FHA Scandal Spreads Across Nation

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PHILADELPHIA — Until it all collapsed in rubble, sending out tremors to every corner of the country, the dream house of Leon Bloom, realtor, seemed destined to stand for years.

Bloom was an area management broker for the Federal Housing Administration. To outsiders it may seem an insignificant title, but it established for Bloom a kind of realty kingdom over a large section of Philadelphia. It meant that whenever the FHA foreclosed a mortgage on a home in his domain, Bloom would receive a fee for managing the property, arranging for repairs and preparing it for eventual resale.

Before long, the enterprising Bloom had discovered new riches in his kingdom. Repair contractors, eager for his business, began kicking back 10 per cent of their profits to him. As his business grew—as the FHA acquired more properties that he managed—Bloom found that his kickback revenue was running as high as $40,000 and $50,000 a year.

In 1970, with his prosperity embracing a boat and a condominium in Florida, Bloom received a telephone call from a very important man in the home finance business—John B. Boyle, deputy director of the Philadelphia office of the FHA. It seemed that Boyle knew something about Bloom's extracurricular deals and wanted to talk about them. They arranged to have dinner.

It quickly became apparent that Bloom was not to be undone by the FHA boss. Boyle merely wanted some of the action for himself. As Bloom, in federal court testimony, recalled the scene, Boyle had gone right to the point:

"Mr. Boyle said that he was under the impression that I had an arrangement with various contractors that were doing FHA work and that he would like to have a piece of the cake."

So Bloom began slicing his cake, paying $100 a week to Boyle and also to another top FHA official, Michael J. Hughes, chief of the property management section. And every Christmas Bloom would send one of his employees, William (Uncle Billy) McGrath, out to Boyle's New Jersey home with a case of liquor.

It's all over now. Boyle went to jail

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for a year. Hughes was fined. Bloom, who cooperated with federal prosecutors, drew two years. A lot of other bubbles burst here, too. The Philadelphia area's top FHA official, Thomas J. Gallagher Jr., has gone to jail on income tax charges growing out of bribes he received. Seventeen real estate dealers have been convicted or have pleaded guilty. The large government-approved mortgage house was fined $160,000 for making false statements to the FHA.

But the pattern of kickbacks, bribes, fraud, tax evasion and conflict of interest in FHA programs isn't just a Philadelphia phenomenon. It is a national scandal erupting now in city after city. An astonishing diversity of culprits—lowly appraisers and prominent FHA chiefs, rich realtors and middle-level bureaucrats—are involved.

"It's unbelievable what went on in this city," says John Housner, deputy U.S. attorney in Detroit. "Paying bribes was just like delivering the mail. It was a daily phenomenon."

It is a classic national case of white-collar entrepreneurs reaping illicit profits from a government program designed to help the poor get decent housing. Subsidies aimed at low-income families in the slums were harvested instead of brokers, speculators, lenders and government employees. Taxpayers are picking up a lot of the losses. Two government funds created to back up the subsidy programs will be $1.5 billion in the red as a result next year.

The Justice Department says investigations of FHA frauds are under way in 20 cities, making this one of the biggest white-collar prosecutions in history. The chiefs of three metropolitan FHA insurance offices have been indicted. By the end of last year, there had been 180 indictments involving 317 persons engaged in inner-city programs of the Department of Housing and Urban Development. The scope is illustrated by reports from these cities.

- In Detroit, a grand jury has indicted more than 100 government officials, real estate speculators, and repair contractors. One speculator testified he paid the FHA's chief deputy appraiser and three other appraisers more than $100,000 in bribes over three years. A federal source predicted that "more people and more important people" will be indicted in 1974 than in the previous two years combined. "The big stuff to come will hit government people, mortgage companies, and some surprising names," the Detroit source said.
- A Chicago grand jury has indicted 71 people and convicted 54, including two former presidents of the local affiliate of one of the nation's biggest home-building firms. Both pleaded guilty to bribery of officials. Indictments of FHA officials have reached as high as the supervisor of inspections for the northern Illinois region. Payoffs ranged from as little as $200 to as much as $10,000.
- A big Florida builder, according to testimony introduced in federal court, agreed to pay $500 for each commitment of FHA insurance approved by an FHA regional official in Coral Gables. He put down $30,000 for the first 167 commitments, according to the testimony.
- A wave of indictments in Nassau County, N.Y., led to a guilty plea by the FHA director who was bribed to promote two lesser FHA officials who in turn were already being bribed by a large mortgage banking firm.

Apparently much more is to come. There are 16 grand juries meeting on the issue around the country and sources familiar with thier work expect a new round of idictments this spring.

So far, 38 local HUD employees have been indicted. Most of the other cases are against brokers, dealers and lenders accused of making false statements to the government about repairs made ployees have been idicted. Most of the other cases are against brokers, dealers and lenders accused of making false statements to the government about repairs made to houses or inccurate appraisals. Some investigators believe certain firms make a practice of seeking out low-income home-buyers and selling them homes they can't pay for—secure in the knowledge the government will pick up the defaulted mortgages.

In Columbia, S.C., U.S. Attorney Marvin Smith said he has about two dozen cases involving dealers underlinvestigation.

"My feeling is there is a considerable amount of fraud," Smith said. "It's the builders just finding a body and getting him to pretend he's buying a house without ever intending to pay for it It winds up with the dealer in effect telling the house to the government."

Florida's housing scandals illustrate what can happen when the promise of high-level political influence becomes entwined with FHA largesse. Newspaper stories thers have reported the basic oultine of a plan in which a former volunteer aide of Sen. Edward Gurney (R-Fla.) allegedly solicited funds from builders with the implicit promise of Gurney's assistance. Gurney has denied that the volunteer, Larry Williams, represented him, and insists he knew nothing about the solicitation in his behalf of an estimated $300,000.

How the system operated was detailed in federal court in Jacksonville recently by an FBI agent who said Williams told him the following:

"Mr. Williams and Mr. (Jim) Groot (Gurney's former administrative assistant flew to Miami, Florida, and contacted William Pelski, director of the FHA, Coral Gables, Florida. Mr.Williams and Groo explained to Pelski the reasons for the fund-raising, they were for expenses for Senator Gurney, and for the field office in Florida.

"Pelski agreed to let Williams know when he found a builder who he thought would contribute funds to this fund.

"About two weeks later, Pelski called Mr. Williams and told him that John J. Priestes (a builder) was in need of FHA commitments and would probably pay for the commitments.

"Mr. Williams flew to Miami, Florida, met John Priests on a houseboat which was arranged by Pelski.

"Priestes agreed to pay $500 for each FHA commitment under the Section 235 of the National Housing Act and Pelski agreed to furnish Priestes with these commitmnts.S

"Priestes paid $30,000 as the first payment for 167 FHA Section 235 commitments.

One example of a common FHA fraud is the appraisal scheme. It partially explains why the government has been forced to acquire so many defaulted properties—at vastly inflated costs—in the past few years. It works like this:

A builder buys a house in the ghetto for $10,000 and makes a few cosmetic repairs costing, say, $3,000. He has invested a total of $13,000. A bribed FHA appraiser makes a quick survey and appraises the property at $18,000. It is sold to a low-income buyer for a minimal down payment. A mortgage company puts up the balance and is insured by the FHA. The buyer quickly discovers the home is collapsing around him—soil pipes don't work, the roof leaks, gaping holes in walls have been cheaply panelled over. Unable to pay for repairs, the buyer simply moves out, abandoning the house along with his $200 down payment. The government must buy up the mortgage.

Everyone prospers but the government and the home-buyer. The real estate man made a $5,000 profit when he sold the property. The crooked appraiser got his fee. The mortgage banker collected his insurance. The government got a run-down house.

"There was this fundamental defect in the system," says Daniel Kearney, HUD's deputy assistant secretary for housing production and mortgage credit. "You had a system where all the risks were borne by the government. The broker and mortgage banker and the buyer had no incentive to see that it worked."

If the builders and mortgage bankers had no incentives to stop the fraud, HUD had only a minimal security system for detecting it. If an appraiser put a phony figure on a piece of paper (and took his cut from the realtor), that figure was apt to float upward through the HUD hierarchy without objection. There was a system of supervisory appraisers who were supposed to double check 5 per cent of the appraisals on a random basis. By 1970, with the FHA insuring more than a million mortgages, the system was inadequate.

The fraud is costing taxpayers millions of dollars as the government is forced to acquire slum properties at wildly inflated prices. In the Philadelphia area alone, HUD this year is the owner of 4,176 single-family homes it acquired because the insured mortgages were in default. (HUD did not own a single house in Philadelphia six years ago). Today, it also owns 10 apartment projects which it had to acquire at a cost of roughly $3.7 million. Detroit leads the country with more than 15,000 homes acquired by HUD.

Throughout the country, HUD had more than 75,000

JOHN B. BOYLE   LEO BLOOM

... two Philadelphia FHA officials in kickback scheme properties in its inventory last Dec. 31. Not all of them involved fraudulent practices, but a great many are homes whose values were deliberately inflated by phony appraisals and false repair costs.

The soaring rate of government acquisitions is playing havoc with special funds set up to take care of defaults in the riskier mortgage-insurance programs. The new HUD budget estimates that one of those funds will be $715 million in deficit in 1975. The other will be $810 million in the red, it is estimated. With the total deficit approaching $1.5 billion in the combined funds, HUD has been borrowing from the Treasury to cover deficits in those funds so far and now is asking for special appropriations from Congress.

How could such widespread corruption flourish in one government agency and among its commercial partners in the real estate-banking network? Why didn't the FHA scrub itself clean? One reason, in Philadelphia at least, is that the people on top were as much involved as the petty kickback artists at the bottom.

"Any system is only as strong as the people in power," observes U.S. Attorney Robert E. J. Curran, whose office prosecuted more than a score of cases here. "If you have the top FHA people who are corruptible there's a chance of corruption all along the way. When you have the head man on the take, there's no fail-safe."

But beyond that, how did FHA and the people who do business with it stumble in so deeply in the first place? Those who now run the Department of Housing and Urban Development advance this thesis: They are victims of bad housing programs initiated under the Johnson administration, housing programs so huge and unmanageable that the most careful administrators could not stop fraud.

ful administrators could not

In this view, it all goes back to the urban riots of the mid-1960s. Until then, the FHA was a conservative, competently managed agency which since the 1930s had reinforced the housing market by insuring mortgages in middle- and high-income neighborhoods. The FHA had not wanted to insure in low-income neighborhoods because of the high risk that buyers would default and force government acquisition of the mortgages. In fact, the FHA consistently had "red-lined" those neighborhoods — had drawn red lines on a map to delineate high-risk areas

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where mortgages would not be insured.

The riots and the Housing Act of 1968 changed all that. The FHA was pushed into the old, rundown neighborhoods. Other vast new subsidy programs were launched in the panicky atmosphere of the time.

One of them allowed HUD to subsidize mortgage interest payments so that a middle-income family could move to the suburbs by paying as little as 1 per cent interest on a mortgage.

Another authorized HUD to pay part of a low-income family's rent in apartments that had official endorsement by the government. Another new program allowed the FHA to insure mortgages when the down payment was as little as $200 and the terms of repayment as long as 40 years.

It was a drastic change for the FHA, which was promptly swamped with applications by builders and realtors who needed government certification of varying kinds.

"We were in it in such a big way, all of a sudden, that it was all terribly magnified," says William Lilley III, who is now HUD's deputy assistant secretary for policy development. "If we had it to do over again, we wouldn't start a big program like those without getting organized and doing some experimenting. But—Bang!—we went into it in volume production."

Each new program carried with it opportunities for bribery and influence-peddling. Appraisers could get a juicy fee for overstating the value of a property. A middle-level bureaucrat could profit by writing a "letter of feasibility" endorsing a proposed apartment project or merely by putting one favored developer's application ahead of others in the pipeline. A Philadelphia apartment project manager testified he was happy to pay off one HUD official whose favor simply had been to put his request for rent increases ahead of other requests.

One of the more convoluted cases arose on Long Island, N.Y., where 40 people and 10 corporations were indicted. The director of the FHA office in Hempstead, Donald Carroll, had been installed in that top job ostensibly to clean up the mess. He soon was indicted on charges of accepting a bribe from an officer of the area's largest mortgage banking house.

The charge: Taking a bribe to promote two minor officials who already were being bribed by the mortgage banker. One court document said Carroll promoted the two men to "help in the performance of their official duties corruptly." Carroll was sentenced to 10 years. An investigation determined that as much as 10 per cent of the defaulted mortgages in that FHA area involved falsified information.

The charges in Detroit embrace crimes at every step in the FHA processes, ranging from $100 in kickbacks to government appraisers to systematic bribery mounting to six figures.

Already a lot of big names in Detroit's business community are involved. The metropolitan area's six largest real estate speculators have been cut off from further government housing contracts because of the scandals.

Some government appraisers, according to the U.S. attorney's office, earned "six-figure profits" in bribes.

One such person was Emmett R. Newell, who was chief deputy appraiser for the FHA when he was indicted and convicted on eight counts of accepting bribes.

William Hahn, the city's third largest real estate speculator, testified he paid Newell and three other FHA appraisers more than $100,000 in bribes over a three year period. Newell and other appraisers charged $100 per house to guarantee speculators an inflated appraisal that would insure a hefty profit on FHA-guaranteed loans.

One appraiser, Alvin L. Love, charged $120 per house. He used the extra $20 to pay off an FHA assignment clerk to guarantee that he, Love, would be assigned houses he was being bribed to appraise falsely. Love got 10 years on 17 separate bribery counts.