AUDIT REPORT

NATIONWIDE AUDIT
ASSET CONTROL AREA PROGRAM
SINGLE FAMILY HOUSING

2002-NY-0001

FEBRUARY 25, 2002

OFFICE OF AUDIT
NEW YORK/NEW JERSEY

Issue Date February 25, 2002	
Audit Case Number 2002-NY-0001	

TO: John C. Weicher, Assistant Secretary for Housing-Federal Housing Commissioner, H

Alexander C. Malloy

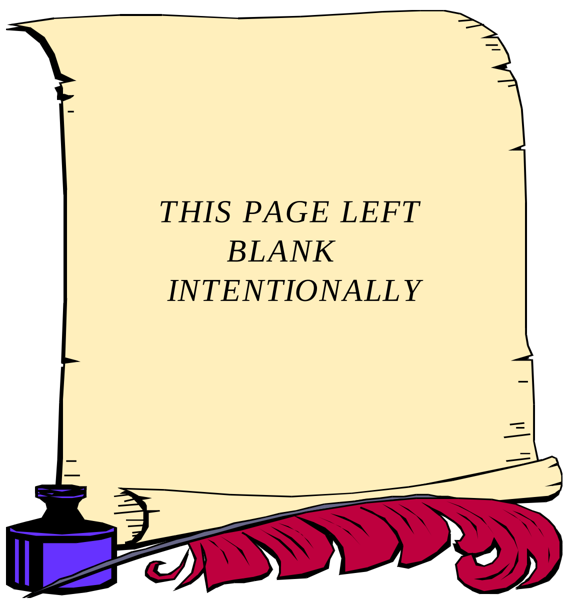
FROM: Alexander C. Malloy, District Inspector General for Audit, 2AGA

SUBJECT: Nationwide Audit
Asset Control Area Program
Single Family Housing

We performed a nationwide audit of the Asset Control Area Program to assess the effectiveness of the Program in meeting its objective of expanded homeownership opportunities in revitalization areas. The audit included reviews at the U.S. Department of Housing and Urban Development (HUD), Single Family Housing in Headquarters, and HUD's Philadelphia and Santa Ana Homeownership Centers (HOC). Also, it included an onsite review of three Local Partners; Rochester, New York; San Bernardino, California; and Washington, D.C. This report contains three findings with recommendations for corrective action.

Within 60 days, please provide us for each recommendation in this report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is not considered necessary. Also, please furnish us copies of any issued correspondence or directives related to this audit. Please be advised that Handbook 2000.06 REV–3 requires management decisions to be reached on all recommendations within 6 months of report issuance. It also provides guidance regarding interim actions and the format and content of your reply.

Should you or your staff have any questions, please contact William H. Rooney, Assistant District Inspector General for Audit, on (212) 264-8000, extension 3976.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Executive Summary

We performed a nationwide audit of the Asset Control Area Program to assess the effectiveness of the Program in meeting its objective of expanded homeownership opportunities in revitalization areas. Specifically, our audit objectives were to determine whether: (1) eligible single-family properties are being made available to local governments and nonprofit entities, (2) homeownership opportunities are being expanded, (3) neighborhoods are being revitalized as a result of improvements to the housing stock, (4) HUD has established adequate management controls over the Asset Control Area Program, and (5) the Asset Control Area Program is an efficient use of HUD resources. The review covered the period between October 1, 1999, and July 31, 2001, and consisted of a review of 53 property case files. A summary of the results of our review is provided below.

Background

The Department of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriation Act of 1999[1] directed the U. S. Department of Housing and Urban Development (HUD) to promote the revitalization of neighborhoods through the creation of Asset Control Areas in HUD approved communities. The Act requires that Asset Control Areas should be included in, or encompass all of a HUD approved revitalization area. HUD negotiates Asset Control Area Agreements with HUD authorized entities (Local Partners) to sell HUD owned properties located within these Asset Control Areas at a discounted price. In turn, the Local Partner must ensure that the properties are rehabilitated and sold to purchasers (home buyers).

HUD has had problems administering rehabilitation programs

HUD has had a history of problems in its attempts to administer rehabilitation programs for its single-family properties. A case in point is the Section 203(k) Program, which is the Department's primary Program for the rehabilitation of single-family properties. There have been a number of Office of Inspector General (OIG) and U.S. General Accounting Office audits citing fraud and mismanagement in the Program. In this regard, we question the need for another rehabilitation program, e.g. the Asset Control Area Program, especially since HUD is experiencing implementation problems. Furthermore, it should be noted that the single-family inventory was over 41,000 properties in 1998 and escalated to approximately 51,000 properties just prior to the first Asset Control Area Agreement being executed in 1999. As of September 2001,

[1] Public Law 105-276, October 21, 1998

the single-family inventory had decreased to around 29,000 properties. In view of the problems HUD is having implementing the Asset Control Area Program, and due to the fact that HUD's inventory of single family properties is decreasing, we question whether there is still a need for the Program. Thus, we believe that HUD should perform a needs assessment on the disposition of HUD single-family properties to determine whether the Asset Control Area Program is currently needed.

HUD needs to evaluate its capabilities to administer the Program

In light of the above opinion, we believe that the rehabilitation of properties and an increase in homeownership in revitalization areas is a noble mission. To this end, the Asset Control Area Program has only produced a limited positive impact on neighborhoods. Therefore, HUD needs to evaluate whether it has the capabilities to administer another rehabilitation program. This would include developing the controls to minimize fraud. It should also include an analysis of the cost to the Mutual Mortgage Insurance Fund compared to the benefits provided. In addition, HUD needs to determine whether it will provide both the financial and administrative resources to make the Program a success. If not, the Program will be ineffective and families and neighborhoods will suffer.

HUD does not have the management controls in place to assess the Program

The audit disclosed that HUD is unable to adequately evaluate the effectiveness of the Asset Control Area Program. We attribute this to HUD's failure to implement adequate management controls to assess the Program's activities. As a result, HUD cannot assure the Congress that the Program is meetings its objectives. Moreover, our review disclosed that the Program, as it is being implemented, has increased HUD's administrative burden regarding its Property Disposition Program and has had little impact nationwide. If HUD is to continue the Program, it must either strengthen its management controls or look for a more efficient method to deliver the activities of the Program.

As of July 31, 2001, there were only 16 Asset Control Area Agreements executed between HUD and Local Partners. The majority of the homes sold to home buyers were completed by two of the Local Partners (328 out of 340). The remaining 14 Local Partners have sold only 12 properties to home buyers.

Agreements allow for items that are prohibited by the Act

Our review of the Rochester, New York, San Bernardino County, California, and Washington, DC, Asset Control Area Agreements disclosed that they provide for activities that are prohibited by provisions of the Act that established the Asset Control Area Program. Contrary to specific provisions of the Act, the Asset Control Area Agreements are allowing activities to be carried out in areas that are not designated as revitalization areas, permitting the sale of properties to for profit developers at discounted prices, and allowing the sale of properties to home buyers that are not rehabilitated.

Properties sold at less than the agreed upon amount

Our review of the Washington, DC, Asset Control Area Program disclosed that the HOC and the Local Partner are not complying with the HUD approved Asset Control Area Agreement. Specifically, we found that: (1) the HOC sold HUD properties to the Washington, DC Local Partner at a lower price than that allowed by the Agreement; (2) the Washington, DC Local Partner sold properties to home buyers in excess of the sales limitation price; and (3) the Washington, DC Local Partner sold properties to home buyers that were not rehabilitated. As a result, at August 29, 2001, a total of 41 properties had been identified with purchase prices based on their last listed prices instead of their "as is" appraised values. This will result in a loss of $354,352 to HUD. More significantly, the three home buyers who purchased the properties from the Local Partner, actually incurred more costs for the acquisition and rehabilitation of the properties than if they had purchased the properties directly from HUD. In our opinion, this appears counterproductive to the Act's intent of expanding homeownership opportunities in revitalization areas.

HUD will need to make decisive changes in the administration of the Asset Control Area Program, if it is to meet the objectives of the Act. Unless HUD is willing to assess, monitor and evaluate the Program, the Asset Control Area Program will not achieve its primary mission of expanded homeownership opportunities in revitalization areas.

Exit Conference

On November 1, 2001, we held an exit conference with Single Family Housing Officials to discuss our draft findings and recommendations. We provided a draft of this report to the Assistant Secretary for Housing on November 23, 2001. HUD provided a written response to our draft report on December 18, 2001, which is provided in Appendix A.

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Abbreviations

ACA	Asset Control Area
CACS	Church Association for Community Services
FHA	Federal Housing Administration
HOC	Homeownership Center
HUD	U.S. Department of Housing and Urban Development
M&M	Marketing and Management
OIG	Office of Inspector General
USC	United States Code

Introduction

The Department of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriation Act of 1999 amended Section 204 of the National Housing Act. The purpose of Public Law 105–276 is to require the Secretary to carry out a program under which eligible properties shall be made available for sale in a manner that promotes revitalization, through expanded homeownership opportunities.

Background

The legislation requires HUD to enter into agreements with a Local Partner, (a unit of local government or a nonprofit organization). The Local Partner establishes Asset Control Areas that consist of part or all of a revitalization area. The Local Partner then acquires all HUD Real Estate Owned properties in the Asset Control Areas, and agrees to rehabilitate each property. The legislation further requires HUD to offer discounts off the appraised value of the property to the Local Partner. The discounts are intended to contribute to the cost of rehabilitating and re-selling the properties to home buyers. Once the Local Partner acquires the properties, the properties are to be repaired prior to sale; so home buyers are not burden with high repair costs.

The first Asset Control Area Agreement was executed in December 1999. As of July 31, 2001 a total of 16 Asset Control Area Agreements had been executed between HUD and various Local Partners. While each agreement differs in many areas, the basic structure for most of the agreements is that the Local Partner agrees to purchase from HUD all single-family properties in designated asset control areas. The properties would be sold at a discount (10, 30 or 50 percent) to the Local Partner based on the amount of repairs needed. For properties sold to eligible buyers, the Local Partner agrees to complete all needed repairs. The agreements call for the Local Partners to sell a certain percentage of the properties to eligible buyers. The required percentage of sales to eligible buyers varied from 60 to 100 percent depending on the agreement. Also, there is a wide variation in each agreement's definition of an eligible buyer, incomes vary from 60 percent to 120 percent of the area median income.

The status report on the current Asset Control Area Agreements as of July 31, 2001 shows the following activity:

Local Partner Location	**Purchase Agreement Date**	**Properties Designated to Local Partner**	**Properties Sold To Partner**	**Properties sold to home buyer**
1. San Bernardino, CA	Oct-99	510	415	190
2. Miami-Dade, FL	Dec-99	85	59	0
3. Rochester, NY	Apr-00	496	239	138
4. Chicago, IL	May-00	209	88	7
5. Fort Lauderdale, FL	May-00	25	20	1
6. Cleveland, OH	Jul-00	138	99	4
7. Reading, PA	Sep-00	56	35	0
8. Washington, DC	Oct-00	148	14	0
9. Burlington, VT	Oct-00	3	1	0
10. Denver, CO	Oct-00	11	5	0
11. Los Angeles, CA	Dec-00	40	0	0
12. Rhode Island Housing Authority	Apr-01	0	0	0
13.Hartford, CT & Manchester, CT	Apr-01	11	6	0
14. Bridgeport, CT	Apr-01	13	0	0
15. Prince Georges County, MD	Jun-01	0	0	0
16. Harvey, IL	Jun-01	0	0	0
Total		1745	981	340

Audit Objectives

The overall objective of our review was to evaluate and assess the effectiveness of the Asset Control Area Program in meeting its objective of expanded homeownership opportunities in revitalization areas. Specific objectives were to determine whether:

- Eligible single-family properties are being made available to local governments and nonprofit entities.

- Homeownership opportunities are being expanded.

- Neighborhoods are being revitalized as a result of improvements to the housing stock.

- HUD has established adequate management controls over the Asset Control Area Program.

- The Asset Control Area Program is an efficient use of HUD resources.

Scope of Review

We reviewed ten Asset Control Agreements, and performed site visits at three locations. At the time of our review, two Local Partners had the majority of the activity under the Asset Control Area Program. Therefore, we performed fieldwork at those two entities, which were the City of Rochester, New York, and San Bernardino County, California. We also performed work in Headquarters and the HOCs in Philadelphia, Pennsylvania and Santa Ana, California. Additionally, fieldwork was performed in Washington, DC, which has a nonprofit as its Local Partner, the Church Association for Community Services (CACS). To accomplish our audit objectives we performed the following audit procedures:

- Reviewed Public Law and Statute establishing the Asset Control Area Program.

- Obtained and reviewed Asset Control Area Agreements, and the status reports for 10 Local Partners.

- Interviewed Officials in HUD Headquarters, the Philadelphia and Santa Ana HOC, the Management & Marketing (M&M) Contractors, the City of Rochester, New York, San Bernardino County, and the CACS in Washington, DC.

- Reviewed the Rochester, San Bernardino and Washington Asset Control Area Program.

- We selected a sample of 53 property case files, 19 pertaining to Rochester, 26 pertaining to San Bernardino, and 8 pertaining to Washington, DC. We examined the case files to determine timeliness, appropriateness and reasonableness of the procedures and actions taken.

- Reviewed the tracking systems of the Rochester and San Bernardino Asset Control Area Programs.

- Used Microsoft Office Access and Audit Command Language (ACL) software to perform an analysis of the location of properties, timeliness trends and sales to eligible buyers.

Audit period

We performed the audit fieldwork between June 2001 and November 2001. The audit covered the period from October 1, 1999 to July 31, 2001 and incorporated the results of our survey on Rochester's Asset Control Area Program. We updated our report to reflect current actions where applicable. We conducted our audit in accordance with generally accepted governmental auditing standards.

A copy of this report was sent to the Assistant Secretary for Housing.

HUD Needs To Strengthen Its Management Controls Over The Asset Control Area Program

The audit disclosed that HUD is unable to adequately evaluate the effectiveness of the Asset Control Area Program. We attribute this to HUD's failure to implement adequate management controls to assess the Program's activities. As a result, HUD cannot assure the Congress that the Program is meetings its objectives. Moreover, our review disclosed that the Program, as it is being implemented, has increased HUD's administrative burden regarding its Property Disposition Program and has had little impact nationwide. If HUD is to continue the Program, it must either strengthen its management controls or look for a more efficient method to deliver the activities of the Program.

Background

The Department of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriation Act of 1999[2] directs HUD to promote the revitalization of neighborhoods through the creation of Asset Control Areas in HUD approved communities. The Act requires that Asset Control Areas be included in, or encompass all of a HUD approved revitalization area. HUD negotiates Asset Control Area Agreements with HUD authorized entities (Local Partners) to sell HUD owned properties located within these Asset Control Areas at a discounted price. In turn, the Local Partner must ensure that the properties are rehabilitated and sold to purchasers (home buyers).

Scope

As part of our review, we examined ten[3] executed Asset Control Area Program Agreements. In addition, we visited three Local Partners: Rochester, New York, San Bernardino County, California, and Washington, DC.

Regulations and monitoring procedures not developed

The Act requires the Secretary to issue regulations

Title 12, United States Code (USC), Section 1710(h)(10) requires the Secretary to issue regulations to implement the Asset Control Area Program. Such regulations were to take

[2] Public Law 105-276, October 21, 1998

[3] The 10 agreements reviewed were Rochester, NY, San Bernardino County, CA, Cleveland, OH, Chicago, IL, Ft. Lauderdale, FL, Los Angeles, CA, Miami, FL, Prince George County, MD, Reading, PA, and Washington DC.

effect no later than the expiration of the 2-year period beginning on the date of the enactment of the Department of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999. The Act was approved on October 21, 1998.

Regulations have not been enacted

In October 2000, we inquired about the regulations and were told that they had not been published. On January 30, 2001, we followed up with HUD's Director, Field Operations, Office of Deputy Secretary of Single Family Housing and were told that draft regulations were going through an internal edit process. The regulations would then have to go through the normal clearance process before taking effect. At the completion of our audit work in November 2001, regulations still had not been enacted.

Monitoring procedures have not been established

In addition, HUD has not published the monitoring procedures that the local Homeownership Center (HOC) staff should use when monitoring the Program. For example, we observed during our visits to the Rochester, New York and the San Bernardino County, California Asset Control Area Programs, inconsistencies as to how the Programs were monitored. Specifically, the HUD Santa Ana HOC staff has performed quarterly reviews of the San Bernardino County Program since the beginning of calendar year 2001. Whereas, the HUD Philadelphia HOC staff has not prepared any written monitoring reports regarding the Rochester Asset Control Area Program.

Asset Control Area plans are inadequate

Local Partners must have the capacity to administer the Program

A key component of the success of the Asset Control Area Program is that the Local Partners have the capacity to carry out the provisions of the Asset Control Area Agreements. This includes the financial, staffing and rehabilitation capabilities. In accordance with Title 12, USC Section 1710(h)(5), the Secretary of HUD may sell an eligible property to a Local Partner only pursuant to a binding Agreement that states that the property will be used in conjunction with a homeownership plan. Our review of Asset Control Area Agreements indicated that most Agreements, require an Asset Control Area plan which outlined how Local Partners intend to implement the Agreement.

Asset Control Area plans are not complete

Our review of the Rochester, New York plan disclosed that it was apparently incomplete. It consist of an one page document covering four topics: homeownership goals, homeownership training, rehabilitation standards, and home buyer qualifications. The plan did not address: how Rochester was going to fund the purchase of the properties from HUD; funding for the rehabilitation work; the staff's qualifications for administrating the Program; or Rochester's workload.

A review of the Washington, DC, Asset Control Area plan disclosed that it was more comprehensive, but was also incomplete. For example, the plan did not provide the specifics as to how the Local Partner would rehabilitate the proprieties, i.e. the specific contractors that the Local Partner planned to use to rehabilitate the properties. Also, the plan did not include any indication as to how the Local Partner plans to finance the rehabilitation work.

Local Partners need to submit comprehensive plans

We believe that the Local Partners should submit a comprehensive Asset Control Area plan to HUD for review. Furthermore, HUD should verify and approve the plan prior to entering into an Asset Control Area Agreement. Such approval should be based on the Local Partner's ability to finance and manage the Program.

Performance goals not specific

Specific performance goals shall be set

Title 12, USC Section 1710(h)(7)(G) requires that the Agreement between the Local Partner and HUD shall set forth the specific performance goals applicable to the Local Partner. Also, the Agreement shall set forth any sanctions for failure to meet such goals and deadlines. Likewise, the Local Partner shall certify compliance with such goals. However, we found that some of the goals in the Agreements are undefined, vague, and contradictory. For example, we examined the amount of time the Local Partner had to complete the rehabilitation work in the ten Agreements. In three of the Agreements, the number of days to complete the rehabilitation work is not addressed. In five of the Agreements, the repairs were to be completed within 180 days after purchase. For two other Agreements, the repairs were to be completed within 220 days after the purchase of the property.

City of Rochester's goals were not specific

Our review of the Rochester, New York Agreement disclosed that it included goals that were not specific. Article 10.1 of the Agreement states that as a goal, the Local Partner ***shall attempt*** to sell a minimum of 65 percent of all designated properties to eligible home buyers. In another example, Article 10.2 states that the Local Partner ***shall attempt*** to limit the total collective sales received during each one-year period to 110 percent less eligible costs.[4] In our opinion, the use of such language in the Agreement does not constitute specific performance goals.

Contracts contained contradictory provisions

We found the wording in a number of the Agreements to be contradictory regarding the limitation of the sale price to the home buyers. For example, in the San Bernardino County Agreement, the Agreement provides that the County shall not sell a designated property to a home buyer for a price that is in excess of 110 percent of the eligible costs. However, under the County's Program, it must accept the best purchase price offered, therefore, it can not control the amount of funds it receives.

Our review disclosed six other Agreements that contain the 110 percent clause. However, these Agreements contain an additional clause. The Agreements allow the Local Partner to sell individual properties to home buyers at more than 110 percent of the eligible costs, provided the average sale price to the home buyers for any given quarter does not exceed 110 percent.

In our opinion, the lack of specific and consistent goals makes it difficult to ensure that the overall Asset Control Area Program is meeting its objectives.

Reports were not consistent or accurate

Quarterly reports were inconsistent in format

We reviewed the reports of the Rochester, New York and San Bernardino County Asset Area Control Programs that were submitted to HUD and found inconsistencies. In fact, the reports were so different, that in our opinion, HUD can not compare the two Programs to determine any trends.

[4] Eligible costs include the purchase price of the property, plus the cost to rehabilitate, market and close the sale of the property.

For example, San Bernardino County's quarterly reports identified the acquisition cost of the property, and the cost to rehabilitate, market and close the sale of properties to home buyers. Also, San Bernardino County included a 10 percent administrative fee as their cost to administer the Program.

The Rochester, New York, reports provided the acquisition cost of the property, but did not reflect the actual rehabilitation costs, because under Rochester's Program the home buyer repairs the property. Also, Rochester's reports did not contain other types of costs, such as, marketing or administrative costs.

Information in quarterly reports subsequently changed

Also, we found that certain information in the reports sent to HUD subsequently changed. In San Bernardino County, there were costs that changed since the quarterly reports were submitted to HUD because of refunds and other transactions. However, these changes were not reported to HUD in the subsequent quarterly reports. Furthermore, the reports did not address the activity that was being performed by the City of San Bernardino, California.

Regarding the San Bernardino County's reports, we found that calculations in some reports were not correct. In our sample of 26 properties, we found six cases where the administrative costs were calculated incorrectly, averaging about $260.00 in the County's favor.

The Asset Control Area Program has placed an increased burden on HUD's Property Disposition Program

In our opinion, the Asset Control Area Program, as it is being implemented, is placing a burden on HUD's Property Disposition Program. First, the negotiations regarding the Agreements are time consuming and complex. Second, the duties and responsibilities of HUD's Marketing and Management (M&M) contractors and Closing Agents have increased. Third, the Agreements have led to procedures that are complex, hard to control and staff intensive.

Each agreement was modified to meet the local needs

Each Agreement that we reviewed has been modified to meet the local needs of the community. It is these modifications that have led to time-consuming negotiations. For example, the negotiations must include how the community will implement and finance its rehabilitation program and how the program impacts local ordinances.

M&M responsibilities have increased

In addition, the responsibilities of the M&M contractor have increased in the following manner. The contractors are the focal point of HUD's Property Disposition effort. As such, the M&M contractor must identify those properties that are within an Asset Control Area. In San Bernardino County, the M&M contractor segregates the properties that fall into zip codes and then determines if it qualifies for the Asset Control Area Program. Also, the M&M contractor must maintain a tracking system and submit weekly status reports to the local HOC and San Bernardino County regarding the disposition of these properties.

Modifications made to the M&M and closing agent's contracts

Both the M&M contractors' and the closing agents' contracts had to be amended to reflect the requirements of the Asset Control Area Program. The modifications have resulted in an increase in fees for the M&M contractors and the Closing Agents.

Asset Control Area discount procedures have added to HUD's burden

As part of our review, we examined the fiscal controls that are in place to ensure that HUD has implemented adequate controls regarding the Asset Control Area Program. We found that controls regarding the determination of the discount sales price needs to be strengthened and possibly should be reexamined.

Sales price is determined at a price discounted from the value of the asset

Once HUD appraises a property, the amount of repairs needed determines the level of the sale discount that will be provided. Title 12, USC Section 1710(h)(6)(C) provides sole discretion to the Secretary, when establishing the discount. The discount will be one of the following: minimal discount, standard discount, or a deep discount. The Secretary will determine the criteria as to how to apply the discount.

In the ten Agreements we reviewed, they stipulate that the discounts are to be based upon a repair report. We found that HUD defined the minimal discount to be 10 percent if the repair report requires $5,000 or less of repairs. The standard discount is 30 percent, if the repair report requires between $5,001 and $15,000 of repairs. Lastly, the deep discount is 50 percent if the repair report requires over \$15,000 of repairs.

Local entity prepares the repair estimate

We found a number of fundamental problems with the discount determination. First, the entity that is receiving the benefit of the discount develops the repair estimate. In our opinion, for HUD to have adequate controls regarding the amount of the discount that is to be provided, HUD should monitor the consistency and validity of the repair reports. As stated above, HUD has not developed any monitoring procedures. Even without procedures, the Santa Ana HOC attempts to verify the San Bernardino County discounts. But, the HOC has found this to be time intensive.

Items included in repair reports were inconsistent

Another concern is the consistency of items included in the repair reports. For example, San Bernardino County's repair reports were based upon Minimum Property Requirements. We learned from the County's staff that Minimum Property Requirements are HUD's Minimum Property Standards plus additional items. Also, San Bernardino's Agreement had a separate exhibit for additions and clarifications of Minimum Property Requirements. Whereas, the Rochester, New York Agreement states that the repair report should be based upon the Valuation Conditions in the appraisal and a Supplemental Repair Form. The Supplemental Repair Form includes items that are code violations in the City of Rochester. Also, we found that the HUD HOC staff and the Local Partner disagree over what items should be included in the repair report and the estimated costs of the items.

Discount not adequate to complete the repairs

Lastly, there is a concern about whether the discount provides enough funds to complete the repairs. Under the discount provision, Title 12, USC Section 1710(h)(6)(C)(i)(I), the amount is to be appropriate to provide reasonable resources to improve the property. We found a number of repair estimates where a 30 or 50 percent discount would simply not equal the total cost of all needed repairs.

HUD's discretion on applying discount levels

The statute provides for three discount levels and leaves it up to HUD as to which discount to apply and how to apply it. It was the Conferees (see Finding 2) intent that adequate rehabilitation and renovations must be made to these

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houses to make them attractive to home buyers, as well as, to increase the stability of the neighborhood. Therefore, rehabilitation standards should include whether the properties are in good, safe and habitable condition; whether major systems are dependable and in good repair; and whether the properties are marketable to prospective owner occupants given the standards and preferences of the local community.

HUD needs to strengthen controls and reexamine procedures

But, the current method for determining the discount has led to procedures that are cumbersome, staff intensive, and may not be adequate to meet the Program's objectives. At a minimum, HUD needs to strengthen the controls if it continues to determine the discount with the aforementioned criteria. Moreover, we believe HUD should examine other methods for making the discount determination, especially those that are not as staff intensive, but still take into consideration the financial safety and soundness of the Mutual Mortgage Insurance Fund along with the objectives of the Program

Limited impact nationwide on the Program's objectives

The Program has had limited nationwide impact

Ultimately, the purpose of the Asset Control Area Program is to make sure that HUD owned properties are made available for sale in a manner that promotes revitalization through expanded homeownership opportunities, in revitalization areas. Based on Program results, it appears that the Program has had little nationwide impact since the Public Law was passed over two and half years ago.

As of July 31, 2001, 16 Asset Control Area Agreements had been executed between HUD and local entities. At the stated date, the local entities had purchased a total of 981 properties from HUD. Of these, 340 properties had been sold to home buyers. However, two of the local entities: Rochester, New York and San Bernardino, County, California accounted for 654 of the properties purchased and 328 of the sales to home buyers. It should be mentioned that because of the nature of the Rochester, New York Program (See Finding 2) there is less than adequate assurance that the 138 properties identified as sold to home buyers will be rehabilitated. Excluding San Bernardino County and Rochester, the other 14 local entities had only sold a total of 12 properties. It should be noted that when the Asset Control Area Program was approved in 1998 and 1999, HUD's inventory of Single Family properties was at historically high levels. The single-family inventory was approximately 41,000 properties in 1998 and escalated to about 51,000 properties just prior to the first Asset Control Area Agreement being executed in 1999. As of September 2001, the single-family inventory had decreased to around 29,000 properties. Thus, we believe that HUD should perform a needs assessment on the disposition of HUD owned single-family properties to determine whether the Asset Control Area Program is currently needed.

Auditee Comments

HUD states that there has been a decline in the inventory of HUD owned single-family properties since December 1999 but this decline does not obviate the potential value of the Asset Control Area Program. HUD's response goes on to say that HUD has strengthened its monitoring of the Asset Control Area Program, have begun physical inspections of the properties acquired by Local Partners, and is developing a revised policy statement based on input from all parties involved in the Program. Also, HUD indicated that since the re-evaluation began and while the revised policy is being finalized, no new agreements have been or will be negotiated.

HUD agrees that regulations are needed, and anticipates that proposed or interim regulations will be published within the next few months. Also, HUD provides in its response that the new Asset Control Area policy, once approved and implemented will provide the HOCs with more involvement in the oversight of the Local Partners.

In addition, HUD's response indicates that the new Asset Control Area policy will provide for the following: require Local Partners to submit comprehensive plans detailing financial and management aspects of the Program; establish procedures, that include more oversight by the HOCs regarding reviewing and approving the Asset Control Area plans; require Local Partners to send reports to HUD on a monthly, quarterly and annual basis; and require that Local Partners to submit an Asset Control Area plan that addresses its specific performance goals.

HUD agreed that the discount method needs to be examined and in its response stated that it will propose a new discount determination formula that will provide for three levels of discount based on the extent of the repairs necessary.

OIG Evaluation of Auditee Comments

In assessing the need for the Asset Control Area Program it is imperative that the impact of the Program on HUD's limited staff resources be considered. More involvement by the HOCs in the approval process, increased monitoring, performance of physical inspections and greater emphasis on the review of reports will place a greater burden on HUD's staff. The regulations and the new Asset Control Area policy need to be approved and implemented as timely as possible to ensure that the changes to the Asset Control Area Program noted in HUD's response can be put into practice as soon as possible.

Recommendations

We recommend that HUD:

1A. Assess the need for the Asset Control Area Program in light of: (1) the decline in the inventory of HUD owned single-family properties; (2) the Program being susceptible to Program abuse by housing investors and contractors as is the case in similar Programs; and (3) the fact that the Program will place an increased burden on the HUD staff. Based on the results of the assessment, HUD should determine whether the implementation of the Program should continue.

If implementation continues, we recommend that HUD:

1B. Complete and implement the regulations for the Asset Control Area Program.

1C. Establish monitoring procedures.

1D. Instruct the Local Partners to submit comprehensive Asset Control Area plans that include how the Local Partner will finance and manage the Program.

1E. Establish procedures for the HOC to review and approve the Asset Control Area plans. The reviews should include verification of the commitments made by the Local Partners in their plans.

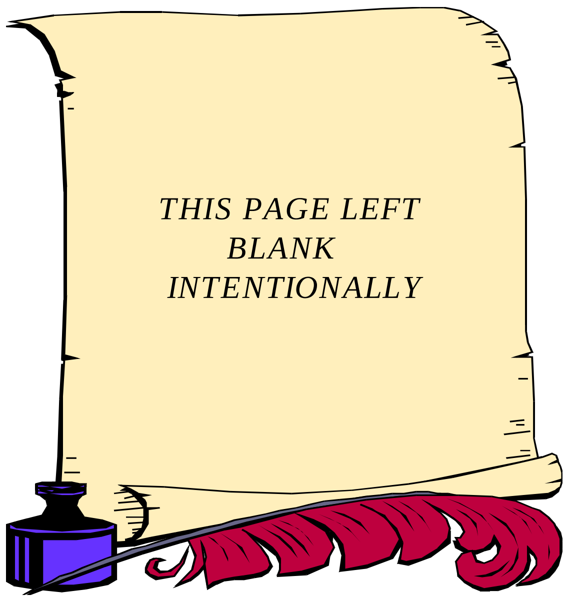
1F. Ensure that future agreements include specific performance goals and sanctions for failure to meet such goals and deadlines. Enforce sanctions against Local Partners that do not meet their performance goals.

1G. Ensure that quarterly reports consistently contain accurate figures.

1H. Strengthen the controls to ensure that discounts are accurate. Further, HUD should examine the method by which the discount is determined to ensure that it meets the objectives of the Program while taking into account the financial stability of the Mutual Mortgage Insurance Fund and the impact on HUD's resources.

In addition, in order to ensure that the Program stays at a manageable size. We recommend that HUD:

1I. Limit the number of properties that are involved in the Asset Control Area Program. This would give HUD flexibility to control the size of the Program; however, HUD may need to seek legislative change to obtain this flexibility.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Asset Control Area Agreements Do Not Comply With The Act That Established The Asset Control Area Program

Our review of the Rochester, New York, San Bernardino County, California, and Washington, DC, Asset Control Area Agreements disclosed that they provide for activities that are prohibited by provisions of the Act that established the Asset Control Area Program. Contrary to specific provisions of the Act, the Asset Control Area Agreements are allowing activities to be carried out in areas that are not designated as revitalization areas; permitting the sale of properties to for profit developers at discounted prices, and allowing the sale of properties to home buyers prior to being rehabilitated.

We believe that this occurred because HUD did not ensure that the negotiated Asset Control Area Agreements comply with the provisions of the Act. Specifically, we noted that the initial Agreements were negotiated by HUD Headquarters staff, and in our opinion, at the time of these negotiations the Headquarter staff was not completely aware of the intent of the Program. As a result, the Program is not being implemented in compliance with the intent of the 1999 Appropriation Act.

Criteria

The Department of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriation Act of 1999 amended Section 204 of the National Housing Act. The purpose was to require the Secretary to carry out a program under which eligible assets shall be made available for sale in a manner that promotes the revitalization, through expanded homeownership opportunities, of revitalization areas.

<u>Asset Control Areas that were not in or part of revitalization areas were included in the Agreements</u>

The Asset Control Area Program's primary objective is to expand homeownership opportunities in HUD approved revitalization areas. Title 12, USC Section 1710(h)(4)(B)(i) states that an asset control area shall be an area that consists of part or all of a revitalization area. Further, Title 12, USC Section 1710(h)(3) states that the Secretary shall designate areas as revitalization areas which can only be areas that meet one of the following requirements: very-low income, high concentration of eligible assets or low home ownership rate.

Asset control areas did not meet revitalization area requirements

Our review disclosed that the Rochester, New York and San Bernardino County, California, Asset Control Area Agreements contain asset control areas that are not part of revitalization areas. Rochester's Asset Control Area Agreement, dated April 7, 2000, contains 11 postal zip codes as asset control areas pertaining to almost the entire City of Rochester. Our review noted that zip code 14615 was not identified as a revitalization area when HUD published Notice H-00-3; Designation of Fiscal Year 2000 Revitalization Areas, February 15, 2000.

On February 12, 2001, HUD's Philadelphia HOC advised Rochester officials that zip code 14615 was not part of its Asset Control Area Agreement. However, our review disclosed that at least three properties located in the 14615 zip code were sold to Rochester by HUD as part of the Asset Control Area Program. Consequently, asset control activities were carried out in an area that was not designated as a revitalization area.

San Bernardino County's Asset Control Area Agreement defined 12 areas as asset control areas. Our discussions with HUD's Santa Ana HOC staff and a review of San Bernardino's map of revitalization areas disclosed that large portions of the asset control areas were not in revitalization areas. Consequently, HUD sold a significant number of properties to the County under the Asset Control Area Program that were not in revitalization areas. The San Bernardino County and HUD's Santa Ana HOC staff is aware of this and plan to correct it during their negotiations of a renewal of the Agreement. However, our review disclosed that some of the proposed revised asset control areas are still not in revitalization areas.

In our opinion, the above occurred because the HUD personnel, who negotiated the original Asset Control Area Agreements, were not familiar with the provisions of the Act regarding revitalization areas. Also, we noted that the HUD

Headquarters personnel, who negotiated the Agreements, did not always involve the HOC staff during the negotiation process.

Change in revitalization area criteria

Effective August 18, 2000, HUD Notice H-00-16, redefined a revitalization area as a distressed neighborhood, which has a high concentration of eligible HUD assets, a substantially low rate of homeownership as compared to the metropolitan area, or residents with very low incomes (less than 60 percent of median household income of the metropolitan area or the state). Prior to August 2000, revitalization areas were generally defined by zip codes. HUD Notice H-00-16, provides that more closely defined locations, such as, census tracts, census places, or even targeted streets or geographical boundaries may be used as criteria.

Properties not in distressed areas

While performing our audit, we noted that some of the properties did not appear to be in economically distressed areas. During our review of San Bernardino County's Asset Control Area Program, we found that eight of the properties in our sample of 26, were not located in revitalization areas. We observed that several of the homes were relatively newly constructed. Also, while in Rochester, we noted that some properties did not appear to be located in economically distressed areas. In Rochester and Washington, DC, the asset control areas remain defined as revitalization areas based on entire zip codes, rather than census tracts or other geographic boundaries.

Rochester and San Bernardino County's current Asset Control Area Agreements are not in compliance with HUD's Notice H-00-16, revitalization area criteria. The Asset Control Area Agreements in both Rochester and San Bernardino County have exceeded their original term of 12 months and are due for renewal. Both original Agreements have been extended while changes are being negotiated. In our opinion, HUD should not renew the Agreements until the asset control areas are redefined in accordance with the new criteria.

Contrary to the Provisions of the Act, properties were sold to for profit developers at discounted prices

Criteria

Title 12, USC Section 1710 (h)(6)(A) states that each eligible asset sold through the Asset Control Area Program to a preferred purchaser shall be sold at a price that is discounted from the value of the asset. Also, Title 12, USC Section 1710(h) (4)(A) defines a preferred purchaser as the unit of general local government having jurisdiction with respect to the area in which the eligible assets are located; or a non profit organization.

Cooperative Agreement with City of San Bernardino

San Bernardino County's Asset Control Area Agreement requires the County to enter into cooperative agreements with the Cities of Highlands, Redlands and San Bernardino, California. The Agreement, dated September 21, 1999, between the County and the Redevelopment Agency of the City of San Bernardino, California states that the City of Bernardino shall have the right of first refusal to purchase properties located in asset control areas. In March 2001, the cooperation agreement was amended, so that all of the properties located in the asset control areas would be transferred to the City of San Bernardino.

San Bernardino's Program does not comply with the Law

The City of San Bernardino uses its Acquisition, Rehabilitation and Resale (ARR) Program to rehabilitate and sell properties to home buyers. For properties located in the asset control areas of the City of San Bernardino, the County transferred the properties to the City at the County's acquisition cost (discount price). The City, through its ARR Program sold the properties to for-profit developers at the acquisition cost (discount price). The for-profit developers rehabilitated the properties and sold them to home buyers at the market price.

At the time of our review, the County had transferred 122 properties to the City. The City's quarterly report for the period ending May 31, 2001 indicates that 21 properties were transferred to for-profit developers, rehabilitated and subsequently sold to home buyers. The total acquisition costs for the 21 properties was $840,000 (net of the discount). We were told that the developers rehabilitated the properties at a cost of $1,000,000(this amount has not been verified by the County) and sold the properties to home buyers for a total of $1,920,000. Under the City's ARR Program, the benefit of the Asset Control Area discount was passed along to the for-profit developers. The Act distinctly states that HUD is only allowed to provide discounted property sales to either a unit of the local government or a non-profit organization.

In addition, Section 5.4 of the Asset Control Area Agreement between HUD and San Bernardino County states that the County shall use net profits that it receives from the sale of properties for (a) the purchase and/or rehabilitation of additional properties, or (b) eligible investments in Asset control areas. We estimate the profits for the above mentioned 21 properties to be about $80,000. However, because of the design of the County's Program, involving for-profit developers, the County can not assure HUD that these profits are going back to the asset control areas.

Asset Control Area Agreements allow properties to be sold prior to being rehabilitated

Rochester's Asset Control Area Agreement requires home buyers to rehabilitate properties

The Asset Control Area Agreement with Rochester, New York differs from the other Agreements in that it requires the home buyer to perform the necessary rehabilitation instead of the City of Rochester. Article 9.1 and 3.1 of Rochester's Asset Control Area Agreement require the home buyer to rehabilitate the property. Under Rochester's Program, the City acquires properties from HUD at the discounted sales price; afterward, the properties are listed for sale and sold to home buyers. The properties in many instances are sold at or near the appraised value. As a result, the discounted prices that Rochester receives from HUD are not passed along to home buyers. In this regard, depending on the income eligibility of home buyers, Rochester may provide grants to assist home buyers in repairing the properties; however, home buyers have the final responsibility to rehabilitate the properties.

The Act requires Rochester to rehabilitate each property purchased

In our opinion, the Agreement's provisions that require the home buyer, instead of Rochester, to repair the property do not comply with either the wording or the intent of the Act. Title 12, USC Section 1710(h)(5)(A)(iii) of the statute states that "the preferred purchaser (Rochester) agreed that

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each property purchased would be rehabilitated”. While not perfectly clear, it seems fair to conclude from this language that Congress meant that the preferred purchaser should rehabilitate the property, not the home buyer. Furthermore, the Conference Committee, House Conference Report regarding the Act states, "assets offered for sale must be repaired, so purchasers (home buyers) are not saddled with high repair costs. The Conferees believed that adequate rehabilitation and renovations must be made to these homes to make them attractive to buyers as well as to increase the stability of the neighborhood." Therefore, it is our opinion that the law makers intended that the properties be rehabilitated <u>before</u> being offered for sale to home buyers; thus, ensuring that one of the purposes of the Program, neighborhood revitalization, would be accomplished.

Rochester’s Program is not in compliance with the Act

In addition, as a practical matter, if Rochester is not required to make the repairs to the properties, then it is foreseeable that the repairs may not be made. In this regard, Rochester’s Program has limited enforcement mechanisms to ensure that the repairs are performed. Rochester’s sale agreement with home buyers require home buyers to agree to rehabilitate the property in accordance with the City’s applicable housing codes. Even if Rochester monitors the home buyer’s compliance through its normal code enforcement procedures, HUD should seriously question whether the home buyers are financially able to fund the repairs, which in some cases could be quite expensive. Another problem with Rochester’s Program, from a practical point, is that since Rochester sells the properties prior to repairs being made, the home buyer in many cases can’t obtain a FHA insured mortgage because the property does not meet minimum property standards.

Congress in the Conference Report recognized this problem, when it mentioned that purchasers (home buyers) should not be "saddled with high repair costs." This is precisely what will occur under Rochester’s plan when it requires the home buyer to make repairs. Under the Act, Congress requires Rochester to agree that each property would be rehabilitated. In our opinion, Rochester’s Program does not comply with the intention of the Act, as Rochester requires the home buyer to repair the property. We believe this occurred because the staff in HUD headquarters initially negotiated the Agreement and, in our opinion, the staff may not have completely understood the intent of the Program. Also, the Headquarters staff did not always involve the HOC staff in the negotiations of the initial Agreement.

Auditee Comments

HUD agrees that the HUD staff responsible for negotiating the Asset Control Area Program must be familiar with the requirements of the 1999 Act. Further, HUD plans to provide training to the staff, and institute a new policy to require staff to consult with both the Director of HUD's Program Support and the Real Estate Owned Director to determine the adequacy of the proposed Local Partner's operational and financial capacity.

HUD comments provide that all future Asset Control Area activities will be within the confines of approved revitalization areas that meet the criteria established in Notice H-00-16.

Concerning the San Bernardino County Asset Control Area Agreement, HUD indicated the City of San Bernardino was removed from the County's Program effective September 1, 2001 and that the HOC and the County are working to identify and document appropriate areas to be included in the Asset Control Area. The HOC has extended the County's Asset Control Area Agreement for 60 days with the caveat that without new documentation from the County within 30 days, the Asset Control Area boundaries will be adjusted to currently designated revitalization areas.

HUD comments also provide that the HOC intends to reanalysis the zip codes for the City of Rochester's Asset Control Area Program within the next 90 days. Further, HUD comments provide that under Rochester's Asset Control Area Program, repair grants are provided to some lower income home buyers. For these sales, Rochester will oversee the selection and performance of the repair contractor. For other sales, Rochester does not have a day-to-day involvement with the repairs. This practice is not in comp1iance with Congressional intent as stated in the House Conference Report. Rochester's current Agreement expired on December 31, 2001. It is anticipated that a 90 day extension will be issued in anticipation of the implementation of the new Asset Control Area Policy. Once the new policy is implemented, an attempt will be made to have the City of Rochester execute a new Agreement.

OIG Evaluation of Auditee Comments

Pertaining to HUD's comments on the City of Rochester's Asset Control Area Program, we believe that the City of Rochester should be informed that its current Asset Control Area Agreement will not be renewed unless its Program comply with the Asset Control Area Program's Congressional intent.

Recommendations

We recommend that HUD:

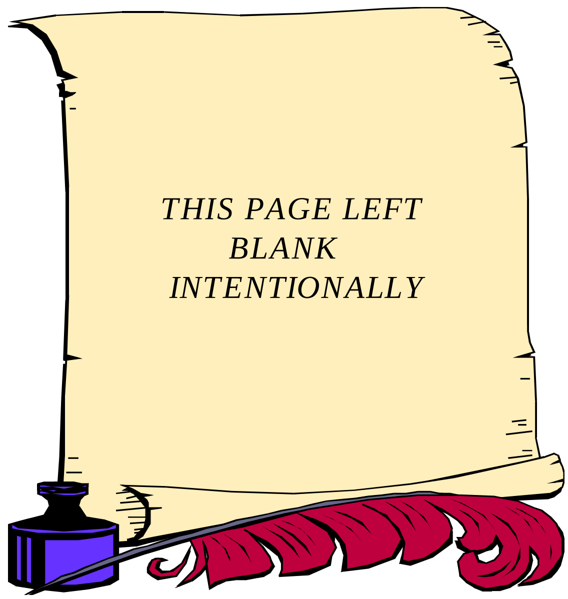
2A. Ensure that the staffs that negotiate the Asset Control Area Agreements or renewals are familiar with the requirements of the Act and that the HOC staff is included in the negotiations of the Agreements.

2B. Establish minimum standards for evaluating and documenting designated asset control areas to ensue that the areas meet the criteria pertaining to revitalization areas.

2C. Defer the renewal or the granting of further extensions of Asset Control Area Agreements until the asset control areas are redefined. Only areas that meet the criteria for revitalization under the current criteria should be included. Special attention should be paid to the San Bernardino County and City of Rochester Asset Control Area Agreements.

2D. Instruct San Bernardino County, California not to sell properties to the City of San Bernardino, California, until the City has revised its Program to comply with the provisions of the Act regarding sales to for-profit developers.

2E Review the Rochester, New York Asset Control Area Program to determine if it complies with the requirements of the Act. If HUD determines that the Program does not comply with the provisions of the Act, do not renew the current Agreement.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The HOC And The Washington, DC Local Partner Are Not Complying With The Asset Control Area Program Agreement

Our review of the Washington, DC Asset Control Area Program disclosed that the HOC and the Washington, DC Local Partner did not comply with the HUD approved Asset Control Area Agreement. Specifically, the review disclosed that: (1) the HOC sold HUD properties to the Washington, DC Local Partner at a lower price than that allowed by the Agreement; (2) the Washington, DC Local Partner sold properties to home buyers in excess of the sales limitation price; and (3) the Washington, DC Local Partner sold properties to home buyers that were not rehabilitated.

We believe that this occurred because the HOC did not ensure that the HUD approved Asset Control Area Agreement was followed. As a result, HUD will lose $354,352 on the sale of properties to the Washington, DC Local Partner, and home buyers will pay excessive prices when purchasing HUD properties under the Asset Control Area Program.

Background

In October 2000, HUD entered into an Asset Control Area Agreement with a Washington, DC, non-profit entity, Church Association for Community Services, (Local Partner). The Asset Control Agreement designated five zip codes in Washington, DC as revitalization areas. The initial HUD properties were transferred to the Local Partner in May 2001, and as of September 10, 2001, the Local Partner had sold three properties to home buyers.

HOC sold HUD properties to the Local Partner at a lower price than that allowed by the Agreement

Criteria

Title 12, USC Section 1710 (h)(6)(A) states that each property sold through the Asset Control Area Program, shall be sold at a price that is discounted from the value of the property based on the appraised value of the property. Furthermore, Title 12, USC Section 1710 (h)(6)(B) states that each property appraisal should be based upon the "as is" physical condition of the property. Also, Section 6.1 of the Local Partner's Asset Control Area Agreement states that the purchase price for properties shall be based on the properties' appraised value minus the applicable discount.

Purchase prices not calculated correctly

Our review disclosed that for the initial properties sold to the Washington, DC Local Partner, the purchase price was not calculated in accordance with the Asset Control Area Agreement. The HUD M&M Contractor sold the properties to the Local Partner at the last listed price[5], instead of the "as is" appraised price. A representative of a M&M contractor stated that when the Washington, DC Program started, the M&M contractor was instructed by the HOC to sell properties to Local Partner at the last listed price, instead of the "as is" appraised value. HOC staff indicated that they allowed the sale price to be based on the last listed price instead of the "as is" appraised price because the properties had not sold at the last listed price; therefore, it seemed logical to sell the properties at the last listed price instead of the higher "as is" appraised value. We disagree with the HOC staff because HUD allows a discount to be applied to the purchase price. Applying the discount to the last listed price, instead of the "as is" appraised price, results in a loss to the HUD Insurance Fund. Furthermore, this is contrary to the Asset Control Agreement which clearly states that the Local Partner should purchase properties based on the "as is" appraised value of the property. As a result, as of August 29, 2001, a total of 41 properties had been identified as having sale prices based on the last listed price of the property instead of the "as is" appraised value. This will results in a loss of $354,352 to HUD.

Properties Sold in Excess of the 110 Percent Limit

Criteria

Section 10.3A of the Washington, DC Asset Control Area Agreement states the Washington, DC Local Partner shall not sell a property purchased from HUD for more than one hundred ten percent (110 percent) of eligible expenses[6]. The Agreement further states in Section 10.3B that with HUD's approval, the Local Partner may elect to sell

[5] Initially a property is listed for sale at the appraised value, if the property is not sold within so many days, the asking price for the property is reduced. This occurs until the property is sold. Thus, the listed price can be less than the appraised value of property.

[6] Eligible costs include the purchase price of the property, plus the cost to rehabilitate, market and close the sale of the property.

individual properties for more than the 110 percent, provided the 110 percent limit is met for the portfolio of sales that are reported each quarter.

Properties sold in excess of the 110 percent limit

Our review of the three properties sold by the Washington, DC Local Partner to home buyers disclosed that the three properties were sold well in excess of the 110 percent limitation. For two properties, the sale prices, which do not include the rehabilitation costs, were 634 and 263 percent of the Local Partner's purchase costs based on the information provided below:

HUD Case Number	Local Partner Purchase Price from HUD	Local Partner Sale Price to Home Buyer
081-056550	$17,010	$108,000
081-057081	$30,375	$ 80,000

In both of the above cases, the home buyer had to also finance the cost of rehabilitating the property. In the third case, the Local Partner purchased the property, which had projected rehabilitation costs of $43,600, from HUD for $51,200. The Local Partner sold the property for $185,000, which exceeds the 110 percent limitation.

Regarding the three sold properties, the Local Partner did not comply with the Asset Control Area Agreement pertaining to sale price limitation. Further, we found no indication that the Local Partner requested HUD approval for those sales. Based on a review of five other properties with sales contracts, it does not appear that the Local Partner will meet the 110 percent limitation on its portfolio for the quarter ending September 30, 2001.

Local Partner has not complied with the 110 percent sale price limitation

In our opinion, the Local Partner is not complying with the sale price limitation. As a consequence, the three home buyers who purchased properties from the Local Partner actually incurred more costs for the acquisition and rehabilitation of the properties than they would have if they had purchased the properties directly from HUD. In our opinion, this appears counterproductive to the Act's intent of expanding homeownership opportunities in revitalization areas.

Local Partner sold properties that were not rehabilitated

As stated above, we noticed that the Washington, DC Local Partner sold properties to home buyers before necessary repairs were made. Section 9.1 and 10.1 of the Washington, DC Agreement require all repairs to be completed before the property is conveyed to a home buyer. As we previously stated in Finding 2, we believe that the intent of the Act is that all properties be repaired prior to being sold to home buyers. Our review disclosed that for two of the three properties sold, the home buyers had to obtain financing, which included funding for rehabilitation work (one obtained funding under the Section 203K Program and the other obtained a conventional mortgage with an escrow for rehabilitation work). In our opinion, these types of sales to home buyers not only do not comply with the intent of the Act, but are prohibited by the Asset Control Area Agreement between HUD and the Washington, DC Local Partner.

Auditee Comments

HUD's comments provided that when an Asset Control Area Agreement is executed, there is an initial transfer of properties on-hand. These properties have generally been in the HUD inventory for several months and have been marked down as they failed to sell. The HOC therefore believed that the "last list price" was a better indicator of the market price of these properties than the "as is" appraised value. To characterize the difference between the "as is" appraised value and "last list price" as a loss to HUD is not accurate. The market has already determined that the "as is" appraised value is not the market value of the property. It seems inappropriate to charge HUD's Asset Control Area Local Partner the value reflected in the appraisal when the market indicates that the appraised value is too high.

HUD also provided in its comments that the draft audit report accurately points out that Church Association for Community Services (CACS) sold properties for more than "110 percent of Eligible Expenses" sale price limitation. However, this limitation is imposed on sales to target buyers. For properties sold to non-target buyers, the 110 percent limitation may be exceeded on individual properties, but the excess must be invested in the Asset Control Area so that the 110 percent limitation is met on a cumulative basis. Permitting sales in excess of the "110 percent of Eligible Expenses" limitation is a departure from the standard nonprofit sales programs, and is unique to the Asset Control Area concept. This approach arose in the course of meetings with several Asset Control Area Local Partners and prospective Partners. All of these groups pointed out that limits on sale prices for the entire Asset Control Area is not desirable, for two reasons:

- In a concentrated Asset Control Area, or in a broad, high volume Asset Control Area, suppressed pricing would disturb real estate markets and tax roles. Many of the Asset Control Area purchasers are municipal entities, and they were particularly sensitive to this.

- A concentration of income e1igible buyers within an Asset Control Area seemed to be imprudent urban planning. A mix of income levels should be the goal.

As a result, HUD has agreed to allow sales at market values, provided that sales proceeds above the 110 percent limit are re-invested in the Asset Control Area.

HUD agreed with recommendation 3C and stated that the Local Partner has been advised by the HOC that it must rehabilitate all properties prior to the property being conveyed to a home buyer.

OIG Evaluation of Auditee Comments

The Asset Control Area agreement clearly states that the Local Partner should purchase properties based on the "as is" appraised value of the property. As such applying the discount to the "last list price" does result in a loss to the HUD Insurance funds, since HUD should have received the amount based on the "as is" appraised value as stated in the Asset Control Area Agreement. Also, HUD's contention that the "last list price" is a better indicator of the market price is not supported by our review, which disclosed that a Local Partner sold two of three properties (prior to rehabilitation) not only in excess of the "last list price" but also in excess of the "as is" appraised value.

At the time of our review all three completed sales had exceeded the 110 percent limitation. While all three sales were to non-targeted buyers, our concern is that the Local Partner will not meet the 110 percent requirement on its entire portfolio. Also, each of the three home buyers incurred more costs to obtain the HUD-owned property under the Asset Control Area Program then they would have if they had purchased the property directly from HUD. This appears counterproductive to the Act's intent of expanding homeownership opportunities. HUD needs to ensure that the Local Partner complies with all requirements pertaining to the sale of properties under the Asset Control Area Agreement.

Recommendations

We recommend that HUD:

3A. Ensure that the HOC and M&M Contractors calculate the correct purchase price of all Asset Control Area properties in accordance with the Agreement.

3B. Instruct the Washington, DC Local Partner, Church Association for Community Services, to comply with the sale price limitation and rehabilitation requirements in its Asset Control Area Agreement.

3C. Review the Asset Control Area Program to determine if home buyers are incurring excessive costs when purchasing HUD properties, and ensure that the necessary actions are taken to prevent such occurrences.

Management Controls

In planning and performing our audit, we obtained an understanding of the management controls that were relevant to our audit. Management is responsible for establishing effective management controls. Management controls, in the broadest sense, include the plan of organization, methods and procedures adopted by management to ensure its goals are met. Management controls include the processes for planning, organizing, directing and controlling program operations. They include the systems for measuring, reporting and monitoring program performance.

Relevant Management Controls

We determined the following management controls were relevant to our audit objective:

- Program operations - Policies and procedures HUD has established for processing the acquisition, rehabilitation and sale of Asset Control Area Properties.
- Validity and Reliability of Data - Policies and procedures that HUD has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with Laws and Regulations - Policies and procedures that HUD has implemented to reasonably ensure that resource use is 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 all of the relevant control identified above.

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

Significant Weaknesses

Based on our review, we believe that significant weaknesses exists in the following management controls. These weaknesses are described in the findings section of this report.

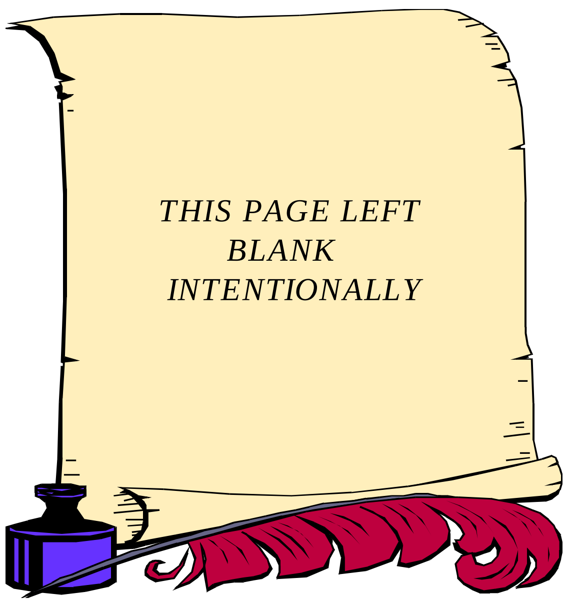
- HUD did not timely implement regulations and monitoring procedures for the Asset Control Area Program. Finding 1 (Program Operations).

- HUD did not develop procedures to ensure that the Asset Control Area Agreements complied with the Act. Finding 2 (Compliance with Laws and Regulations),

- HUD did not implement adequate procedures to ensure accuracy of Asset Control Area data. Finding 1 (Validity and Reliability of Data), (Compliance with Laws and Regulations).

Follow Up On Prior Audits

This is the first OIG audit of the Asset Control Area Program.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Auditee Comments

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-8000
December 18, 2001

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

MEMORANDUM FOR: Alexander C. Malloy, District Inspector General for Audit, 2AGA

FROM: John C. Weicher, Assistant Secretary for Housing-Federal Housing Commissioner, H

SUBJECT: FHA's Response to the Nationwide Audit of the Asset Control Area Program

Thank you for the opportunity to review and comment on the draft audit report you developed as a result of your nationwide audit of the Asset Control Area (ACA) Program. The report assesses the effectiveness of the Program in meeting its objectives of expanding homeownership opportunities in revitalization area and contains three findings with recommendations for corrective action.

With respect to the key recommendations in the draft audit report, corrective actions are underway, and we believe that implementation should continue given the Congressional interest in this Program. We strongly agree that regulation and monitoring procedures need to be established and implemented for Asset Control Areas before the Program becomes permanent. Regulations have been drafted and are currently being reviewed to ensure that they address the issues raised in your draft audit report. In addition, new Asset Control Area Program policy statement is being drafted, based on the lessons learned during the Demonstration Program and the draft audit report.

As shown in the table on page 2 of your report, the ACA Program is a new activity. Of the 16 ACAs, five were in existence for less than six months when the report was completed and four others were less than a year old. Therefore, we believe that it is too early to draw conclusions as to its effectiveness and the impact it is having on the neighborhoods involved, and certainly too early to draw conclusions about the national impact of the Program. There is some evidence to indicate that the Program can be beneficial in specific neighborhoods. For example, in the city of Rochester, sales of HUD-owned properties to owner-occupant homebuyers increased from 30 percent to 74 percent within the ACA.

Please see the attachment for HUD's response to each of your recommendations. If you have any questions regarding this response, please contact Frederick C. Douglas, Deputy Assistant Secretary for Single Family Housing, at (202) 708-3175.

Attachment

Recommendations and HUD's Response

1 A Assess the need for the Asset Control Area Program in light of: (1) the decline in the inventory of HUD owned single-family properties, (2) the Program being susceptible to Program abuse by housing investors and contractors, as is the case in similar Programs, and (3) the fact that the Program will place an increased burden on the HUD staff. Based on the results of the assessment, HUD should determine whether the implementation of the Program shou1d continue.

Beginning in December 1999, HUD implemented the Asset Control Area (ACA) Demonstration Program. There has been a decline in the inventory of HIJD-owned single-family homes since then, from 48,300 to 28,600 as of September 2001. This decline is welcome, but does not obviate the potential value of the ACA Program or other property disposition initiatives.

There is a risk of abuse in any program, and it is particularly important to establish adequate controls to prevent abuse in any new program. HUD has therefore strengthened its monitoring of the ACA Program. The ACA Local Partners are currently providing HUD with quarterly reports on the properties they acquire from HUD. These quarterly reports are reviewed by Homeownership Center (HOC) personnel and when problems are detected, they are immediately addressed. Program deviations will be treated as a breach of the contractual agreement and could result in suspension from the ACA Program or a reduction in the scope of the Agreement.

In addition to reviewing the quarterly reports, HOC personnel have begun physical inspections of the properties acquired by the ACA Local Partner to ensure compliance with the Program requirements.

During the summer of 2001, HUD held a series of meetings to review the ACA Demonstration Program, discuss progress to-date, Program impediments and successes. These meetings involved the ACA Local Partners, the ACA Deal Managers, HOC staff, and Headquarters personnel. As a result of these discussions, HUD is developing a revised ACA policy statement addressing approving partners, pricing properties, performance goals, sanctions and other issues raised in the draft ACA audit. These changes will enable the ACA Partners to make the rehabilitation envisioned in the legislation and increase homeownership, while strengthening controls and increasing accountability. Since this re-evaluation began and while the revised policy is being finalized, no new agreements have been or will be negotiated.

Meanwhile, quarterly conferences are being held between HOC personnel and representatives of the existing ACA Local Partners to resolve Program issues and/or concerns.

lB Complete and implement the regulations for the Asset Control Area Program.

We certainly agree that regulations are necessary for this Program. Regulations have been drafted and are under review to ensure that they correspond to the new ACA policy and address the issues raised in the draft audit report. It is anticipated that proposed or interim regulations will be published within the next few months.

1C Establish monitoring procedures.

It is important that monitoring procedures be established for the Local Partners. The new ACA Policy, once approved and implemented, will provide the HOCs with more involvement in the oversight of the Local partners. The Local Partners will be required to send reports to HUD on a monthly, quarterly and annual basis. Guidance will be provided to the HOCs on reviewing these reports and other information, and the appropriate follow-up, in addition, HUD will conduct an annual performance review of each ACA Program participant.

1D Instruct the Local Partners to submit comprehensive Asset Control Area plans that include how the Local Partner will finance and manage the Program.

We agree that Local Partners should be required to submit comprehensive plans detailing the financial and management aspects of the Program. The new ACA Policy will contain such a requirement.

1E Establish procedures for the HOC to review and approve the Asset Control Area plans. The reviews should include verification of the commitments made by the Local Partners in their plans.

The new ACA Policy will establish the procedures for reviewing and approving ACA plans submitted by the Local Partner. The Deal Managers (HOC personnel) will review the plan and provide their results to the HOC Director, with a recommendation as to whether to proceed with the negotiations with the Local Partner. Review/approval criteria will be established by HUD Headquarters and disseminated to the HOCs following the approval of the new ACA Policy.

1F Ensure that future agreements include specific performance goals and sanctions for failure to meet such goals and deadlines Enforce sanctions against Local Partners that do not meet their performance goals.

The new ACA Policy will require that the Local Partner submit an ACA Plan addressing its specific performance goals for increasing the rate of homeownership with the assets that are under its control. A material failure to meet these goals will be treated as a breach of the contractual agreement and could result in suspension from this Program or a reduction in the scope of the Agreement. Guidance will be provided to the HOCs, following the implementation of the new ACA Policy, addressing the sanctions that can be taken against the Local Partner.

IG Ensure that quarterly reports consistently contain accurate figures.

As discussed in our response to Finding 1C, the Local Partners will be required to submit monthly, quarterly and annual reports to HUD. The format and content of the reports will be prescribed. This will facilitate oversight and enable comparisons between ACAs. To confirm the accuracy of the data, we believe that a limited review of a sampling of cases on-site at the Local Partner's location will suffice to indicate potential problems that merit further investigation.

1H Strengthen the controls to ensure that discounts are accurate. Further, HUD should examine the method by which the discount is determined to ensure that it meets the objectives of the Program while taking into account the financial stability of the Mutual Mortgage Insurance Fund and the impact on HUD's resources.

We agree with this finding and will propose a new discount determination formula in the new ACA Policy. In compliance with the statute, the new policy will provide for three levels of discount based on the extent of repairs necessary. In addition, we anticipate developing an annual ceiling on sales under all of the discount programs, including the ACA Program. Once adopted, the HOCs will track the cumulative amount of discounts and make appropriate adjustments when nearing the cap.

2A Ensure that the staffs that negotiate the Asset Control Area agreements or renewals are familiar with the requirements of the Act and that the HOC staff is included in the negotiation of the Agreements.

We agree that the HUI) staff responsible for negotiating the ACAs must be familiar with the requirements of the Act. We plan to provide training to the ACA Deal Managers and other HOC staff on the revised ACA Policy, once this is issued. The new policy will require the Deal Managers to consult with both the Director of the Program Support Division and the Real Estate Owned Director to determine the adequacy of the (proposed) ACA Local Partner's operational and financial capacity. The Deal Manager will then present the results to the HOC Director for his/her approval.

In addition to the initial training, WJD Hea4quarters will continue holding weekly conference calls to discuss this Program with HOC staff responsible for its administration.

2B Establish minimum standards for evaluating and documenting designated asset control areas to ensure that the areas meet the criteria pertaining to the revitalization areas.

Notice H-0O-16 issued August 18.2000 announced uniform standards for evaluating and designating revitalization areas within the Office of Single Family Housing. The criteria identified in this Notice should be used as the sole criteria to support and evaluate designation of revitalization areas for the ACAs. All future ACA agreements will be within the confines of approved revitalization areas that meet the criteria established in this Notice

2C Defer the removal or the granting of further extension of any Asset Control Area Agreements until the asset control areas are redefined so that they only include areas meeting toe criteria for revitalization areas under the current criteria. HLTD should pay special attention to the Sari Bernardino County and City of Rochester Asset Control Area Agreements.

All future ACA agreements will be within the confines of approved revitalization areas that meet the criteria established by Housing Notice H-00-16. HUB will proactively respond to community requests for review and establishment of revitalization areas on an on-going basis.

The Santa Ana HOC and the County of San Bernardino are working together to identify and document appropriate areas to be included within the ACA. The County of San Bernardino believes the current ACA boundaries are eligible and appropriate, and will work with the Santa Ana HOC to document and adjust the areas as necessary. The Santa Ana HOC has extended the ACA Agreement for 60 days with the caveat that without new documentation from the County of San Bernardino within 30 days, the HOC will adjust the ACA boundaries to currently designated revitalization areas.

With regard to the City of Rochester ACA Program, when the Philadelphia HOC realized that zip code 14615 was not an approved R~evita1ization Area, it acted quickly to remove this zip code from the ACA Agreement. The specific sales mentioned in the draft audit occurred before this zip code was removed. The decision to remove zip code 14615 was contested strongly by the City of Rochester. The Philadelphia HOC therefore analyzed the zip code carefully. Certain parts of the zip code, those areas that comply with the revitalization area definition, have now been approved and will soon be reincorporated into the ACA Agreement. Prior to this action, all revitalization areas in the City of Rochester were approved on a zip code level and had been approved under the direct sales program before the ACA Program was enacted. The Philadelphia HOC intends to reanalyze these zip codes within the next 90 days.

2D Instruct San Bernardino County, California, not to sell properties to the City of San Bernardino, California until the City has revised its Program to comply with the provisions of the Act regarding sales to for-profit developers.

The City of San Bernardino requested removal from the ACA Program on August 7, 2001. The County of San Bernardino and the Santa Ana Homeownership Center (HOC) agreed to remove the City of San Bernardino from participation effective September 1, 2001. The ACA boundaries were subsequently adjusted.

2E Review the Rochester, New York Asset Control Area Program to determine if it complies with the requirements of the Act. If HUD determines that the Program does not comply with the provisions of the Act, negotiate a new Agreement instead of renewing the current one,

Under Rochester's ACA Program, repair grants are provided to some lower income homebuyers. For these sales, the city oversees the selection and performance of the repair contractor. For other sales, Rochester does not have a day-to-day involvement with the repairs. This practice is not in compliance with Congressional intent as stated in the House Conference Report. Rochester's current agreement expires on December 31, 2001 It is anticipated that a 90 day extension would be issued in anticipation of the implementation of the new ACA Policy. Once the new policy is implemented, an attempt will be made to have the City of Rochester execute a new agreement.

3A Ensure that the HOC and M&M contractors calculate the correct purchase price of all Asset Control Area properties in accordance with the Agreement.

Under the ACA Program, HUD is authorized to sell 100 percent of its foreclosed single family homes located in designated revitalization areas to a local government agency or qualified nonprofit at discounts determined by the extent of the rehabilitation required. The M&M contractor establishes the sales price based upon the repair reports it receives and the "as is" appraised value.

When an ACA agreement is executed, there is an initial transfer of properties on-hand. These properties have generally been in the HUD inventory for several months and been marked down as they failed to sell. The Philadelphia HOC therefore believed that the "last list price" was a better indicator of thee market price of these homes than the "as is" appraised value. As of October 15, 2001, 52 properties in the ACA had previously been marketed, or been under contract, and were therefore included in the ACA Program at the last list price. Of these 52,37 were provided to the ACA Program during the first 30 days, and the others were included when contracts on the properties fell through.

To characterize the difference between the 'as is" appraised value and last list price as a loss to HUD is not accurate. The market has already determined that the "as is" appraised value is not the market value of the property. It seems inappropriate to charge HUD's ACA local partner the value reflected in the appraisal when the market indicates that the appraised value is too high.

3B Instruct the Washington, DC Local Partner, Church Association for Community Services, to comply with the sale price limitation and rehabilitation requirements in its Asset Control Area Agreement.

The Philadelphia HOC has received the first quarterly report from Church Association for Community Services (CACS) reflecting c1osings that have taken place through September 30, 2001.

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The draft audit report accurately points out that CACS sold properties for more than the "110% of Eligible Expenses" sale price limitation. However, this limitation is imposed on sales to "Target Buyers", those with incomes of 115% or below of the Area Median Income and further defined in the ACA Agreement. For properties sold to "Non-Target Buyers", the 110% limitation may be exceeded on individual properties, per Article 10.3.C, but the excess must be invested in the ACA so that the 110% limitation is met on a cumulative basis.

The reported sales in this first quarter were to "Non-Target Buyers". Permitting sales in excess of the "110% of Eligible Expenses" limitation is a departure from the standard nonprofit sales programs, and is unique to the ACA concept. This approach arose in the course of meetings with several ACA partners and prospective partners. All of these groups pointed out that limits on sale prices for the entire ACA is not desirable, for two reasons

- In a concentrated ACA area, or in a broad, high volume ACA, suppressed pricing would disturb real estate markets and tax roles. Many of the ACA purchasers are municipal entities, and they were particularly sensitive to this.

- A concentration of income eligible buyers within an ACA area seemed to be imprudent urban planning. A mix of income levels should be the goal.

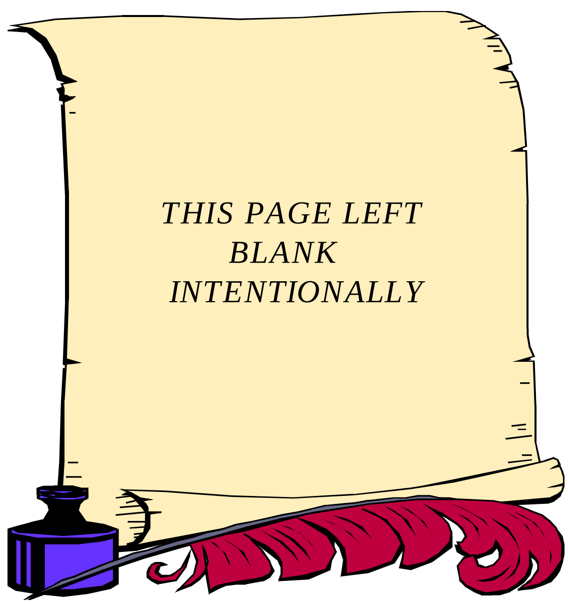
As a result, HUD has agreed to allow sales at market values, provided that sales proceeds above the 110% limit are re-invested in the ACA, for example to assist "target" buyers in the form of price subsidy, downpayment assistance, or other benefits. That policy applies to the specific sales discussed in the draft audit report

3C Review the Asset Control Area Program to determine if homebuyers are incurring excessive costs when purchasing HUD properties. If so, take the necessary actions to prevent such a situation[6]

We agree with this recommendation for the Washington, DC Local Partner, Church Association for Community Services (CACS). CACS has been advised by the Philadelphia HOC that it must rehabilitate all properties prior to the property being conveyed to a homebuyer.

CACS apparently did not understand the contract requirement and was of the understanding that only "Targeted" homes were to be rehabilitated. The sales indicated in the draft audit report were "Non-Target" homes. One home was sold by CACS with the understanding that repairs would be made by the purchaser and the other home was repaired by CACS utilizing a 203(k) loan obtained in the purchaser's name.

This misunderstanding by CACS has been corrected and all repairs will be performed by CACS prior to the property being conveyed to a homebuyer.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Linda Halliday (52P)
Department of Veteran Affairs
Office of Inspector General
810 Vermont Avenue, NW
Washington, DC 20420

William Withrow (52KC)
Department of Veterans Affairs
OIG Audit Operations Division
1100 Main , Room 1330
Kansas City, Missouri 64105-2112

Sharon Pinkerton, Senior Advisor
Subcommittee on Criminal Justice
Drug Policy & Human Resources
B373 Rayburn Housing Office Building
Washington, DC 20515

Stanley Czerwinski, Director
Housing and Telecommunications Issues
US General Accounting Division Office
441 G Street, NW, Room 2T23
Washington, DC 20548

Steve Redburn, Chief Housing Branch
Office of Management and Budget
New Executive Office Building
725 17th Street, NW, Room 9226
Washington, DC 20503

The Honorable Fred Thompson
Ranking Member
Committee on Governmental Affairs
340 Dirksen Senate Office Building
United States Senate
Washington, DC 20510

The Honorable Joseph Lieberman
Chairman
Committee on Governmental Affairs
706 Hart Senate Office Building
United States Senate
Washington, DC 20510

The Honorable Dan Burton
Chairman
Committee on Government Reform
2185 Rayburn Building
House Representatives
Washington, DC 20515

The Honorable Henry A. Waxman
Ranking Member
Committee On Government Reform
2204 Rayburn Building
House of Representatives
Washington, DC 20515

Andy Cochran
House Committee on Financial Services
2129 Rayburn H.O.B.
Washington, DC 20515