

## How the Money Works on Computer Glitches at HUD

Hamilton had various contracts to help HUD with loan sales and other reengineering of its financial assets. HUD took the position in negotiating those contracts that it would not pay Hamilton under a compensation system in which Hamilton derived a % of its compensation from savings generated from sales performance. Hence, Hamilton helped generate \$2.2 billion of savings but did not receive a % of such savings as reward.

HUD also took the position in its various negotiations that they did not want to pay for a "Cadillac"; that a "Chevy" would do. This is one of the reasons that when OMB did an analysis of loan sales costs, including Hamilton's fees, they informed HUD that they were substantially below RTC fees on comparable transactions.

According to Hamilton's contract, Hamilton was responsible to help HUD complete the sales and to perform various deliverables. There was no requirement regarding standards of savings to be achieved. Hamilton was not an underwriter and all efforts were strictly "best efforts." HUD on numerous occasions stated that Hamilton if anything was too concerned with taxpayer savings and felt no need to encourage additional focus on taxpayers. In addition, HUD was not willing to pay for any type of "underwriting" role, wanting to manage and control competitive auctions themselves.

When Hamilton reported to HUD in late 1996 its discovery of a "computer glitch" on the West of the Mississippi (WOM) sale in Fall of 1995 and North Central in 1996, it disclosed that if the potential opportunity cost to HUD was \$2.3 million for WOM and \$1.5 million for North Central. That means if the glitch had not occurred and all other things had been equal that instead of the sales generating \$1.006 billion in revenues, they would have generated \$1.006 billion in revenues. Or, instead of generating \$343.8 million of budget savings under credit subsidy (that is money that can then be spent), they might have generated as much as \$347.6 million. On the full program, total savings would rise from \$2.2 billion to \$2.2 billion.

To help HUD with the sales, Hamilton was paid \$1.765 million for WOM and approximately \$.868 million for North Central, for a total of \$2.6 million for two sales that generated \$343.8 million of profit for the FHA General Fund---lowering the amount of taxpayers money necessary to fund ongoing originations and operations of that fund. Hamilton's expenses and all the expenses of doing the transaction were funded by the transaction. Again, Hamilton did not receive any % of the \$343.8 million in savings, even though the savings was widely attributed to many of the innovations that Hamilton had introduced, including the use of the Bell Labs optimization model.

When Hamilton reported the computer glitch to the Assistant Secretary of Housing and the FHA comptroller (also the contract GTM), they in turn reviewed Hamilton's report with the HUD Office of General Counsel.

No effort was made to ask Hamilton for an adjustment on their payments. That is because such a mistake does not constitute a "breach" under Hamilton's contracts. Hence, Hamilton was not responsible to return any of its compensation to HUD. If the mistake was a breach under the contract, Hamilton was required to return a pro rata amount. At the most, it would be approximately \$80,000.

Ten months later HUD suddenly took the position that Hamilton owed HUD the full potential opportunity cost amount of \$3.8 million, or approximately \$1.2 million more than Hamilton was paid to help HUD with the sales. HUD also terminated Hamilton's contract (with remaining work in process of approximately \$10 million) in a highly visible manner, in which most of HUD's positions were communicated via smears in the national press. While, in essence, holding Hamilton responsible retroactively to be an "underwriter," HUD did not propose that Hamilton should get a % of the upside. Throughout its performance of work for HUD, Hamilton had weekly meetings with HUD contract representatives. They indicated that Hamilton's performance was more than satisfactory throughout this period.

Although the agreement was made under seal, HUD and DOJ had welcomed an arrangement with Ervin & Associates that they would receive compensation of 15-30% of any bounty he made for the taxpayers. If the government had agreed to a comparable deal with Hamilton to accomplish the loan sales as it offered Ervin to stop them, Hamilton would have made \$330-660 million on the loan sales, far far more than it ever made. When, after four years of investigation, events proved that Ervin had produced no evidence of any wrongdoing from the beginning, HUD responded by giving Ervin a \$2 million settlement as part of a negotiation on his civil suit against the government, and refused to pay Hamilton owed for services performed. With the blessings of government funding and extensive information regarding Hamilton supplied by HUD, among other methods, under FOIA, Ervin then served its lawsuit on Hamilton.

Now, let's look at HUD treatment of the "computer glitches" of the American Management Systems (AMS).

AMS has had a contract to build HUDCAPS, its integrated financial system, since 1993. HUD has paid AMS \$206 million so far. System "computer glitches" so far total \$17 billion for fiscal 1998, \$59 billion for fiscal 1999 and an unreported amount for fiscal 2000. After five-eight years, the system can not reconcile cash balances with Treasury and so HUD simply accepts Treasuries cash balance.

The notion of "computer glitches" causing a system to not work after 2-3 years is one that reasonable people accept. The notion of "computer glitches" being a reasonable excuse to not balance a check book with billions unaccounted for over a three year period after eight years of designing and installing a system is not. Yet HUD has not fired AMS. HUD has not asked for any money back. HUD has not disclosed information, let alone criticizing AMS in the media. The precise definition of performance, deliverables and what constitute a breach in AMS contract are unknown. This is

because HUD refuses to comply with FOIA law by providing a copy of AMS contract when FOIA-ed.

It would be very interesting to have the HUD contracting office, the HUD GTR and HUD GTM on the two contracts sit in the same room and explain to a team of reporters the difference in the treatments of the two contractors...one who made money for the taxpayers and one that lost money for the taxpayers.

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DAVID A. HANDZO

202-639-6085

January 6, 1998

BY HAND DELIVERY

Judith Hetherton  
Counsel to the Inspector General  
U.S. Department of Housing and Urban Development  
Office of the Inspector General  
451 7th Street, S.W.  
Washington, D.C. 20410-4500

Re: Hamilton Securities Advisory Services, Inc. and The Hamilton Securities Group, Inc.

Dear Ms. Hetherton:

Your letter of December 22, 1997, invited Hamilton to provide you with any information suggesting that the HUD Office of the Inspector General has leaked information to the media regarding its investigation. This letter responds.

- On October 24, 1997, The Washington Times ran an article headlined "HUD orders fired firm to surrender documents." The article, which necessarily was written on October 23, reported HUD's "demand" that Hamilton "immediately" turn over all documents related to the sales for which errors in optimization analysis occurred. The Inspector General subpoena to which this article obviously referred was served on Hamilton at 4:57 p.m. on the same day the article was published - October 24. Indeed, your letter to me of October 27, 1997, recites that Hamilton's counsel was first informed of the existence of the subpoena at 3:15 p.m. on the 24th. We can draw no other conclusion than that The Washington Times was informed of the subpoena at least 24 hours before it was served on Hamilton, and we can think of no possible source for such information other than HUD's Office of the Inspector General. Please provide me with a list of the

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individuals at HUD who knew on October 23 that the subpoena was about to be issued. In addition, please inform me in writing what steps you are taking to determine which of these individuals revealed this information to The Washington Times.

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- ▶ The U.S. News & World Report article published on November 11, 1996, quotes from a 1993 Hamilton document (bates number 0010184-0010211) that was provided to your office pursuant to subpoena on August 30, 1996. That document was confidential, inasmuch as it was part of Hamilton's bid proposal for Contract No. 18161. Obviously, therefore, only HUD and Hamilton possessed copies. Hamilton did not provide a copy of the document to the reporters. Necessarily, HUD was the source. And since it is our understanding that the IG's Office took possession of Hamilton-related documents from other divisions of HUD, only the IG's Office could have been the source of this document. Please let me know how this document came into the possession of the reporters.

I look forward to your prompt response.

Very truly yours,



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cc: Leslie H. Lepow, Esq.

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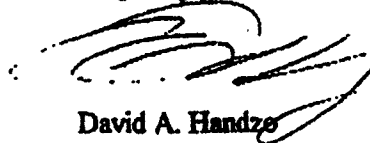
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