



U.S. Department of Agriculture



Office of Inspector General  
Southeast Region

# **Audit Report**

## **Rural Development - Local Governments' Management of Multi-Family Housing Projects in North Carolina**

Report No. 04004-4-AT  
July 2004

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Southeast Region - Audit

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DATE: July 15, 2004

REPLY TO

ATTN OF: 04004-4-At

SUBJECT: Rural Development - Local Governments' Management  
of Multi-Family Housing Projects in North Carolina

TO: John J. Cooper  
State Director  
Rural Development - North Carolina

This report presents the results of the subject audit. Your response, dated June 24, 2004, to the draft report is included as exhibit A, with excerpts and the Office of Inspector General's position incorporated in the relevant Findings and Recommendations section of the report. Based on your response, we have accepted management decisions on all recommendations in the report.

Follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer. Final action on the management decisions should be completed within 1 year of the date of this report to preclude being listed in the Department's Performance and Accountability Report.

We appreciate the courtesies and cooperation extended to us by members of your staff during the audit.

/s/

RAYMOND G. POLAND  
Regional Inspector General

Attachment

# ***Executive Summary***

## ***Rural Development - Local Governments' Management of Multi-Family Housing Projects in North Carolina***

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### **Results in Brief**

Rural Development's (RD) Rural Housing Service administers the Multi-Family Housing (MFH) Program, which includes loans and/or grants for Rural Rental Housing and Rural Cooperative Housing. More than 455,000 rental units in 18,000 complexes across the nation are financed by loans through the U.S. Department of Agriculture's MFH programs. A total of 612 MFH complexes are located in North Carolina, 18 are owned and managed by local governments. We visited four local government managed MFH projects and four RD area offices.

The Roanoke-Chowan Regional Housing Authority (RCRHA) did not keep Greenwood Terrace tenants' security deposits separate from other project funds, as required. Housing authority officials claimed it was more convenient to keep security deposits in the "revolving" account, similar to their other projects. As a result, tenants' security deposit funds, which should only be used for refunds and forfeits, could be susceptible to unauthorized uses.

One RD area office (Henderson) did not followup with one housing authority (RCRHA) to ensure that corrective actions were taken on deficiencies noted during supervisory reviews. In addition, this RD area office did not followup to ensure that reserve account funds in the amount of \$11,400 were used for the capital improvement. The responsible RD servicing official stated that it was an "oversight" and that recently the area office had restructured their staff's responsibilities so that adequate supervision could now be provided. As a result, the RD area office had no assurance that the housing authority corrected the deficiencies noted during their reviews.

The local government housing authorities for Fairmont Housing, Walnut Terrace, and Greenwood Terrace expended project funds in accordance with RD's regulations and the funds were used for authorized purposes. Also, for all four projects visited, the physical condition of the projects was properly maintained.

Our audit scope also included a review of Greenevers Housing Authority's management of the Brown's Terrace MFH project. We referred issues noted during our review of this project to the Office of Inspector General – Investigations.

No reportable conditions were identified for the other three area offices visited.

**Recommendations  
In Brief**

We recommend that the North Carolina RD State Office:

- instruct RCRHA officials to keep the tenants' security deposits separate from other project funds,
- instruct RCRHA officials to ensure the balance in the security deposit account is reflective of the security deposits paid by the current tenants,
- instruct the Henderson RD Area Office to require the RCRHA to correct the deficiencies noted in the March 2002 supervisory review, and
- require RCRHA to transfer the \$11,400, used for a capital improvement, from Greenwood Terrace's reserve account to its general operating account.

**Agency Response**

The North Carolina RD State Office (SO) concurred with the four recommendations contained in the report and plans to take the appropriate corrective actions. The North Carolina RD SO response to the draft report is included as exhibit A of the audit report.

**OIG Position**

We agree with the North Carolina RD SO's response and we were able to reach management decision on the report's four recommendations.

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# ***Background and Objectives***

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## **Background**

The U.S. Department of Agriculture's Rural Development (RD) administers programs addressing the needs of people with low- or moderate-incomes who often have trouble finding adequate and affordable rental housing in rural areas. RD's Rural Housing Service (RHS) administers the Multi-Family Housing (MFH) program, which includes loans and/or grants for Rural Rental Housing (RRH) and Rural Cooperative Housing. Under RHS' RRH loan programs, RD makes direct, competitive mortgage loans to eligible borrowers to provide affordable multi-family rental housing in rural areas. Borrowers are owners who may be individuals, partnerships, cooperatives, trusts, public agencies, corporations, and other organizations. MFH provides housing to very low-, low-, and moderate-income families; the elderly; and persons with disabilities.

Management, which can include local governments, is responsible for complying with all applicable laws, regulations, and loan covenants of the MFH program. RD Instruction 1930-C details the requirements the borrower must follow for managing MFH projects. The manual also provides overall guidance on the duties and responsibilities of reporting the financial activities and maintaining the physical condition of MFH projects. Management is required to account for all project income and expenses, maintain documentation of financial operations, and submit annual financial reports for the project in accordance with RD regulations. Loan agreements provide the basic requirements for maintaining the physical condition of the project.

The following accounts are standard for all RRH loans (1) general operating, (2) reserve, and (3) tenant security deposit accounts. The general operating account records all project income and disbursements, exclusive of the tenants' security deposits. The reserve account is primarily used to meet major capital expenses of a project. Security deposits are held in the tenants' security deposit account by the borrower, in trust, until so used.

RD Instruction 1930-C also discusses the agency's responsibilities for effective supervision in the operation and management of MFH projects. The regulations state that a servicing official will conduct supervisory visits and review borrower management reports. Supervisory visits include evaluating the management program, reviewing borrower records, inspecting proper maintenance, and determining if the project is operating according to budget.

The North Carolina State Office, located in Raleigh, North Carolina, administers RD programs from eight area offices across the State. Currently, each area office employs a MFH specialist who manages approximately 40-45 projects in their respective area. These individuals are responsible for servicing all of these MFH loans in their pre-determined counties. There are 612 MFH complexes in North Carolina, 18 of which are managed by local governments.

## **Objectives**

The objectives of this audit were to determine whether (1) RD area offices conducted annual supervisory reviews of selected projects and followup, as appropriate; (2) the local government housing authorities expended project funds in accordance with RD's regulations and that funds were used for authorized purposes; and (3) the physical condition of projects were properly maintained.

Our review was performed during the period September through November 2003. We visited four MFH projects owned and managed by local governments in the State of North Carolina.

# ***Findings and Recommendations***

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## **Finding 1**

### **Security Deposits Commingled With Other Project Funds**

The Roanoke-Chowan Regional Housing Authority (RCRHA) did not keep Greenwood Terrace's tenants' security deposits separate from other project funds, as required. Housing authority officials claimed it was more convenient to keep security deposits in their "revolving" account, similar to their other projects. As a result, the tenants' security deposit funds, which should only be used for refunds and forfeits, could be susceptible to unauthorized uses.

RD Instruction 1930-C requires that tenant security deposits shall be deposited, upon receipt, in a separate bank account that is kept separate from project funds and will be handled according to any State or local laws governing security deposits. Funds in the security deposit account shall be used only for authorized purposes. Any amount of the security deposit account, which is retained by the borrower as a result of lease or occupancy violations, shall be transferred to the general operating account and treated as income of the housing.

Our review included RCRHA's management of fiscal year (FY) 2002 Greenwood Terrace operations. Bank statements were reviewed to verify that tenant security deposits were being maintained separately from other project funds. There was a separate account to maintain the tenants' security deposits, however, it was determined that these funds and transactions were maintained in RCRHA's "revolving" account, which is an RD authorized account. When a tenant moves in, they pay both their first month's pro-rated rent along with their security deposit with one check or money order to RCRHA. The housing authority deposits this money directly into the "revolving" account and the security deposits were never transferred into the Greenwood Terrace's tenants' security deposit account, as required.

There was no tenant move-in list for FY 2002 maintained by RCRHA. The tenants' security deposits subaccount from the Greenwood Terrace portion of the RCRHA "revolving" account was analyzed using the monthly general ledger trial balances to determine the number of tenants that moved in during the year. It was determined that eight tenants moved into Greenwood Terrace Apartment units in FY 2002. The trial balances showed that a total of \$794.00 was paid in security deposits for FY 2002 for the eight tenants. The leases for these eight tenants were obtained to verify the amount paid. The leases showed that \$793.00 should have been paid for security deposits during the year. The \$1 discrepancy was due to an overpayment and the tenant received a refund during the year when the error was found. The



\$793.00 was deposited into RCRHA's "revolving" account instead of the project's tenants' security deposit account.

Also, there was no tenant move-out list for FY 2002 to identify tenants who vacated units. The tenants' security deposits' subaccount from the Greenwood Terrace portion of the RCRHA "revolving" account was analyzed using the monthly general ledger trial balances to determine the number of tenants that moved out during the year. It was determined that eight tenants moved out of Greenwood Terrace rental units during FY 2002. When a tenant moves out, their original security deposit either gets returned to them if no damage has been done to the unit or gets paid to RCRHA to cover charges for damages to the unit caused by the tenant. A total of \$149.90 was paid to tenants during FY 2002 as refunds on their security deposits. RCRHA retained a total of \$421.10 during FY 2002 to cover damages to the units caused by the tenants. However, all security deposit refunds to tenants and security deposit forfeits to the housing authority were paid from the "revolving" account instead of the tenants' security deposit account.

We determined through analysis of the "revolving" account general ledgers that there should have been at least 13 transactions to the tenants' security deposit account (8 for security deposits, 4 for security deposit refunds to tenants, and at least 1 lumpsum transaction representing the security deposit forfeits that the housing authority was able to keep to cover damages caused by tenants). However, only one transaction occurred in the tenants' security deposit account during FY 2002.

### **Recommendation No. 1**

Instruct RCRHA officials to keep the tenants' security deposits separate from other project funds in accordance with RD regulations.

**Agency Response.** In the June 24, 2004, response, the North Carolina RD SO agreed to implement the recommendation by July 16, 2004.

**OIG Position.** We accept management decision for this recommendation.

### **Recommendation No. 2**

Instruct RCRHA officials to reconcile the balance in the security deposit account to the security deposits paid by the current tenants of the project.

**Agency Response.** In the June 24, 2004, response, the North Carolina RD SO agreed to implement the recommendation by July 16, 2004.

**OIG Position.** We accept management decision for this recommendation.

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**Finding 2****Lack of Followup by the RD Area Office to Ensure Corrective Actions Were Taken**

The RD Henderson Area Office did not followup with RCRHA to ensure that corrective actions were taken on deficiencies noted during supervisory reviews. The responsible RD servicing official stated that it was an “oversight” and that the area office had recently restructured their staff’s responsibilities so that adequate supervision could be provided. As a result, the RD area office had no assurance that the housing authority corrected the deficiencies noted during their reviews.

RD Instruction 1930-C states that a thorough supervisory visit will be performed no later than 12 months following the post occupancy visit, and at least every 36 months thereafter, for each project. A letter highlighting any needed followup actions and a copy of the completed supervisory visit checklist will be directed to the borrower within 30 days after the visit. Followup will continue through resolution of any problems.

Our review included RCRHA’s management of FY 2002 Greenwood Terrace operations. Bank statements were reviewed to verify that tenant security deposits were being maintained separately from other project funds. There was a separate account to maintain the tenants’ security deposits, however, it was determined that these funds and transactions were maintained in RCRHA’s “revolving” account, which is an RD authorized account. When a tenant moves in, they pay both their first month’s pro-rated rent along with their security deposit with one check or money order to RCRHA. The housing authority deposits this money directly into the “revolving” account and the security deposits were never transferred into the Greenwood Terrace’s tenants’ security deposit account, as required.

Our review covered four RD area offices’ supervision and oversight of local government housing authorities and their management of MFH projects.

**Supervisory Visit Findings**

The responsible RD servicing official performed a supervisory visit in March 2002, and communicated the results to the RCRHA Chairman of the Board of Commissioners in an April 2002 memorandum. The memorandum cited deficiencies relating to the interior (e.g., roaches in apartment, missing doorstops) and exterior (e.g., broken concrete on sidewalks, paint siding) inspections of the project during the supervisory visit. The RD area office required RCRHA to acknowledge the deficiencies noted and to prepare and submit a corrective action plan within 30 days of the date of the memorandum.

RCRHA officials did not respond to the memorandum and the RD servicing official did not followup with the housing authority to ensure the deficiencies were corrected. Therefore, the RD servicing official had no assurance that RCRHA had taken action to correct the deficiencies cited in the memorandum.

### **Capital Improvement Funding**

The RD area office did not followup to ensure that reserve account funds were used for a capital improvement. The Executive Director of RCRHA received authorization to use reserve funds to pay for the exterior painting of Greenwood Terrace, which is a capital improvement project. However, RCRHA officials withdrew the funds from the Greenwood Terrace's general operating account rather than its reserve account. As a result, the RD area office's year-end analysis of RCRHA's FY 2002 financial reports found that the financial strength of Greenwood Terrace was not sound.

RD Instruction 1930-C states that the reserve account is primarily used to meet major capital expenses of a project. The borrower will request withdrawal of reserve funds in a written or confirmed manner before they are needed. Funds from the reserve account may be used for capital expenditures such as replacement of furnishings or equipment and major repairs to the housing.

In May 2002, the Executive Director of RCRHA sent a memorandum and corresponding bids to the RD area office requesting use of Greenwood Terrace's reserve funds for the exterior painting of all units. The RD area office authorized the withdrawal of \$11,400 from Greenwood Terrace's reserve account for the exterior painting because they considered the expenditure to be a capital improvement.

During the year-end analysis of Greenwood Terrace's FY 2002 financial statements, the RD area office noticed that operating funds were used for a capital expenditure. In a memorandum to the RCRHA Chairman of the Board of Commissioners, the RD area office stated that they approved the use of \$11,400 from the reserve account to paint the exterior of the units. However, the expense was paid from the general operating account. The area office also stated in the memorandum that the financial strength of the housing authority was not sound as of June 30, 2002, since the general operating account did not contain 10 percent of the projected operating and maintenance expenses, as required by RD Instruction 1930-C.

The Executive Director stated that RCRHA had intentions to transfer the funds from Greenwood Terrace's reserve account to replace the funds used from its operating account for the exterior painting, and that not doing so was an "oversight."

The RD area office did not followup to ensure that reserve account funds were used for capital improvement and made no recommendation to RCRHA to transfer the \$11,400 from the “revolving” account to the project’s reserve account. The RD servicing official stated that it was an “oversight” and she did not have adequate time to properly service all the projects under her supervision. The Henderson RD Area Office officials stated that they recently restructured their staff’s responsibilities so that adequate supervision of projects can be provided.

**Recommendation No. 3**

Instruct the RCRHA to correct the deficiencies noted in the March 2002 supervisory review.

**Agency Response.** In the June 24, 2004, response, the North Carolina RD SO agreed to implement the recommendation by July 16, 2004.

**OIG Position.** We accept management decision for this recommendation.

**Recommendation No. 4**

Require RCRHA to transfer the \$11,400, used for a capital improvement, from Greenwood Terrace’s reserve account to its general operating account.

**Agency Response.** In the June 24, 2004, response, the North Carolina RD SO agreed to implement the recommendation by July 16, 2004.

**OIG Position.** We accept management decision for this recommendation.

# ***Scope and Methodology***

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A total of 612 MFH projects are located in North Carolina; 18 of these are managed by local governments (i.e., housing authorities). Four MFH sites were judgmentally selected and visited. Specifically, the criteria for selection included (1) coverage of four different area offices, (2) the number of projects managed by each housing authority, (3) the number of units within each project, and (4) recommendations made by State agency officials and MFH specialists.

The audit was conducted in accordance with generally accepted government auditing standards. Site visits were performed from September through November 2003. This review covered RD's supervision and oversight of MFH projects, and the local governments' management of FY 2002's MFH project operations.

We performed audit work at four MFH projects and their respective RD area offices in North Carolina. Our sample included:

- Fairmont Housing (50 units) managed by Fairmont Housing Authority and serviced by the Elizabethtown Area Office,
- Brown's Terrace Apartments (30 units) managed by Greenevers Housing Authority and serviced by the Kinston Area Office,
- Walnut Terrace (50 units) managed by the Williamston Housing Authority and serviced by the Williamston Area Office, and
- Greenwood Terrace Apartments (28 units) managed by the Roanoke-Chowan Regional Housing Authority and serviced by the Henderson Area Office.

To accomplish the audit objectives, our review consisted of the following audit steps:

- review of applicable RD and North Carolina State laws, regulations, policies and procedures;
- interviews with North Carolina RD State officials, area office officials, and housing authority officials;
- review of projects' management plans, annual audit reports, and identity-of-interest disclosure certificates;
- review of the MFH Project Budget (Form RD 1930-7);

- analysis of authorized reserve account withdrawals and the bidding process;
- review of the supervisory visits conducted by RD area offices;
- analysis of trial balances, general ledgers, journals, bank statements, and cancelled checks for project accounts;
- assessment of expended project funds using receipts, invoices, timesheets, etc.; and
- observation of the physical condition of the project.

# Exhibit A – Agency Response

Exhibit A – Page 1 of x



United States Department of Agriculture  
Rural Development  
North Carolina State Office

June 24, 2004

**Subject:** Rural Development – Local Governments' Management of  
Multi-Family Housing Projects in North Carolina  
Reply to Attn: 04004-4-At

**To:** USDA  
Office of Inspector General  
Atlanta, GA 20208

**In response to the findings and recommendations of the above subject audit, the following corrective actions will be concluded on July 16, 2004.**

- Instruct RCRHA officials to keep the tenants' security deposits separate from other project funds,
- Instruct RCRHA officials to ensure the balance in the security deposit account is reflective of the security deposits paid by the current tenants,
- Instruct the Henderson RD Area Office to require the RCRHA to correct the deficiencies noted in the March 2002 supervisory review, and
- Require RCRHA to transfer the \$11,400, used for a capital improvement, from Greenwood Terrace's reserve account to its general operating account.

**If you have any questions, or if we can provide additional information, please contact Mr. William A. Hobbs, Director Multi-Family Housing Programs at 919-873-2050.**

*John J. Cooper*  
JOHN J. COOPER  
State Director

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