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February 14, 2001

2001-AT-0801

MEMORANDUM FOR: Frederick Douglas, Deputy Assistant Secretary for Single Family Housing, HU

For 

FROM: Nancy Cooper, District Inspector General for Audit, Southeast/Caribbean, 4AGA

SUBJECT: Interim Results - Officer/Teacher Next Door Program

This memorandum report provides interim results of our nationwide audit of HUD's Officer Next Door/Teacher Next Door (OND/TND) property disposition program. Audit work is ongoing; however, our preliminary results identified significant conditions that we wish to bring to your attention immediately.

OBJECTIVES, SCOPE AND METHODOLOGY

The primary objective of the audit is to determine whether HUD has established adequate management controls over the OND and TND programs to ensure compliance with program requirements and achievement of program goals. To accomplish our objectives, we have reviewed program procedures and records, and interviewed program officials at HUD Headquarters, the Atlanta Homeownership Center (HOC), and one Management and Marketing (M&M) contractor; and we inspected and tested compliance on 29 properties sold in the Dade County, Florida area. We are conducting additional fieldwork around the nation and plan to report on the nationwide results on or about March 2001.

The audit covers the period from August 11, 1997, the start of the OND program, through July 31, 2000. We conducted the entrance conference for this audit on August 22, 2000. We are evaluating management controls over program operations and compliance with applicable laws and regulations. The audit is being conducted in accordance with generally accepted government auditing standards.

BACKGROUND

OND/TND's purpose is to strengthen America's communities and build a safer nation by offering homeownership opportunities to law enforcement officers and teachers in revitalization areas. Officers and teachers may purchase one HUD-owned single-family home in a revitalization area or in a HUD-approved exception area at a 50 percent discount off the list

price. The officer or teacher must then live in the home as their sole residence for 3 years from the date of closing. HUD sold approximately 3,824 homes under OND/TND from August 11, 1997, through July 31, 2000. HUD discounted about \$152 million off the list price of these homes.

HUD initiated OND on August 11, 1997 (HUD Notice 97-51). Several significant changes to OND became effective August 2, 1999, with the issuance of Federal Register Notice 4277-I-02. The interim rule required (1) a second mortgage for the amount of the discount, (2) initial and annual certification of occupancy, (3) that officers not own any other residential real estate, and (4) that only single-family homes are eligible. On November 17, 1999, HUD expanded OND to include teachers (HUD Directive 99-30).

INTERIM RESULTS

Second Mortgages Were Not Executed

To qualify for the 50 percent discount, effective August 2, 1999, officers and teachers must execute a second mortgage and note on behalf of HUD. The amount of the second mortgage equals the difference between the list price and the discounted sales price of the home. If the buyer fails to meet the continuing obligations of the program, the amount of the second mortgage will be due and payable. The second mortgage requirement is an important management control to ensure program goals are met and to prevent program fraud by homebuyers. The second mortgage obstructs resale and/or equity skimming during the 3-year occupancy term. It may also deter homebuyers from renting the home or violating other program requirements.

Closing agents did not execute second mortgages on 56 percent of the property sales in our sample that closed after the effective date of the second mortgage requirement. Our sample of all 29 OND home sales clustered in the Dade County area included 9 home sales subject to the second mortgage requirement. Second mortgages were not filed on 5 of these 9 home sales. These five sales closed on various dates from December 22, 1999, to June 9, 2000. Additional evidence provided by the M&M contractor showed that second mortgages were not filed on 16 of 17 closings from March 24, 2000, to September 13, 2000. The M&M contractor's review of past closings was ongoing at the time of our October 2000 site visit.

This condition occurred, in part, because HUD did not establish and communicate the new requirement in a timely manner. Once communicated, HUD did not establish adequate controls to ensure second mortgages were executed on HUD's behalf. The second mortgage requirement became effective August 2, 1999 (FR- 4277-I-02). However, about 3 months passed before HUD issued Directive 99-30 (effective November 17, 1999) that included instruction about the second mortgage requirement. Even then, the requirement was not implemented because the HOC did not effectively communicate this requirement to M&M contractors and closing agents until about February 1, 2000. As noted above, even after February 1, 2000, 16 sales closed that did not have the required second mortgages.

We conclude that HUD management control procedures were not adequate to ensure that closing agents executed second mortgages on about 1,341 closings after August 2, 1999, totaling approximately \$58.5 million. This condition significantly increases the risk of program fraud and abuse, and eliminates HUD's strongest avenue of recourse against homebuyers who fail to comply with the continuing obligations of the OND/TND programs.

High Levels of Noncompliance and Potential Fraud Are Identified

HUD prohibits OND/TND homebuyers from owning any other residential real property other than the home they purchased through OND/TND during the 3-year occupancy term. Program participants must certify, initially and once annually for the duration of the 3-year occupancy term, that they own and live in the house and do not own other residential real property.

Our interim results indicate that a high proportion of homebuyers abused and defrauded the OND/TND program. Seven of the 29 homebuyers we reviewed, or about 26 percent, violated one or more program requirements, as indicated in the following table.

HOMEBUYER	HOME WAS VACANT	HOME LISTED FOR SALE	HOME WAS SOLD	HOME WAS RENTED	OWNS ANOTHER HOME
A	X				
B	X	X			
C	X		X		
D				X	
E				X	X
F				X	
G				X	X
Totals	3	1	1	4	2

We also found strong indications that many other homebuyers may have violated the program requirements listed in the table. OIG Investigations currently had 81 OND/TND homebuyers under investigation for suspected violations, including 5 who were convicted and another 4 who pled guilty. HUD OND/TND program staff in headquarters estimated that 25 percent of all OND/TND homebuyers violated occupancy requirements after closing. Also, the Atlanta HOC began, but did not complete, a proactive monitoring effort that identified 12 homebuyers who were suspected of violating OND/TND occupancy requirements. No actions were taken on the monitoring results and the 12 suspect cases were not referred to OIG Investigations.

The OND/TND program appears to be at high risk for noncompliance and abuse by homebuyers. HUD's management controls are inadequate to prevent and detect the noncompliance and abuse identified above. HOC procedures do not provide for specific monitoring to ensure OND/TND homebuyers adhere to their continuing obligations to HUD during the 3-year occupancy term.

As a result, HUD has little assurance that the approximate 3,824 OND/TND homebuyers are contributing to the OND/TND goal of strengthening America's communities and building a safer nation.

Tracking and Referral Process for Suspected Violations Is Needed

HUD has not established an adequate process for tracking and referring suspect cases. HUD Headquarters program staff did not maintain a log or similar system to identify and track suspect cases referred to OIG Investigations. OND/TND program specialists in HUD Headquarters have identified suspect cases from complaints received from various sources. These program specialists referred some suspect cases to OIG. However, the specialists made their referrals individually to various persons and offices within OIG. The OND/TND specialists neither maintained complete records of their referrals, nor coordinated with one another to maintain a central log or other complete record of referrals made. In addition, program specialists in Headquarters were unaware of referrals that HOC staff may have made.

As a result, the number and identity of suspect cases identified by HUD and cases referred to OIG are not readily determinable.

PRELIMINARY RECOMMENDATIONS

Upon completion, our audit may identify other conditions, and recommendations may be revised. No formal response to the recommendations is required at this time. If program officials take corrective actions, we will consider such actions in our final report.

1. Require closing agents and M&M contractors to review all closed OND/TND sales and file second mortgages where needed.
2. Establish management controls to ensure that closing agents execute second mortgages on behalf of HUD on all OND/TND sales.
3. Develop a management control procedure to specifically monitor OND/TND homebuyers to ensure that they meet their continuing obligations throughout the 3-year occupancy term.
4. Establish a centralized log at headquarters or at each HOC to record suspected violations, actions taken to confirm or clear the suspected violation, and cases referred to OIG Investigations.

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