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TO: Phillip A. Murray, Deputy Assistant Secretary for Single Family Housing, HU

Edgar Moore

FROM: Edgar Moore, Regional Inspector General for Audit, New York/New Jersey, 2AGA

SUBJECT: HUD's Administration of the Asset Control Area Program Needs Improvement.

# HIGHLIGHTS

## What We Audited and Why

We conducted an audit of the U.S Department of Housing and Urban Development (HUD)'s Asset Control Area (ACA) program as a follow-up to a previous OIG audit of this program[1], and as a part of the Office of Inspector General's (OIG) strategic plan goals to improve HUD's fiscal accountability. The objective of the audit was to determine whether HUD administered the ACA program in compliance with ACA program requirements and federal regulations.

## What We Found

Generally HUD's Asset Control Area (ACA) program has increased homeownership for low and moderate income borrowers and contributed to the revitalization of blighted communities; however, HUD's administration of the ACA program was not always in compliance with ACA program requirements and federal regulations, thus it needs improvement. Specifically, 1) final ACA regulations need to be issued, 2) existing ACA program requirements need to be

[1] National Audit, Asset Control Area Program, Single Family Housing, Report No. 2002-NY-0001, issued February 25, 2002.

adequately enforced, and 3) HUD's monitoring needs to improve to ensure compliance with ACA program requirements and federal regulations. As a result, final regulations are not issued to ensure compliance, nonqualified entities were allowed to administer and/or participate in the program, required public records searches were not supported or conducted, properties outside of asset control areas were included in the program, properties were not sold within HUD timeframes and dollar limits, potential conflicts of interest were not identified and resolved, and net development costs were incorrectly calculated. We attribute this to HUD's lack of guidance by not issuing final ACA program regulations and its inadequate monitoring to detect and report issues of noncompliance.

## What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing instruct the Single Family Asset Management Office to develop and implement controls to ensure that the final Asset Control Area regulations are issued within a timely manner, provide additional training and technical assistance to ACA program participants and staff to ensure that they are aware of future issued ACA regulations, ensure that existing and future ACA requirements are adequately enforced, and enhance controls to ensure that HUD monitoring is effective in improving ACA participants' compliance with program requirements.

## Auditee's Response

We provided HUD officials the draft report on June 26, 2009. We discussed the results of our audit with officials from HUD's Office of Single Family Asset Management during the audit and at an exit conference held on July 1, 2009. HUD officials generally disagreed with the draft audit report. Based on the oral comments provided by HUD officials during the exit conference, the draft audit report was revised where warranted and resubmitted to HUD officials on July 16, 2009. HUD officials were given until July 28, 2009, to provide written comments, but were unable to provide written comments by that date.

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# BACKGROUND AND OBJECTIVES

Section 204 of the National Housing Act, 12 U.S.C (United States Code) 1710 directed HUD to promote the revitalization of neighborhoods through the creation of Asset Control Areas (ACAs) in HUD approved communities. The legislation directed the Secretary to issue ACA program regulations prior to the expiration of a two year period beginning on October 21, 1998. However, Section 1303 of Public Law 107-206 dated August 2, 2002 extended the deadline for issuing the Asset Control Area (ACA) program regulations to September 15, 2002.

The Secretary has the authority to designate as revitalization areas those locations that meet one of the following requirements: very low income area; high concentration of default or foreclosed assets; or has a low home ownership rate. The purpose of the ACA program is to promote the revitalization of designated communities, through expanding homeownership opportunities at designated revitalization areas. HUD sells single-family homes at a discount to units of local government and approved nonprofit organizations (preferred purchasers). Discount sales are not offered to for-profit organizations (purchasers). The discounted single family homes have to be 1) designed as a dwelling for occupancy by one to four families; 2) located in a revitalization area; 3) previously subject to mortgage insurance; and 4) owned by the Secretary pursuant to the payment of insurance benefits. The purchasers perform rehabilitation work on the homes and resell them to eligible buyers for no greater than the lesser of the ACA properties' fair market value or 115 percent of the net development costs. An eligible buyer has to reside in the home for three years unless the home buyer is an officer, teacher or emergency medical technician. With the exception of teachers, police officers and emergency medical technicians, the eligible home buyer's household income has to be equal or be lesser than 115 percent of the median income for the area.

As of January 17, 2008, HUD sold a total of 1,633 properties to 13 ACA participants (local governments or non-profit organizations). A total of 1,325 properties were sold to home buyers. As of January 17, 2008, there were a total of 15 ACA participants of which eight had expired ACA agreements and will not be renewed.

A review of corrective action[2] taken on recommendations in the nationwide audit report[3] on HUD's ACA program, recommended that HUD should reevaluate and adjust the final action target date for implementing the ACA program regulations, and that appropriate training should be provided to HUD employees and program participants during fiscal year 2004; however, although training was provided and proposed ACA program regulations were published on December 22, 2008, final ACA program regulations have not been issued yet.

Our audit objective was to determine whether HUD administered the ACA program in compliance with ACA program requirements and federal regulations.

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[2] Corrective Action Verification, Asset Control Area Program, Report number 2003-NY-0801, Dated September 30, 2003.

[3] National Audit, Asset Control Area Program, Single Family Housing, Report No. 2002-NY-0001, issued February 25, 2002.

# RESULTS OF AUDIT

## Finding: HUD's Administration of the Asset Control Area Program Needs Improvement.

Generally HUD's Asset Control Area (ACA) program has increased homeownership for low and moderate income borrowers and contributed to the revitalization of blighted communities; however, HUD's administration of the ACA program was not always in compliance with ACA requirements and federal regulations, thus it needs improvement. Specifically, 1) final ACA regulations need to be issued, 2) existing ACA program requirements need to be adequately enforced, and 3) HUD's monitoring needs to improve to ensure compliance with ACA program requirements and federal regulations. As a result, final regulations are not issued to ensure compliance, nonqualified entities were allowed to administer and/or participate in the program, required public records searches were not supported or conducted, properties outside of asset control areas were included in the program, properties were not sold within HUD timeframes and dollar limits, potential conflicts of interest were not identified and resolved, and net development costs were incorrectly calculated. We attribute this to HUD's lack of guidance by not issuing final ACA program regulations and its inadequate monitoring to detect and report on issues identified.

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**ACA Regulations Have Not Been Issued.**

Final regulations for the Asset Control Area (ACA) program have not been issued. According to United States Codes (U.S.C) Section 1710 (h) the secretary was required to issue regulations to implement the program. Such regulations were supposed to have taken effect not later than the expiration of a two-year period beginning on October 21, 1998. However, the deadline for issuing the regulations was extended to September 15, 2002 and previous OIG reports[4] have recommended that regulations be developed and issued; yet, ACA regulations still have not been issued. Accordingly, due to the delay in issuing ACA regulations, there is no assurance that program participants are administering the ACA program consistently. It appears that ACA regulations have not been issued because it was not a priority, as such; we attribute this to HUD not establishing or implementing procedures to ensure that the regulations would be issued to meet the established deadlines. HUD's senior officials in the Office of Single Family Asset Management, responsible for overseeing the ACA program, stated that the proposed ACA program regulations were published on December 22, 2008 and the final ACA program regulations are scheduled to be issued within the next fiscal year. They state that

[4] National Audit, Asset Control Area Program, Single Family Housing, Report No. 2002-NY-0001, issued February 25, 2002 and a Memorandum for Corrective Action Verification Report No: 2003-NY-0801, Dated September 30, 2003.

because a key position within the Headquarters Office of Single Family Asset Management was vacant, publishing of these regulations is taking an extended time, along with the need to obtain general public comments, complete legal reviews of proposed regulations and obtain concurrences from many officials; nevertheless the regulations are still not issued.

**Existing ACA Program Requirements Were not Adequately Enforced**

Based on audits of four entities (Rochester, New York; Camden, New Jersey; Reading , Pennsylvania; and Dallas, Texas) participating in HUD's ACA program, we concluded that existing ACA program requirements have not been adequately enforced. Specifically, nonqualified entities were allowed to administer the program, required public record searches were not supported or performed, properties outside of designated asset control areas were transferred to a participating entity's jurisdiction, and properties were not sold within HUD's established timeframes. The details are described below:

A. Nonqualified entities were administering ACA programs for three of the four audited ACA programs. Two nonprofit entities were allowed to participate or administer the ACA programs for Rochester, New York and Reading, Pennsylvania without having approval to participate in HUD's single family programs. Also, a for-profit organization was allowed to administer the Camden, New Jersey's ACA program. According to the Standard Operating Procedures (SOP), Section (4.5) an ACA program participant may carry out its obligations through its various departments and through arrangements with other approved participating entities (PEs) pursuant to HUD's published guidelines. The participating entities must be a HUD approved nonprofit organizations. However, since the Headquarters Office of Single Family Asset Management staff did not designate these three entities as approved participating entities, they were not qualified to participate in the ACA program. Headquarters officials stated that ACA agreements signed by the housing commissioner are enforceable legal contracts and are deemed to be waivers for ACA program requirements included in the SOP. However, although the housing commissioner's signing an ACA agreement creates a legally enforceable agreement and effectively waives compliance with some program requirements, this does not ensure that the entities have adequate financial and administrative capacity to effectively and efficiently administer the program. Nevertheless, headquarters officials have stated that upon future renewal of any ACA agreement, staff will ensure that all participating entities are HUD approved nonprofit entities before they are allowed to participate in the ACA program.

B. The Philadelphia Homeownership Center staff could not provide documents to support that required public record searches were conducted for three of the four audited ACA participating entities (Rochester, New York; Camden, New

Jersey; and Reading, Pennsylvania), their board members, staff and associated entities. For the fourth ACA participant (Dallas, Texas), the Denver Homeownership Center's staff provided documents to support that the public records searches were conducted. However, the Denver Homeownership Center staff did not provide documentation for their conclusions regarding a possible conflict of interest involving a principal staff of the fourth ACA participant. According to the Standard Operating Procedures (SOP), Section (2.3.3) the ACA Program Support Division in each homeownership center was required to conduct public record searches of the ACA participants' board members, principal staff, and business partners to determine potential conflicts of interest and ineligible participants affiliated with the ACA program participants. However, documentation was not provided by homeownership center staff to support that these public record searchers had been conducted by the ACA Program Support Division; as a result, there is no assurance that all potential conflicts of interest are being identified and resolved.

C. Two properties located outside of the Dallas, Texas asset control area were transferred to the ACA participant in Dallas, Texas. To determine whether properties sold to ACA participants were located in approved ACA areas, we tested a non-statistical sample of 156 properties sold to the four ACA participants in our sample. According to SOP, section (4.4) the ACA agreement will outline the geographic areas to be covered by the program participant during the term of the agreement. Nevertheless, although the ACA agreement specified the program jurisdiction, HUD transferred two properties located outside of the designated asset control area to the ACA participant in Dallas, Texas, thereby circumventing the general requirements.

D. Several prior external annual audits and HUD reviews, as well as our audits of the four ACA participants revealed that the four participants were not able to sell ACA properties within timeframe imposed by HUD. An average of over 22 percent of the ACA properties had not been sold after 18 months from the date of acquisition. According to the ACA agreement, ACA participants were required to resell 75 and 100 percent of its ACA properties to eligible home buyers within 12 and 18 months respectively after they were acquired from HUD. However, HUD officials neither sought corrective actions from ACA participants nor imposed sanctions on these ACA participants for not complying with the timeframes established by HUD. Office of Single Family Asset Management official stated that ACA participants were not able to sell the ACA properties within the established timeframe due to economic and other regional factors, which impacted the real estate markets; however, no action was taken to adjust the timeframes to market conditions.

**HUD's Monitoring Was Not Adequate.**

Audits of the four ACA participants and reviews of HUD monitoring reports for the four audited ACA participants revealed that Homeownership Center (HOC) staff's monitoring of ACA participants needs to be improved to ensure ACA participant's compliance with the ACA program requirements. Although officials indicate that monitoring was conducted, we found that

1. Conflicts of interest existed in the Rochester, New York's ACA program operations. The conflict was caused by allowing two board members of the participating entity that administered the Rochester's ACA program, to work for two different entities that provided the Rochester ACA program with administrative and financial services. In this instance, the participating entity received a fee from the City for administering the ACA program, and the financial institution obtained a fee from all banks that provided loans used for repair costs related to the ACA properties. Accordingly, due to the business relationships of the board members, it could raise questions about the reasonableness of the fees paid to the participating entity to administer the program, and it could appear that the financing of the program was conducted in a manner that benefited the financial institution by maximizing its fees. Although HUD conducted an annual monitoring review of the City of Rochester's ACA program, HUD's annual reviews did not report any conflict of interest issues The ACA agreement provided that the purchaser (Rochester) and its agents, board of directors, principal staff, and contractors were to avoid any and all conflicts of interest and self-dealing. However, by not identifying and eliminating these conflict of interest matters, there is the potential that the public and other interested parties might not believe that the program is being administered in an efficient and independent manner;

2. The ACA participants in Dallas, Texas; Rochester, New York; and Camden, New Jersey included either ineligible or unsupported costs in determining some ACA properties' net development costs. The net development costs for each ACA property are used in the process of determining the maximum resale price for each ACA property. Net development costs for 16 out of 24 tested ACA properties associated with the three ACA participants were found to include unsupported or ineligible costs. According to the ACA agreement, ineligible costs that cannot be a part of the net development costs or eligible expenses include housing developer fees, sales bonuses, resale incentives, and any development costs that are paid from local, state, or federal grant funds (including but not limited to HOME or CDBG funds[5]). However, other than for Camden, New Jersey, HUD's monitoring reviews of the ACA participant

[5] The Home Investment Partnership Program (HOME) and Community Development Block Grant (CDBG) Program are HUD's Community Planning and Development programs in which resources are provided to address a range of community development needs such as housing rehabilitation and down-payment assistance, etc.

in Dallas, Texas and Rochester, New York did not identify inadequacies or that ineligible costs were included in determining the ACA properties' net development costs. Accordingly, by not identifying these inaccuracies HUD's monitoring was not always effective in ensuring ACA participants compliance with the program requirements.

3. Two of the four audited ACA participants (Rochester, New York and Camden, New Jersey) sold ACA properties for more than the maximum limit imposed by HUD. The noncompliance cases resulted from either including ineligible costs in the calculation of net development costs or selling ACA properties at fair market value that exceeded 115 percent of the ACA properties' net development costs. Verification of 48 ACA property files to determine whether ACA properties were sold to eligible home buyers for the lesser of fair market value or 115 percent of net development costs revealed that five of the 48 ACA properties were sold for more than the lesser of fair market value or 115 percent of net development costs. HUD's monitoring reviews of the ACA participant in Rochester, New York did not determine or report that an ACA property had been sold for more than the limit imposed by HUD. According to the ACA agreement between HUD and the three ACA participants, ACA participants were required to sell ACA properties for no more than the lesser of 115 percent of the net development costs or fair market value of the ACA properties.

According to the SOP, section (2.2) Housing Program Officers (HPOs) will provide ongoing monitoring and evaluation of ACA program participants and coordinate ACA program activities among HOC participants and Headquarters staff as needed to ensure that quality controls for the ACA program are in effect. HPOs' duties include 1) providing continual guidance, training, and assistance to ACA program applicants and participants; 2) addressing a participant's specific compliance issues and providing notification of such issues to HOC directors and other appropriate HUD staff of instances of nonperformance and/or noncompliance; 3) providing written and oral notification to the ACA program participant of noted instances of noncompliance and corrective/remedial actions needed; and 4) making a recommendation of an applicant's approval/disapproval for the ACA program and preparing the HOC's written justification to support such recommendation. However, based on the deficiencies noted above HUD's monitoring was not always adequate or efficient enough to ensure ACA participants' compliance with the ACA program requirements and federal regulations. Headquarters Housing officials disagreed and stated that the monitoring performed including contracted out monitoring procedures were adequate and that our review had not determined material instances of non-compliance, However, although the Asset Control Area program monitoring is generally being conducted, there is room for improvement and the issuance of final regulations and more consistent and uniform monitoring will improve compliance with program requirements and increase the effectiveness and efficiency of the program.

## Conclusion

Generally HUD's Asset Control Area (ACA) program has increased homeownership for low and moderate income borrowers and contributed to the revitalization of blighted communities; however, since HUD's administration of the ACA program did not adequately follow ACA requirements, it needs improvement. Specifically, ACA final regulations have not been issued, program requirements were not always adequately enforced, and HUD's monitoring was not adequate to ensure compliance with program requirements. As a result, final regulations are not issued to ensure compliance, nonqualified entities were allowed to administer the program, required public records searches were not supported or conducted, properties outside of asset control areas were included in the program, properties were not sold within HUD timeframes and dollar limits, potential conflicts of interest were not identified and resolved, and development costs were incorrectly calculated. We attribute this to HUD's lack of guidance by not issuing final ACA program regulations and its inadequate monitoring to detect and report issues of noncompliance. Accordingly, HUD needs to develop and implement controls to ensure that the final Asset Control Area regulations are immediately issued, provide additional training and technical assistance so that ACA program participants and staff are aware of the future issued ACA regulations, ensure that existing and future ACA requirements are adequately enforced, and that HUD monitoring is always effective in improving ACA participants' compliance with program requirements.

## Recommendation

We recommend that the Deputy Assistant Secretary for Single Family Housing instruct the Office of Single Family Asset Management to:

1A. Develop and implement controls to ensure that the final Asset Control Area regulations are issued in a timely manner.

1B. Develop and implement controls to provide additional training and technical assistance to ensure that ACA program participants and staff are aware of the future ACA regulations when issued.

1C. Develop and implement controls to ensure that existing and future ACA requirements are always adequately enforced.

1D. Enhance procedures to ensure that HUD's monitoring is always effectively performed to ensure ACA participants' compliance with program requirements.

# SCOPE AND METHODOLOGY

We conducted audits of the ACA participants in Rochester, New York; Dallas, Texas; Reading, Pennsylvania; and Camden, New Jersey.

Our audit was conducted in Newark, New Jersey; Rochester, New York; Dallas, Texas; Reading, Pennsylvania; Camden, New Jersey; and Washington, D.C., from March 2008 through April 2009. The audit period was calendar years 2006 and 2007. To achieve the audit objectives we:

- Obtained and reviewed relevant laws, draft regulations, HUD standard operating procedures, ACA program agreements, audit reports, and HUD monitoring review reports.

- Analyzed information and reports submitted to HUD by the four ACA participants.

- Conducted interviews with HUD staff from the Denver and Philadelphia Homeownership Centers; Headquarters Single Family Asset Management staff; and officials from the four ACA participants.

- Traced payments for costs associated with the ACA properties to source documents such as cancelled checks and vendors' invoices.

- Selected non-statistical samples at each audited participating entity to examine appraisal reports, review property files, verify property locations, and conduct inspections of select properties. The sizes of the sample universes varied because of timing differences as to when properties were acquired and finally sold, and to address different objectives; therefore the results of these samples cannot be projected. The samples were as follows:

    - From a universe of 409 ACA properties associated with Rochester, NY (179); Dallas, TX (140); Camden, NJ (31); and Reading, PA (59), we selected and reviewed a sample of 140 ACA property appraisal reports (73, 14, 4, and 49 respectively) to determine the value of the properties and whether their resale price was within required limits.

    - From the same universe of 409 properties, we selected and reviewed a sample of 48 ACA property files (21 from Rochester; 14 from Dallas; 4 from Camden; and 9 from Reading) to ensure that the files documented compliance with program regulations.

    - From a universe of 331 ACA properties that had been sold to the three participating entities, Rochester, NY (132); Dallas, TX (140); and Reading, PA (59), we selected a sample of 156 ACA properties (132; 14; and 10 respectively) to determine whether they were located within HUD's approved ACA areas.

    - From a universe of 382 ACA properties associated with Rochester, NY (132); Dallas, TX (140); Camden, NJ (51); and Reading, PA (59), we selected and inspected a sample of 38 ACA properties (13; 10; 5; and 10 respectively), to verify that the properties were repaired in compliance with ACA program requirements.

- Utilized data retrieval tools such as LexisNexis to perform public records searches to identify any potential conflicts of interest.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient and 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

# INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.
- Safeguarding of assets and segregation of duties.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

## Relevant Internal Controls

We determined the following internal controls were relevant to our audit objectives:

- Program operations – Policies and procedures that management implemented to reasonably ensure that its program met its objectives.

- Validity and reliability of data – Policies and procedures that management implemented to reasonably ensure that valid and reliable data were obtained, maintained and fairly disclosed in reports.

- Compliance with laws and regulations - Policies and procedures that management implemented to reasonably ensure that its resource use was consistent with laws and regulations.

- Safeguarding resources-Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

## Significant Weaknesses

Based on our review we believe the following items were significant weaknesses:

- HUD did not have adequate controls over compliance with laws and regulations because final ACA program regulations have not been issued and existing ACA program requirements and other federal regulations were not adequately enforced.

- HUD did not have adequate controls over the ACA program operations as HUD's monitoring of the ACA program needs improvement to detect all ACA participants' noncompliance with the ACA program requirements and federal regulations.