filed by a top consultant at HUD and complaints from senior agency employees, the housing agency's inspector general has opened a criminal investigation into allegations that the \$11 billion mortgage-sale program may have been tainted by contracting fraud and instances of insider dealing. Now in its fifth month, the inquiry has resulted in the issuance of subpoenas and extensive interviews of senior HUD officials. People close to the matter say no conclusions have been reached about



**ADVISER.** C. Austin Fitts directed the Federal Housing Administration before going to work as a HUD adviser with partner Russell Davis. Some officials have raised questions about ties between HUD and her firm.

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whether laws were violated. But according to documents and these sources, the inquiry is focused on two questions:

■ Did certain Wall Street investment firms somehow gain an inside track to win loan packages? Most sales were conducted with sealed bids.

■ Did HUD officials break or bend procurement laws in awarding rich contracts to consulting firms retained to help manage the program?

At the center of the inquiry are two women who played key roles in developing the program. One is C. Austin Fitts, who served as federal housing commis-

small company to retain Hamilton. The firm, Williams, Adley & Co., paid Fitts's company \$6.6 million but denies it was forced to hire her firm.

Through her attorney, Dunlap denies pressuring Williams, Adley and says the firm itself proposed hiring Hamilton. The attorney also says that Dunlap never favored either Hamilton or Wall Street firms. In a statement, Dunlap, who resigned from HUD last month to take a job with a national housing organization, said: "Throughout my tenure at HUD, I acted in the best interests of the department."

Fitts, 45, a former Wall Street investment banker, says her firm was never

dals, Cisneros says he has started his own investigation of the FHA's procurement practices, including the "appropriateness" of past contract awards to Hamilton and to other program consultants. He says outside financial experts will conduct the review and determine what reforms are needed.

**A good plan.** The note-sale program was developed to address a growing problem. The agency has to pay claims to lenders when borrowers default on HUD-insured mortgages. By 1993, HUD owned mortgages on 2,400 multifamily housing projects and 90,000 single family homes. HUD officials say selling off the mortgages made sense

because the agency was wasting valuable resources to service the loans.

Clearly born of good impulses, the program was nevertheless a constant source of controversy. Inside HUD, senior employees began complaining more than a year ago that top agency managers were skirting procurement rules and paying excessive fees to Hamilton Securities. Top HUD officials apparently took no actions on the complaints. This past summer, there were more allegations—and they were much more sensational. A financial consultant named John Ervin, once one of HUD's top contractors and a competitor of Hamilton, filed a lawsuit in federal court charging widespread abuse in the

management of the note-sale program. Ervin's original and amended complaints are packed with allegations, some of which, he says, came from HUD employees.

Ervin's allegations, if true, are damning. He accuses HUD managers—specifically Helen Dunlap—of "contracting corruption and favoritism." Dunlap twisted procurement laws, Ervin says, to funnel millions of dollars in consulting business to Hamilton. Ervin says that HUD, in collusion with Hamilton, "stacked the deck against small investors," structuring the note sales so that the "big boys" on Wall Street would win most of the business. He cited as examples Goldman Sachs & Co., "a very large contributor" to the Democratic Party, and BlackRock Capital Fi-



**ASSETS AND LIABILITIES.** *The mortgage-sales program was born of a good impulse, to allow HUD to shed troubled loans like the ones on these buildings in Chicago while generating new revenue. The program has largely worked well, but questions have been raised about alleged insider dealings.*

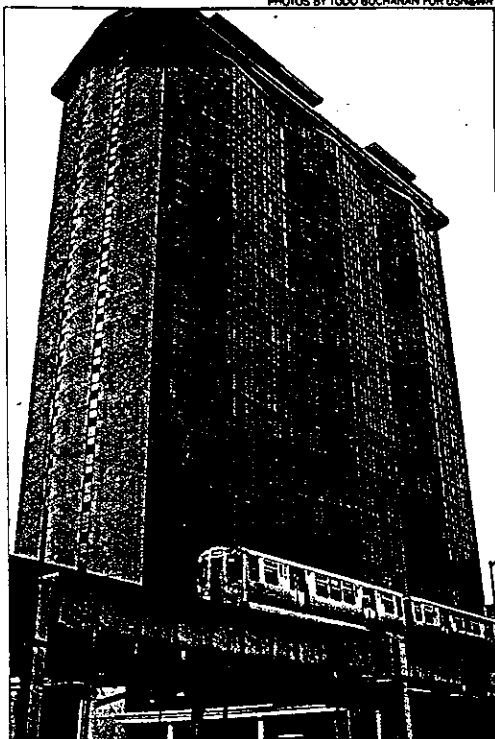
sioner a few years back and whose financial advisory firm is paid \$868,000 a month by HUD to help the agency manage the program and advise the agency on other issues. The other is Helen Dunlap, an advocate for low-income housing from California who took a top job at HUD in the fall of 1993. She directed the note-sale program. The two became friends and were part of the "New Girls Network"—a name others gave to an informal group of officials and consultants that wielded a lot of clout at HUD.

**Pressure?** In the case of Dunlap, several agency employees allege that she improperly directed lucrative business to Fitts's company, the Hamilton Securities Group Inc. In one case, a senior HUD employee says, Dunlap and another agency official "pressured" a

shown favoritism by Dunlap or other HUD officials. She also says her company never steered any note-sale business to Wall Street firms.

Inspector General Susan Gaffney declined to discuss her inquiry. But *U.S. News* has learned that her investigators recently seized Dunlap's records at HUD, and Fitts's company was served with subpoenas last August for some 50,000 documents. They included thousands of electronic-mail communications between Hamilton, HUD officials and firms that bid on the mortgage sales.

HUD Secretary Henry Cisneros defends the note-sale program, which is run by the Federal Housing Administration. "I believe our policy of note sales," he says, "was the right one." However, mindful of the agency's history of scan-



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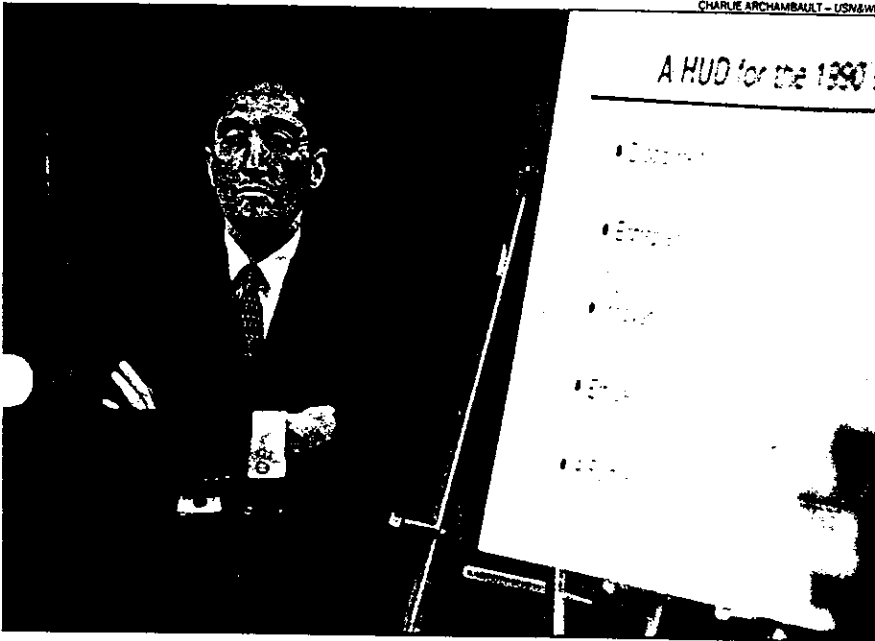
nance LP, a respected financial powerhouse. Goldman and BlackRock deny any impropriety.

Ervin, who did not sue Hamilton, says he was "blackballed" at HUD after repeatedly complaining. Agency officials call Ervin "a disgruntled contractor" and say his allegations must be viewed with skepticism because his company, which managed HUD assets, lost out whenever mortgages were sold off.

Investigators are carefully tracking the allegations in Ervin's lawsuit and have

and had "access to confidential information" on the mortgage sales. Though she didn't identify the bidders, people familiar with the letter say she was referring to BlackRock Capital, among others. Burstein also cited a meeting at HUD in which, she wrote, Hamilton officials "discussed the marketing of assets in a portfolio in front of a representative" of BlackRock, "which was bidding on that particular portfolio." At one point, Burstein added, Hamilton's representative "suddenly spoke, laughing, 'We have to watch what we say; remember there's a bidder in the room.'"

CHARLIE ARCHAMBAULT - USNEWS



**THE SECRETARY.** Henry Cisneros says he has worked hard to correct past abuses at the housing agency. The loan-sale program, he says, is just one example of innovation and produced big savings for the taxpayers.

questioned at least two companies that worked with Hamilton in developing the note-sale program. Both were asked about Hamilton's dealings with BlackRock Capital. One of the companies is Asset Strategies Group, a financial advisory firm that fell out with Hamilton over management differences last year.

"Going wrong." Asset Strategies has made its own complaints about improprieties in the mortgage-sales program. In September 1995, a company attorney, Karen Burstein, wrote to HUD complaining about shoddy work on loan packages and raising concerns about possible "manipulation" of the note-sale program. She warned that "something is, or is going, wrong."

In perhaps her most damaging charge, Burstein asserted that some bidders were working out of Hamilton's offices

Hamilton and BlackRock both deny any inside information ever was passed. Hamilton says BlackRock personnel worked out of its offices as a subcontractor helping structure an \$884 million note sale. During this period, which covered 1995 and part of this year, Hamilton also was structuring other note sales. HUD approved the arrangement.

BlackRock Capital did not bid on the \$884 million deal it helped design. However, one of the winners was an investment fund managed by Goldman, Sachs, which had partnered with BlackRock in successfully bidding on a prior note sale. Both investment firms say they acted properly at all times. Often partnering with others, BlackRock has won about one fourth of the business auctioned thus far, or \$1.6 billion.

HUD officials insist that all bidders have a fair chance at winning. As adviser to HUD on the note-sales program, however, Hamilton Securities was particularly sensitive to the expectations of Wall Street. In a confidential document submitted to HUD three years ago, the company said: "A good financial advisor can take advantage of Wall Street's desire to get a competitive advantage." The document, obtained by *U.S. News*, further explained Hamilton's philosophy: "Wall Street and institutional investors will provide a substantial amount of advice for free" in exchange for increasing "their understanding of a bidding situation." The company added that "their reward is early information and a possible inside track on future transactions. Properly done, there is nothing wrong with this process."

**Friends.** Fitts's company says it was not suggesting giving an edge to Wall Street firms over other bidders. Hamilton said it provided an equal amount of information to all bidders.

Of particular interest to investigators is Fitts's relationship with Helen Dunlap, the former HUD official. Documents and interviews with senior HUD employees indicate that Dunlap went to bat for Fitts more than once. In one case, the employees say, Dunlap influenced the results of a HUD selection process for recommending outside firms to be the agency's new financial advisers in 1996. According to this account, Hamilton finished out of the "competitive range" in the panel's evaluation. Dunlap intervened, the employees say, urging a new evaluation. The next time around, Hamilton finished first and eventually won a \$20 million contract. HUD officials acknowledge the company may have finished lower in the initial scoring but insist it was still competitive and fully qualified. Since Hamilton was awarded its first HUD contract in 1993, it has won \$47 million in agency-related business.

Fitts says she will ultimately be vindicated. Just a few days after her company got a subpoena from the inspector general last August, Fitts sent an E-mail message to a slew of HUD officials expressing her concern about the "frustration and meanness in the HUD building." She also warned them about the "hippo"—her shorthand for bad news—and urged everyone to stick together. It would be intolerable, she wrote, "if the hippo were to land on our heads this fall—as it surely will—and we were to turn on each other." ■

BY EDWARD T. POUND AND TIMOTHY M. ITO