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Audit Case Number - 97-BO-101-0002

TO: Kevin E. Marchman, Acting Assistant Secretary for Public and Indian Housing, P

FROM: William D. Hartnett, District Inspector General for Audit, New England, 1AGA

SUBJECT: HUD's Public Housing Development Program
Acquisition Method

We performed an audit of HUD's Public Housing Development Acquisition method with the overall objective of determining the progress of Public Housing Authorities (PHA) in implementing the Acquisition method, if local communities were aware of the Acquisition method and whether local opposition to the method existed.

The audit disclosed that the PHAs were partially successful in using Acquisition grant funds to purchase housing units for public housing tenants, were successful in making communities aware of the program, and did experience local community opposition in some locations.

We also found that, of approximately \$344 Million in Acquisition grant funds approved for Fiscal Years (FY) 1991 through 1995 to purchase housing units, approximately \$95 Million, or 28 percent, remains unspent for approved units. It should be noted that approximately 58 percent of these funds remain unspent from FYs 1991 through 1994, which is two to five years ago.

Within 60 days, please provide us, for each recommendation made in the 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 correspondence or directives issued related to this audit.

If you have any questions, please contact our office at (617) 565-5259.

Executive Summary

We performed an audit of the Public Housing Acquisition method of development. The purpose of our audit was to determine:

- PHA progress in implementing the Acquisition method
- Local opposition that exists to the Acquisition method
- Community awareness of the Acquisition method

During Fiscal Years 1991 through 1995, we identified \$344 Million of Acquisition grant funds which were approved by HUD to fund PHA purchases of housing units at 112 PHAs in 34 states, nationwide. Of these funds, \$95 Million remain unspent. Approximately 58% of these unspent funds represent grant funds which were approved two to five years ago (FYs 1991-1994).

Audit results

We determined that grant funds remain unspent for several reasons. We found that local opposition is a major cause of unspent grant funds. Additionally, we found that some PHAs have experienced difficulty finding suitable units to purchase. We also found indications that HUD monitoring of PHAs to ensure timely use of grant funds has not been effective. A Headquarters program official advised us that Public Housing Staff assigned to monitor this has been inadequate and inexperienced. Other HUD and PHA officials that we interviewed confirmed this statement.

As a result, PHAs have not purchased all of the public housing units which were intended when the grant funds were approved.

We found that the communities were generally aware of the acquisition method. Communities became informed of the program through:

- public hearings
- newspaper articles
- press releases
- local opposition
- PHA outreach to realtors and homeowners

Recommendations

We are recommending that HUD's public housing staff review

grants with remaining balances to determine the best use of funds, such as, reformulation to another development method, use under modernization or for operating expenses, continued reservation under the acquisition method, or, as a last resort, recapture. In addition, we are recommending that HUD's public housing staff establish and report on its timetable for reviews of Acquisition grants with remaining balances and the subsequent actions planned and/or taken on the remaining balances.

We held an exit conference with the Director, Office of Capital Improvements under the Office of the Deputy Assistant Secretary for Public Housing Investments on October 11, 1996. On October 23, 1996, we issued a Draft Report to the Acting Assistant Secretary for Public and Indian Housing. We received written comments from the Acting Secretary on December 5, 1996, which generally agreed with our finding and recommendations and are incorporated in our report. A copy of the comments are included, in their entirety, as Appendix A.

Our evaluation of these comments, however, required subsequent discussions with the Director of the Office of Capital Improvements. As a result of these discussions, he advised us that they were planning on reviewing all Acquisition grants with remaining balances, since the 24 projects/grants referred to were only the beginning of their review and represented what they considered to be remaining in the pipeline. On December 18, 1996, the Acting Assistant Secretary provided additional comments to reassure us that the remaining projects, which have reached DOFA, will also be reviewed to determine the best use of the excess funds. In the Evaluation Section of the Finding, we re-emphasize that HUD's public housing staff needs to establish and report on its timetable for reviews of Acquisition grants with remaining balances and the subsequent actions planned and/or taken on the remaining balances. We also added a second recommendation to this effect.

Table of Contents

Management Memorandum	i
-----------------------	---

Executive Summary	iii
-------------------	-----

Introduction	1
--------------	---

Finding

Acquisition Grant Funds Remain Unspent	5
--	---

Internal Controls	15
-------------------	----

Appendices

A Auditee Comments	17
--------------------	----

B Distribution	21
----------------	----

Abbreviations

ACC	Annual Contributions Contract
DOFA	Date of Full Availability
FY	Fiscal Year
HUD	Housing and Urban Development
LOCCS	Line of Credit Control System
OCRA	Omnibus Consolidated Rescissions and Appropriations Act
PAS	Program Accounting System
PHA	Public Housing Authority
PIH	Public and Indian Housing
REV	Revision
SMIRPH	System for Management Retrieval - Public Housing

Introduction

The purpose of the public housing program is to provide decent, safe, and sanitary housing for families that cannot afford such housing in the private market. Public Housing Agencies (PHAs), HUD, homeowners, and tenants are the players in the acquisition method. PHAs develop, own, and operate low-income housing projects. HUD provides technical assistance to PHAs for planning, developing, and managing the projects. HUD also provides financial assistance to the PHAs in the form of grants. Tenants are the users of the housing that is developed.

The purpose of the public housing development program is to fund and oversee the development of the physical structures that comprise public housing. PHAs may use one of three development methods to develop a project: conventional, turnkey, or acquisition.

The Acquisition method is used to purchase existing properties that require little or no repairs. Repair costs are limited to 10 percent of the total development cost of the project. The acquisition process can be broken down into 3 steps:

- 1) The PHA identifies the specific properties to acquire
- 2) After obtaining HUD approval and grant funding the PHA acquires the properties
- 3) Repair work is performed after the property is acquired, either by a contractor or PHA staff

Rules and regulations governing the acquisition program have changed during our audit period. HUD handbook 7417.1 REV-1, the Public Housing Development Handbook, contains the policies and procedures which govern public housing development. This handbook has been updated to change #12 which was issued on December 21, 1992.

HUD allows PHAs 30 months to acquire the housing units after the application is approved (paragraphs 3-161 through 3-163 of change #9 of the Public Housing Development Handbook, dated August, 1990). HUD grants time extensions under the following circumstances: 1) failure of HUD to process within a reasonable time period; 2) environmental review requirements; 3) legal action affecting a project; 4) any other factors beyond the control of the PHA.

The Department has changed the processing requirements for the Acquisition program in order to expedite the development of Public Housing units as follows:

- On December 9, 1993, the Assistant Secretary for Public and Indian Housing (PIH) delegated to HUD Field Office Managers the authority to approve all public housing development reformulations that are requested by PHAs.
- On August 8, 1994 the Assistant Secretary for PIH eliminated HUD on-site

inspections of proposed properties, and also eliminated field office review of appraisals.

On June 16, 1994, the Assistant Secretary for Public and Indian Housing issued a memorandum announcing that Public Housing development responsibilities would be transferred from the Office of Housing to the Office of Public Housing. The memorandum indicated the Office of Public Housing would manage the development function primarily with existing housing staff.

During our audit period of October 1, 1990 through September 30, 1995, we determined that PHAs, nationwide, were approved for acquisition grants totalling \$344,300,824. (this figure excludes acquisition grant funds which were approved and later recaptured because we were unable to obtain an accurate figure for total funds recaptured that could be attributed to the acquisition method).

We performed file reviews and conducted interviews for 38 acquisition grants which were approved for total funding of \$90,145,890, of which we determined \$14,635,300 was recaptured as a result of the rescission of 1995.

Audit objectives

- PHA progress in implementing the Acquisition method
- Local opposition that exists to the Acquisition method
- Communities awareness of the Acquisition method

Audit scope

To accomplish our audit objectives, we:

- Obtained a national database of acquisition grants which were approved during Fiscal Years 91 through 95 to show amounts reserved (approved), amounts disbursed, and remaining unexpended balances.
- Interviewed HUD Field Office Management & Staff to obtain information concerning program effectiveness, local opposition, and community awareness.
- Interviewed PHA Management and Staff to obtain information concerning implementation effectiveness, local opposition, and community awareness.
- Reviewed Field Office and PHA grant files to obtain pertinent documents for specific grants. Documents that we examined included applications, proposal submissions,

Amendments to Annual Contributions Contracts (ACCs), HUD proposal approval letters, appraisals, settlement statements, and correspondence.

- Compared the purchase price of properties acquired to appraised values; in order to determine whether the price exceeded the appraised value.
- Performed "drive-by" inspections of the exteriors of the acquired properties to obtain a general idea of the properties condition.

Audit period

Audit work was performed between October, 1995 and September, 1996 and covered the period October 1, 1990 through September 30, 1995. Where appropriate, the review was extended to include other periods.

We conducted the audit in accordance with generally accepted government auditing standards.

Acquisition Grant Funds Remain Unspent

The Public Housing Acquisition method of development has been partially successful developing new housing units. However, of the \$344 Million of acquisition grant funds approved, nationwide, during Fiscal Years (FY's) 1991 through 1995, at 112 PHAs in 34 states, \$95 Million (28%) remains unspent. Approximately 58% of these unspent funds represent grant funds which were approved 2 to 5 years ago (FY's 1991-1994) to fund the purchase of additional public housing units. Grant funds remain unspent because some PHAs have not developed housing units in a timely manner. Local opposition is a major cause of unspent funds. We also found that some PHAs experienced difficulty finding suitable units to purchase. Additionally, we have been advised by a Headquarters Program official that HUD monitoring of PHAs to ensure timely use of grant funds has not always been effective, due to inexperienced and inadequate staff. As a result, PHAs have not developed all of the public housing units which were intended when the grant funds were approved for FYs 91 through 95. Furthermore, grant funds which remain unspent will not purchase the same number of units which were approved in prior years, because over a period of time, inflation will erode the purchasing power of grant funds.

Acquisition method background and requirements

PHAs use the acquisition method to develop additional public housing by purchasing existing housing stock. HUD requires that the housing that PHAs purchase need little or no repairs (Repair costs are limited to 10% of the total development cost). HUD handbook 7417.1 REV-1, Public Housing Development Handbook, details the program requirements for developing federal public housing units.

HUD's Public Housing Development Desk Guide, dated July, 1995, summarizes the acquisition process as follows:

- the PHA identifies a specific property
- with field office approval, the PHA purchases the property
- repair work is performed after purchase, either by a contractor or PHA staff

Under the acquisition method, it is possible for PHAs to develop public housing units in a short period of time, compared to other development methods. HUD has 3 development methods: conventional, turnkey, and acquisition. According to paragraph 3-162 of change 9 of the Public Housing Development Handbook, dated August, 1990, HUD allows PHAs 30 months to begin construction or rehabilitation under the conventional and turnkey methods. In

contrast, HUD allows PHAs 30 months to complete the acquisition of units. For all 3 development methods, HUD may issue time extensions to PHAs upon request, for delays which are beyond the PHAs control.

According to paragraphs 3-161 and 3-162 of change 9 of the Public Housing Development Handbook, dated August, 1990, and Section 5 of the U.S. Housing Act of 1937 (USHA), field offices may not recapture grant funds due to the failure of a PHA to complete acquisition within 30 months of the date that HUD approved the acquisition grant. Completion of acquisition is the date that the field office approves the Notice of Date of Full Availability (DOFA). DOFA for acquisition projects is the last day of the month in which substantially all of the units (e.g. 95%) have been acquired by the PHA (paragraph 12-91 of change 6 of the Public Housing Development Handbook, dated October, 1988). Also, according to Change 9 of the Handbook and the USHA, HUD may extend the 30 month deadline if the PHA experiences delays caused by:

- failure of HUD to process the project in a reasonable time period
 - environmental review requirements
 - legal action affecting the project
 - other factors which are beyond the control of the PHA.
- The Public Housing Development Handbook does not limit the number of extensions that can be granted to PHAs who have not completed the acquisition of units in a timely manner.

Millions of unspent development and acquisition funds rescinded

On July 27, 1995 President Clinton signed into law the Emergency Supplemental Appropriations Act of 1995. This Act rescinded \$620.6M of FY 1995 funds and prior years unobligated balances for the development or acquisition costs of public housing. (The rescission did not apply to funds for priority replacement housing and funds related to litigation settlements and court orders.) The Act allowed the Secretary to recapture unobligated acquisition grants, irrespective of the length of time funds have been reserved or of any time extension previously approved by HUD, as long as the funds

were not under contract (i.e., ACC) with the PHA.

The effect of the Act was that it allowed HUD to recapture grant funds which were less than 30 months old, and grant funds for which HUD had approved a time extension. In order to satisfy the rescission, the Department recaptured grant funds for acquisition grants which had not yet been obligated (grant funds are obligated after a PHA obtains HUD approval to acquire a specific property or approval to acquire properties in specific neighborhoods).

Uses for development funds expanded

Section 201 of the Omnibus Consolidated Rescissions and Appropriations Act (OCRA) of 1996, enacted April 26, 1996, and transmitted to all Housing Authorities by PIH Notice 96-56 (HA) on July 29, 1996, expanded the eligible uses of development funds. The Act allows PHAs to use development funds for modernization activities (excluding development funds allocated for priority replacement housing). OCRA also permits PHAs to use up to 10% of its allocation of modernization or development funds in any fiscal year (1996 and prior years) for any eligible operating expenditure.

National database of acquisition grants

We utilized the HUD automated System for Management Retrieval - Public Housing (SMIRPH), the Program Accounting System (PAS), and the Line of Credit Control System (LOCCS) to develop a single database of acquisition grants which were approved during Fiscal years 1991 through 1995.

Unfortunately, we determined, through limited testing at HUD Field Offices and PHAs, that the grant data obtained from the above three HUD systems, from which we developed our database, was not completely accurate. We updated the database based upon the results of our testing, and added seven grants to the national database and deleted 13 grants for a net decrease in grant funds reserved of \$264,486,661. This represents a 43 percent decrease from the original national database reservation amount of \$608,787,385.

Furthermore, the HUD SMIRPH system also did not contain accurate amounts for grant funds which the Department had

recaptured in 1995. Because of this, we were unable to determine the overall effectiveness of the acquisition method.

Our revised database shows that \$344.3 Million of acquisition grants were approved during FYs 1991-1995 and that \$95.1 Million of grant funds are unspent, as follows (excluding grant amounts recaptured):

Acquisition Grants Approved During Federal Fiscal Years 1991 - 1995		
Approved	Disbursed	Remaining
\$344,300,824	\$249,166,601	\$95,134,223
100.00%	72.37%	27.63%

Our retrieval from HUD's three systems for the national database was performed on April 10, 1996. Thus, grant funds which were approved prior to October 10, 1993 were over 30 months old on the date of the data retrieval, as follows (excluding grant amounts recaptured):

Acquisition Grants Which Were Over 30 Months Old		
Approved	Disbursed	Remaining
\$259,374,452	\$225,386,694	\$33,987,758
100.00%	86.90%	13.10%

As shown above, \$34.0 Million of grant funds were reserved over 30 months ago. According to program guidelines, all units reserved under these grants should have already been acquired but were not as of April 1996.

We interviewed responsible PHA officials, HUD Field Office Management and Staff, and examined pertinent grant files, concerning 38 acquisition grants we selected which were reserved during FYs 1991 through 1994 (35 of the 38 grants were approved over 30 months ago) and found the following:

38 Grants Which We Examined During the Audit
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Approved	Recaptured	Disbursed	Remaining
\$90,145,890	\$14,635,300	\$47,009,695	\$28,500,895
100.00%	16.24%	52.15%	31.62%

As the chart above shows, 52.1 percent of the funds reserved for these 38 grants were disbursed to acquire 625 of the 968 housing units approved. As a result, therefore, the \$28.5 Million in funds remaining and the \$14.6 Million recaptured, a total of 47.9 percent, represent 343 housing units not acquired. Most importantly, 148 of these unacquired units resulted from HUD's recapture of funds for just six grants from five PHAs, that did not have the funds obligated in time to be saved from the 1995 rescission.

Half of the PHAs (19 out of 38) experienced local opposition. Local opposition delayed or prevented some PHAs from acquiring housing units, while other PHAs were not materially affected by local opposition.

25 out of these 38 grants which we looked at had at least \$280,000 in unspent funds. For 9 of the 25 grants (36%), local opposition had contributed to the funds remaining unspent. Causes for funds remaining unspent for the 25 grants is summarized below:

Reasons For Grant Funds Remaining Unspent	
Local opposition	9
PHA acquired all units but has not used remaining funds	4
PHA experienced problems finding suitable units	3
Grant funds were recently reserved in FY 1994	3
PHA Management and HUD staff were unaware of remaining funds	2
PHA is acquiring units under an older acquisition grant first	1
PHA executive turnover caused delays	1
Other	2
Total	25

Discussion with Program officials

We advised the Director of the Office of Capital Improvements under the Office of the Deputy Assistant Secretary for Public Housing Investments, of the tentative results of our audit. He advised us that:

- He could not improve upon the data that we obtained for our national database of acquisition grants.
- HUD has not been enforcing the 30 month rule; his goal is not to recapture as much unspent grant funds as possible but try to get it used for the purpose for which it was granted.
- Field office monitoring of PHAs to ensure timely use of grant funds has been "pretty spotty" and does not always work.
- A 1994 agreement with the Army Corps of Engineers will help with property inspections.
- Public housing development is not a high priority to the department and the acquisition method is not currently being funded.
- When the acquisition method responsibilities were transferred to public housing, the positions were not transferred, and some of the employees who were assigned program responsibility were not knowledgeable about the program.
- He would like to see unspent funds used to benefit public housing residents, but if a PHA cannot use the funds effectively, the funds should be recaptured.

We were advised by PHA Management and Staff, and by Field Office personnel that:

- The acquisition method was not a priority to HUD.
- HUD employees were not adequately trained and in some cases were not knowledgeable about the method. According to the Director of the Office of Capital

Improvements under the Office of Housing Investments, HUD Headquarters has since provided a one-week training course (September 1995) to assist field office managers and staff with the new Public Housing Development Program.

- Field Office staffing was insufficient.
- The process of selling a home to a PHA under the acquisition method can be time-consuming; this has resulted in some homeowners not willing to sell their homes to PHAs, in other cases, PHAs have lost acquisitions because of delays.

In summary, a variety of causes have resulted in grant funds remaining unspent under the acquisition program, including:

- local opposition
 - program guidelines which do not limit the number of time extensions that a PHA may receive
 - management philosophy of HUD, which has been not to recapture unspent grant funds
 - the method is not a priority to HUD
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Auditee Comments

Prior to receipt of the draft audit report, staff in the Office of Capital Investments were in the process of determining the status of projects in the development pipeline. They have determined that the majority of the projects are moving through the pipeline. There are approximately 24 projects (1,087 units) being developed through the acquisition method remaining in the pipeline. The Office of Public Housing intends to monitor very closely in FY 97, progress by housing authorities in moving units to completion. If the acquisition method is not appropriate for the circumstance, the other options recommended by the audit report will be carefully considered and implemented.

OIG Evaluation of Auditee Comments

We recognize the Acting Assistant Secretary's efforts in reviewing the status of projects in the Development pipeline

expressed in his comments dated December 2, 1996, especially in light of the latest reduced funding levels of HUD programs. Based on the above comments, we had further discussions with the Director of the Office of Capital Improvements under the Office of the Deputy Assistant Secretary for Public Housing Investments. We were informed that the 24 Acquisition projects, addressed in the comments, represent only those projects that have not reached an actual Date of Full Availability (DOFA), i.e., there was no DOFA or it was only a target DOFA. As a result, these were considered to be in the Acquisition pipeline. We reemphasized to them that our review showed a total of 118 grants with remaining balances, from Fiscal Years 1991 through 1995, totalling \$95 million which they should review. A complete schedule of these grants were faxed to them in August 26, 1996 and in an updated schedule, again on December 10, 1996. It should be noted that 89, or 75 percent, of the grants we listed had actual DOFAs, which indicates they have been completed and that some funds could be made available for other productive purposes. As a result of these discussions, we were assured that, when reviews were completed on the first 24 projects, reviews of the other grants were going to be planned. On December 18, 1996, the Acting Assistant Secretary provided additional comments to reassure us that the remaining projects, which have reached DOFA, will also be reviewed to determine the best use of the excess funds. HUD's public housing staff needs to establish and report on its timetable for these reviews and the subsequent actions planned and/or taken on the remaining balances for the grants reviewed. We have added a second recommendation to this effect.

Recommendations

- 1A. Review remaining grant balances to determine the most effective use of these funds, such as: (1) reformulation to another development method, (2) use for modernization, (3) use for operations, (4) continued reservation under the acquisition method, or (5) recapture.
- 1B. Establish and report on your timetable for reviews of Acquisition grants with remaining balances and the subsequent actions planned and/or taken on the remaining balances for the grants reviewed.

Internal Controls

In planning and performing our audit, we considered internal controls of the Public Housing acquisition method of development in order to determine our auditing procedures and not to provide assurance on internal controls.

Internal controls consist of a plan of organization and methods and procedures adopted by management to ensure that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data is obtained, maintained, and fairly disclosed in reports.

Internal controls assessed

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

- Use of grant funds in a timely manner
- Acquisition price of housing units purchased that equals or is below appraised value
- Exterior condition of properties purchased

We assessed all of the relevant internal control areas identified above.

A significant weakness exists if internal controls do not give reasonable assurance that resource use is consistent with laws, regulations, and policies; and that reliable data is obtained, maintained, and fairly disclosed in the financial statements and reports.

Assessment results

Our review disclosed significant weaknesses over HUD's controls to ensure that unspent acquisition funds are used in a timely manner. The weaknesses are described in the finding section of the report.

Auditee Comments

Distribution

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