



U.S. Department of Housing and Urban Development  
District Office of the Inspector General  
Office of Audit  
Richard B. Russell Federal Building  
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September 24, 2001

2001-AT-1806

MEMORANDUM FOR: Charles E. Gardner  
Director, Atlanta Homeownership Center, 4AHH

FROM: *for* *James D. McKay*  
Nancy H. Cooper  
District Inspector General for Audit-Southeast Caribbean, 4AGA

SUBJECT: The Rain Foundation  
Titusville, FL  
Nonprofit Participation in FHA Single Family Insurance Program

As part of a nationwide audit of the Federal Housing Administration's (FHA) Single Family Insurance Program, we audited The Rain Foundation's (Rain) purchase of Real Estate Owned (REO) properties. Our objectives were to determine whether Rain was legitimate and independent (not under the influence, control, or direction of other parties) and passed on the benefits of discounts received on the purchase of HUD homes to low and moderate-income homebuyers.

We concluded that Rain was not independent and did not pass on benefits of discounts it received from HUD. Rain allowed a consultant and venture partners to influence and control most of the properties purchased from HUD. The arrangement created a conflict of interest and defeated HUD's objective of increasing opportunities for affordable homeownership to low and moderate-income persons. Rain and/or the venture partners received excessive profits from the resale of the properties. For the 6 properties we reviewed, Rain received discounts of \$45,593 from HUD. However, it discounted them a total of only \$7,750 below fair market value, while turning a profit for itself and its partners of \$65,035. Also, Rain sold two properties to ineligible buyers, was unable to properly account for property repairs, and submitted inaccurate information to HUD during its re-certification process.

During our audit, HUD issued a 1-year removal action against Rain with an effective date of November 15, 2000. HUD found similar problems including use of joint venture agreements, conflicts of interest, and failure to pass on discounts to homeowners. We believe HUD's action was appropriate. Since HUD has removed Rain from the program, we are making no further recommendations for corrective action.

We sent a draft of this audit memorandum to Rain on September 7, 2001. Rain provided oral comments on September 18, 2001 and written comments on September 19, 2001. Overall, Rain disagreed with our finding.

If you have any questions, please contact James D. McKay, Assistant District Inspector General for Audit, at 404-331-3369.

## **Background**

The Rain Foundation, Inc. is a nonprofit organization under section 501 (c)(3) of the Internal Revenue Code and was incorporated under Florida State law on November 10, 1997. Its office is located in Titusville, Florida. According to its By-Laws, Rain's activities are exclusively charitable and educational, directed towards providing needed services, products, and financial assistance to persons in need, and to facilitate community outreach, affordable housing to lower income persons, and community development activities.

Rain's non-profit status allowed it to participate in the purchase of HUD owned properties. HUD's discount sales program allows nonprofit organizations to purchase HUD owned properties at a discount up to 30 percent in revitalization areas and up to 15 percent in non-revitalization areas. HUD intended that the discounted sales would allow nonprofit agencies to rehabilitate the properties if necessary and then resell them to low and moderate-income homebuyers at a reduced, affordable price.

A five-member Board of Directors governed Rain. The Board of Directors was responsible for managing the business and affairs of the organization, establishing policies, making rules and regulations for guidance of the officers and management of the organization, and appointing and supervising the president. The president was responsible for managing and implementing all program activities for Rain.

Rain also used two consultants to help manage its affordable housing plan – a management consultant/administrative assistant and a project manager. The management consultant/administrative assistant was the financial analyst and determined the marketability and turnover of the properties. The project manager was responsible for overseeing the rehabilitation work and inspecting the properties.

Below is a brief chronology of events pertaining to Rain's participation in HUD's FHA Insurance Program:

- November 3, 1998, HUD approved Rain as a nonprofit organization to participate in the purchase of REO properties at a discount for a 2-year period.
- December 2, 1999, HUD issued a Limited Denial of Participation (LDP) action against Rain and its president. One reason for the sanction was Rain's use of joint ventures. HUD determined that Rain was not the true purchaser of the properties and that the joint venture entities through which it operated were not qualified to participate in the nonprofit program.
- April 6, 2000, Rain and HUD entered into a Settlement Agreement to resolve the administrative sanction. HUD agreed to settle for time served the LDP action issued against Rain and its president. Rain agreed to comply with all HUD program requirements.
- April 14, 2000, Rain submitted its re-certification package under Mortgage Letter 00-08.

- September 22, 2000, HUD issued a proposed removal letter to Rain after its review of the re-certification package and other information. One reason was Rain's continued use of joint venture partners.
- February 15, 2001, HUD issued a 1-year removal action against Rain with an effective date of November 15, 2000. Some of the reasons included use of joint venture agreements, conflicts of interest, and failure to adequately pass on discounts to homeowners. Rain was never approved under Mortgagee Letter 00-08.

Rain has filed a motion with the Board of Contract Appeals seeking to enforce the settlement agreement. Rain contends HUD's February 15, 2001 removal of Rain is a violation of the settlement agreement.

During the period of January 1, 1998, through November 30, 2000, Rain purchased a total of 91 properties with total sales of \$4,857,606 and total discounts of \$577,902.

### **Audit objectives, scope, and methodology**

Our audit objectives were to determine whether Rain was legitimate and independent (not under the influence, control, or direction of other parties) and passed on the benefits of discounts received on the purchase of HUD homes to low and moderate-income homebuyers. To accomplish our objectives, we conducted interviews with HUD officials, Rain's management and consultant, profit-motivated entities involved in the purchase, rehabilitation and resale of the properties, and homebuyers. We also conducted public record searches and on-site reviews of the properties. Further, we reviewed HUD files on Rain, REO case files, property files maintained by Rain, records obtained from the profit-motivated entities, loan origination files, closing files, and Rain's financial data.

We selected six properties for review from HUD's Single Family Asset Management System report. We selected the only 30 percent-discounted property Rain purchased and five 10 percent discounted properties. We focused on those properties Rain resold to homebuyers who obtained FHA insured mortgages.

The audit included properties purchased by Rain from January 1, 1998, through November 30, 2000. We performed fieldwork from January 2001 through August 2001.

## **Benefit of Discount Sales Not Provided to Low and Moderate Income Buyers**

Rain did not properly control and manage its affordable housing program. Rain allowed a consultant and venture partners to influence and control most of the properties purchased from HUD. The arrangement created a conflict of interest and defeated HUD's objective of increasing opportunities for affordable homeownership to low and moderate-income persons. Rain and/or the venture partners received excessive profits from the resale of the properties. For the 6 properties we reviewed, Rain received discounts of \$45,593 from HUD. However, it discounted them a total of only \$7,750 below fair market value, while turning a profit for itself and its partners of \$65,035. Also, Rain sold two properties to ineligible buyers, was unable to properly account for property repairs, and submitted inaccurate information to HUD during its re-certification process.

### **Rain did not properly control and manage its affordable housing program**

Rain did not properly manage or oversee the operations of its affordable housing plan to ensure that HUD program objectives were being pursued and met. Rain improperly allowed a consultant and venture partners seeking to derive a profit from the program to influence, control, and manage its affordable housing program. Rain officials told us they used the joint venture arrangement because it did not have the administrative and financial capacity to buy, renovate, and sell the properties. They explained the arrangement placed the financial burden on the joint venture partners.

Mortgagee Letter 96-52 requires a nonprofit to act on its own behalf and not be under the influence, control, or direction of any outside party seeking to derive a profit or gain from the proposed project, such as a landowner, real estate broker, contractor, builder, lender, or consultant. A nonprofit must have the administrative capability and financial capacity to develop and carry out its proposed affordable housing plan (Housing Notice 94-74, Attachment 1, Requirements 4 and 5; and Mortgagee Letter 96-52). Furthermore, HUD prohibits any person who is an employee, agent, consultant, officer, or an elected or appointed official or who is in a position to participate in a decision-making process or gain inside information from obtaining a personal or financial interest or benefit from the lease or purchase of the property, either for himself or herself or for those with whom he or she has family or business ties, during his or her tenure or for one year thereafter. (Title 24 of the Code of Federal Regulations (CFR) §291.5 (b)).

Rain used a consultant to help it manage its program. Rain did not have a contract that specified the consultant's duties, but Rain officials told us the consultant helped determine the marketability and turnover of the properties and located and obtained joint venture partners.

Of the 91 properties Rain purchased during the audit period, 69 (or 76 percent) involved the use of joint venture partnerships. Five of the six properties we reviewed involved joint venture partnerships. Generally, the agreements specified that the partners were responsible for handling all phases of the purchase, rehabilitation, and resale of the properties. Furthermore, the agreements allowed the partners to set the resale prices. The agreements contained no requirement that the discounts be passed on to low and moderate-income homebuyers. In fact, the agreements stated the purpose of the venture was to purchase real property from HUD for the benefit of the venture, and to rehabilitate and sell the property at or below its fair market

appraised value. The agreements specified the partners were entitled to all the profits from the sale of the property. Rain and the consultant shared fees derived from the HUD discount.

Essentially, Rain had a limited role in the program and used its nonprofit status as a means to obtain the property from HUD at a discount. The consultant received over \$275,000 for helping Rain administer the program and obtaining joint venture partners. The following chart shows they received \$65,035 in fees and profits from the 6 properties we reviewed.

<b>Property Address</b>	<b>Rain's Purchase Price</b>	<b>Rain's Resale Price</b>	<b>Rain's Fee</b>	<b>Consultant Fees and Partner Profit</b>
7800 Pine Hawk Lane	\$40,800	\$71,600	\$ 936	\$11,904
2103 Hartwell Avenue	32,900	67,000	1,000	9,725
5501 Elizabeth Rose Sq.	57,240	94,900	1,000	11,368
10449 Mayflower Road	36,900	55,000	6,500	4,262
1024 Galsworthy Ave	45,239	90,750	3,410	6,821
810 Arlington Street	33,150	75,500	5,950	2,159
Total			\$18,796	\$46,239

Rain did not incur any risk in the purchase, rehabilitation, or resale of the joint venture properties, because Rain invested no monies in them. The partners financed the purchase by finding the lender and/or investing their own monies. Rain was the owner of title, and signed the mortgage note to obtain financing for the purchase while its partners guaranteed the loan.

Several venture partners told us that Rain was not involved in overseeing the rehabilitation work on their properties or setting the resale price. Thus, the partners were allowed to determine the extent of repairs and set the sales price. One partner (involved in the 30 percent discounted property) stated that, had Rain dictated what he could charge, he would not have done business with them. He also stated Rain did not advise him the resale price could not exceed 110 percent of the net development cost.

We interviewed the four homeowners who purchased homes controlled by venture partners. None of them knew that Rain was the seller, and all dealt with their realtor or the venture partner. Rain made no contact with them, and did not assist them in filling out paper work, in explaining the process, or with financial assistance.

We identified other conflicts of interest in three of the six properties we reviewed. The director of Rain was also the Director of Rain Realty. Rain Realty collected a \$2,722.50 commission on the sale of a property located on Galsworthy Avenue. The wife of a venture partner was a sales agent for the Arlington Street property. The sales commission was \$2,642.50. A company owned by a venture partner received a \$2,000 payment at closing from the purchaser on a property located at Mayflower Road.

### **Discounts not passed on**

Although Rain received discounts of \$45,593 from HUD, it sold the 6 properties at or near their appraised fair market value, passing along little, if any discount.

<b>Property Address</b>	<b>Discount to Rain</b>	<b>Resale Appraised Value</b>	<b>Rain's Resale Price</b>	<b>Discount to Homeowner</b>
7800 Pine Hawk Lane	\$ 7,200	\$74,500	\$71,600	\$2,900
2103 Hartwell Avenue	14,100	67,000	67,000	
5501 Elizabeth Rose Sq.	6,360	95,000	94,900	100
10449 Mayflower Road	4,100	55,000	55,000	
1024 Galsworthy Ave	7,983	93,000	90,750	2,250
810 Arlington Street	5,850	78,000	75,500	2,500
<b>Total</b>	<b>\$45,593</b>			<b>\$7,750</b>

Mortgagee Letter 97-5 states that for properties discounted in excess of 15 percent, the resale price cannot exceed 110 percent of the net development cost. If the sale price exceeds 110 percent of net development cost, the excess profit **must be used** to pay down the existing mortgage. Currently, HUD has no specific written restrictions on the resale of properties purchased at a discount of 15 percent or less.

We compared Rain's resale prices of the 6 properties to 110 percent of net development cost. Rain improperly sold the one 30 percent discount property for more than 110 percent of net development cost. Rain (or its partner) received an excess amount of \$12,413 for the Hartwell property. While HUD does not limit the resale prices for properties purchased at a 10 percent discount, the comparison shows Rain (or its partners) sold the other 5 properties significantly higher than 110 percent of their net development costs.

<b>Property Address</b>	<b>HUD Discount Percentage</b>	<b>110 Percent of Net Development Cost</b>	<b>Resale Price</b>	<b>Excess Amount</b>
7800 Pine Hawk Lane	10	\$57,312	\$71,600	\$14,288
2103 Hartwell Avenue	30	54,587	67,000	12,413
5501 Elizabeth Rose Sq	10	83,733	94,900	11,167
10449 Mayflower Road	10	42,200	55,000	12,800
1024 Galsworthy Ave	10	77,372	90,750	13,378
810 Arlington Street	10	67,835	75,500	7,165

As a further test, we also compared Rain's resale prices to HUD's *as-repaired value* from the REO appraisals. Our comparisons showed the resale price of the 6 properties ranged from 118 to 168 percent of HUD's *as-repaired value*.

<b>Property Address</b>	<b>HUD's As-Repaired Value</b>	<b>Rain's Resale Price</b>	<b>Resale Price as a Percentage of HUD's Value</b>
7800 Pine Hawk Lane	\$54,915	\$71,600	130
2103 Hartwell Avenue	53,448	67,000	125
5501 Elizabeth Rose Sq.	77,725	94,900	122
10449 Mayflower Road	42,000	55,000	130
1024 Galsworthy Avenue	76,760	90,750	118
810 Arlington Street	45,000	75,500	168

As shown by these analyses, the discounts to Rain were not used to reduce the price of properties for the benefit of low and moderate-income homebuyers. The higher resale prices resulted in higher mortgages to the homebuyer leading to a higher monthly mortgage payment. This caused an undue financial burden on the low to moderate-income homebuyer.

### **Ineligible purchasers**

Rain sold two properties to ineligible buyers. Rain purchased a property at 7800 Pine Hawk and received a \$7,200 discount. Six months later Rain sold the property to another nonprofit and split the discount with consultants. HUD Handbook 4310.5 REV-2 §10-20 E (2) prohibits properties from being resold to an investor within 1 year of HUD's closing. An investor is defined as a purchaser who does not intend to use the property as his or her principal residence (CFR §291.5 (b)).

In another situation, Rain purchased a property at 5501 Elizabeth Rose Square and received a \$6,360 discount. Rain sold the property to a purchaser whose income exceeded 115 percent of median area income. Mortgagee Letter 96-52 states the affordable housing program must serve the housing needs of low and moderate-income individuals and families. Title 24 CFR 203.41(a)(1) defines low or moderate-income housing as housing that is designed to be affordable to individuals or families whose household income does not exceed 115 percent of the median income for the area.

### **Inadequate system to account for property repairs**

Mortgagee Letter 00-08 requires nonprofits to maintain an acceptable accounting system to report on property purchases, rehabilitation, rental, and resale. However, we found Rain did not have information concerning property repairs for its joint venture activities. For example, Rain did not maintain invoices, work orders, and contracts for the cost of repairs for four of the six properties we reviewed. To obtain the support, we contacted the venture partners and requested the information. However, we only obtained information from two partners. We were unable to locate one partner, and one partner did not provide all the needed documents to support the repair cost, despite numerous requests. As a result, Rain could not support the net development cost of the properties or the net proceeds from the resale.



## Inaccurate information reported to HUD

Rain provided inaccurate information on the Status Report submitted to HUD and on the closing statements (HUD 1).

### *Inaccurate status report*

As part of the recertification process, Attachment 3 of Mortgagee Letter 00-08 required nonprofits to submit a report on prior program accomplishments. Non-profits also had to submit HUD 1 Settlement Statements and addenda supporting the sales.

Rain submitted a Status Report as part of its re-certification package, dated April 2000. The Status Report detailed properties purchased and resold by Rain, net development costs, date of purchase and resale, sales price, owner-occupant, etc. Five of our six properties were included in the Status Report (one was purchased June 22, 2000, and thus was not included in the report). On four of the five properties, Rain did not accurately report amounts paid.

<b>Property Address</b>	<b>Description</b>	<b>Status Report</b>	<b>Actual Cost</b>	<b>Difference</b>
Pine Hawk	Rehabilitation Cost	\$4,800	Unknown *	Unknown
	Holding Cost	2,535	\$3,822	(\$1,287)
	Sales Cost	4,296	2,000	2,296
	Buyer Assistance	500	0	500
Hartwell	Holding Cost	4,308	5,654	(1,346)
	Closing Cost	3,162	2,100	1,062
	Sales Cost	4,020	0	4,020
	Buyer Assistance	4,020	0 **	4,020
Elizabeth Rose	Rehabilitation Cost	8,173	6,797	1,376
	Holding Cost	3,426	1,873	1,553
	Closing Cost	3,730	3,464	266
	Buyer Assistance	500	0	500
Mayflower	Holding Cost	2,345	0	2,345
	Sales Cost	3,300	0	3,300
	Buyer Assistance	3,000	0 ***	3,000

### NOTES:

\* Amount reported by the venture partner. We were unable to locate the partner to obtain the partner's actual cost.

\*\* The buyer received down payment assistance of \$3,350, but it was provided by Individual Freedom Ministries Church, not Rain.

\*\*\* The venture partner increased the sales price by \$3,000 to allow for the assistance. The funds came from the venture partner's proceeds and were not seller's (Rain's) contributions.

Rain did not have the actual cost amounts because these four properties were financed, rehabilitated, and resold by the venture partners. Rain did accurately report the amounts incurred for the Galsworthy property because it did not involve a venture partner.

#### *Inaccurate closing statements*

Two of the closing statements did not accurately reflect the transactions. For 10449 Mayflower Road, Rain closed with HUD on the same day it closed with the homebuyer. The closing statement showed the venture partner received \$1,032 for *Rehabilitation Cost*, and \$1,329 for *Holding and Finance Charges*, indicating financing and rehabilitation efforts took place. In fact, they did not. The venture partner confirmed no rehabilitation work took place and no financing occurred. For the sale of 5501 Elizabeth Rose Square, the closing statement indicated *Cash to Seller* of \$24,025. This would indicate Rain, as the seller, received this amount. However, the disbursement report from the closing agent showed the proceeds actually went to the venture partner.

\* \* \*

Our audit work indicated that Rain did not meet the objective of HUD's Single Family Insurance Program – to provide homeownership opportunities for the low and moderate-income persons and to pass along adequate savings to the homebuyer. In most instances, Rain allowed profit-motivated entities to use its name to purchase, rehabilitation, and resell HUD homes and failed to manage the operations of its affordable housing plan.

#### **Rain's Comments:**

Rain generally disagreed with the finding. Rain's comments or disagreements were as follows:

#### Joint Venture relationship:

Rain said 5 of our 6 sample properties were the subject of a prior litigation involving Rain and HUD, a Board of Contract Appeal's litigation, and eventual settlement. Rain contends the joint venture relationship was resolved by the April 6, 2000, settlement agreement, and that we should not raise that issue again. Rain said it provided HUD copies of the closing files, in accordance with the settlement agreement, concerning the purchase, rehabilitation, and resale of over 30 properties. Rain also said HUD did not provide guidance and counseling or notify Rain of any deficiencies so that Rain could correct such deficiencies. It was not aware of any problems until November 15, 2000, when HUD elected to terminate Rain from the program.

Rain explained it used joint venture agreements to acquire the maximum number of REO properties from HUD at the least risk. Rain said the creative financing arrangement allows the joint venture partner to provide all funds necessary for the acquisition, rehabilitation, and resale of the REO properties. Rain believed the venture arrangement was justified because it does not pass fee simple title to the venture partner. The agreement grants the partner an equitable

interest in the proceeds generated from the sale. Rain believed the use of the joint venture does not violate any REO program requirements.

Discounts not passed on:

Rain said it does not sell the properties at a price greater than 120 percent of net development cost, and does not allow the partner to earn more than 10 percent established by its own internal guidelines. Rain contended that we ignored interest carrying costs, rehabilitation costs and closing costs to the end buyer, in our calculation of net development costs. In addition, Rain noted that we did not consider gifts (down payment or closing costs) made to the buyer. Further, Rain objected to our use of HUD appraisal reports because HUD does not provide them to the non-profit.

Ineligible purchasers and inadequate system

Rain acknowledged that it sold one property to an ineligible non-profit company, and one property to an owner-occupant whose income exceeded HUD's guidelines. Rain also acknowledged it did not maintain accurate records of rehabilitation costs for 4 of the 6 properties. But Rain contends these matters were settled as part of the settlement agreement.

Inaccurate information

Rain contended the information submitted to HUD was accurate. Rain contended that we ignored the actual costs of rehabilitation and carrying costs.

### **OIG Evaluation:**

We believe the venture arrangement is improper because it allows partners seeking to derive a profit from the program to influence, control, and manage the program. Rain improperly relinquished most of its control over the rehabilitation and calculation of the resale price to the venture partners. Rain did not have the receipts to support the rehabilitation costs. Furthermore, the agreements indicated the resale prices were determined by appraisals, not actual net development costs. Accordingly, Rain relinquished its control and authority over the program. Ultimately, homebuyers paid higher prices than necessary, which defeated the purpose of the program.

We computed the allowable net development costs based on HUD's criteria. In accordance with HUD's instructions, we did not allow costs for: (1) excessive interest payments, but limited the interest to 10 percent for up to three months; (2) loan origination fees in excess of 1 percent of the loan amount; and (3) seller's contributions or gifts to the buyer. For example on 810 Arlington Street, Rain included all closing costs or \$5,957. Following HUD guidelines, we included only allowable net development costs or \$3,132.

We reviewed one property (810 Arlington Street), which was purchased and sold after the April 6, 2000, settlement agreement. Rain's files did not contain supporting documentation for the rehabilitation costs.

In February 2001, HUD removed Rain from the program. HUD found similar problems including use of joint venture agreements, conflicts of interest, and failure to adequately pass on discounts to homeowners. We believe HUD's action was appropriate. Since HUD has removed Rain from the program, we are making no further recommendations for corrective action.

AUDITEE COMMENTS

**WALKER & TUDHOPE, P.A.**

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September 15, 2001

Jim McKay, District Inspector General  
for Audit-Southeast/Caribbean  
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Re: Audit of The Rain Foundation, Inc. ("Rain")

Dear Mr McKay:

Walker & Tudhope has the pleasure of representing The Rain Foundation, Inc. ("Rain") with regard to the audit performed by the Inspector General's office. Rain has asked that we respond on behalf of Rain to the written report generated by your office. In that regard, we provide this response.

**BACKGROUND**

The Background facts stated by the Inspector General are essentially correct. However, the Inspector General has omitted material facts which have significant importance in this matter. Specifically, the LDP action against Rain was rescinded by HUD only after Rain filed suit with the Board of Contract Appeals. Rain and HUD settled that litigation by mutual agreement in a written document that was filed with the Board of Contract Appeals. In addition, the Inspector General has omitted the fact that Rain has filed a motion with the Board of Contract Appeals seeking to enforce the parties settlement agreement. In particular, Rain has challenged HUD's February 15, 2001 removal of Rain as a violation of the parties' settlement agreement. This matter is pending with the Board of Contract Appeals.

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**AUDIT OBJECTIVES, SCOPE AND METHODOLOGY**

It is extremely noteworthy that the Inspector General's staff mislead The Rain Foundation, Inc. ("Rain") with regard to the scope and purpose of the audit. On February 2, 2001, the Inspector General delivered a letter to the Rain Foundation which stated:

**"Our office is conducting an internal audit of HUD's management of non-profit organizations that participate in FHA single-family insurance programs. . . [T]his is an internal review of HUD's management. . ."**

At no time during the audit process, which lasted approximately eight months, did the Inspector General's auditors reveal the true purpose of their visit as stated in its exit memorandum dated September 7, 2001 as follows:

**"Our objectives were to determine whether Rain was legitimate and independent (not under the influence, control or direction of other parties) and passed on the benefits of discounts received on the purchase of HUD homes to low- and moderate-income homebuyers."**

The auditors sent by the Inspector General's office repeatedly assured Rain that Rain was not the subject of the audit and that the Inspector General's audit was limited to a review of HUD's management policies of non-profit agencies. The auditors sent to Rain further stated to Rain that their purpose was to search for abuses in HUD's management policies and to determine if there was a lack of any written criteria for management of non-profit agencies participating in the HUD programs. At no time was Rain ever informed that the scope and direction of the audit had changed.

If Rain had been informed of the true nature of the Inspector General audit, Rain would have insisted on being represented at every phase of the audit by its attorney, accountant and other professionals. Rain would have further insisted that the Inspector General auditors provide copies of its work sheets and work product in order to circumvent the misinformation that is now being used against Rain.

During the eight month audit process, Rain made available to the Inspector General's office all of its files regarding ninety-one (91) homes purchased and sold by Rain over a two year period starting in 1998 and ending in 2000. The Inspector General's auditors reviewed Rain Foundation files on a daily basis, contacted Rain Foundation contractors, venture partners, home buyers and title companies, and also reviewed their records as well. Of particular importance is the fact that from the 91 homes purchased and sold by Rain and audited extensively, the Inspector General's auditors find fault in only six (6) homes.

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Of the six properties which the Inspector General auditors find fault, five of the properties were the subject of a prior litigation involving Rain and HUD. Specifically, in December of 1999, HUD issued a Limited Denial of Participation (LDP) action against Rain. Rain appealed this decision to The HUD Board of Contract Appeals which was received and docketed for a hearing pursuant to 24 C.F.R., §24.713 under Case Number 00-C-106-DY. A hearing was scheduled in the case to occur in Orlando, Orange County, Florida, on April 11 and 12, 2000. Prior to the scheduled hearing, on April 6, 2000, the parties settled the litigation by mutual agreement. The parties, thereafter, filed a joint motion to Dismiss the case on April 7, 2000, and filed a copy of the parties' settlement agreement therewith. The Board of Contract Appeals thereafter entered its Order of Dismissal on April 10, 2000 based upon the Joint Motion and the Settlement Agreement, copies of which are attached hereto.

Pursuant to the terms of the parties' Settlement Agreement, HUD agreed to terminate the LDP issued against Rain and Rain agreed to waive any claims against HUD for issuance of the LDP. Rain and HUD further agreed that HUD would monitor all of the Respondent's activities and business records and provide Rain with necessary guidance to insure compliance with HUD's ever-changing policies. In that regard, Rain agreed to furnish HUD with copies of all closing documents used in the purchase and the eventual re-sale of HUD REO properties. Rain fully complied with all of the terms of the parties' Settlement Agreement and provided HUD with copies of all of its files within 48 hours of closing.

The Inspector General now seeks to further punish Rain for matters which were previously settled by prior litigation and eventual settlement agreement. This should come as no surprise to Rain because HUD has already breached the parties' settlement agreement, forcing Rain to seek enforcement of that agreement with The Board of Contract Appeals, a matter which is currently pending in that court.

The Inspector General states that it selected six properties for review. In truth and in fact, the Inspector General's auditors reviewed 91 properties over an eight month period of time. Of the six properties selected for criticism, five of them were already the subject matter of a prior LDP, Board of Contract Appeals litigation, and eventual settlement agreement. Why then, is the Inspector General reviewing files that were previously litigated and resolved? Is there no sanctity in settlement agreements? Does the government really have the power and authority to breach its contracts with non-profit agencies if HUD later determines that it didn't like the deal it reached? Finally, is it fair to punish Rain a second time for the same actions which were previously punished by removal from HUD programs from October, 1999 to April, 2000?

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**BENEFIT OF DISCOUNT SALES NOT PROVIDED  
TO LOW AND MODERATE INCOME BUYERS**

As stated previously herein, the issue of the Joint Venture relationship was previously litigated by the parties in a proceeding which lead to a written settlement agreement which HUD has breached. The settlement agreement notwithstanding, the Inspector General's comments regarding joint venture agreements is flawed.

With regard to Inspector General's contention that Rain was selling HUD REO properties to investors, Rain would argue that the contention is false, and is based upon an ignorance of Florida real estate law, as well as being based upon an ignorance of Rain's partnership relationship with its joint venture partners. With the exception of one of 91 properties, all properties purchased by Rain were re-sold to persons whose incomes did not exceed 115% of the area median income where the property being sold was located. None of the properties resold resulted in a profit that exceeded 120% of net development cost, inclusive of the contractor's fees. Ninety (90) of the 91 properties were resold to qualified low-income buyers. And one property was resold to a non-profit entity which operated a lease-purchase program whose buyer would be considered qualified under HUD's program. Finally, all properties were rehabilitated in accordance with all applicable federal, state and local requirements, and were then sold at, or below, fair market appraised value.

On September 22, 2000 and February 15, 2001, HUD violated the parties' settlement agreement by removing Rain from participation in HUD's Single Family Non-profit program for a period of one (1) year effective from November 15, 2000. The primary reason given for the removal was that Rain entered into joint venture agreements with other organizations/persons. This issue was squarely before this Board of Contract Appeals for determination, and the parties settled this dispute in the settlement agreement and by voluntary dismissal with prejudice of the action. Neither HUD nor the Inspector General, having previously settled the matter, cannot now come back, in violation of the settlement agreement, and reimpose sanctions on a matter it has previously settled in good faith.

Under the terms of the settlement agreement, Rain provided copies of all of its files to HUD which included copies of joint venture agreements. From the date of the settlement agreement (April 6, 2000), through and including November 15, 2000, Rain purchased, rehabilitated and then resold in excess of thirty (30) HUD REO properties. In each case, a copy of the closing files were provided to HUD within 48 hours of closing by over-night courier service. HUD did not object to any matter contained within the closing files until November 15, 2000, when HUD elected to terminate the Respondent from the program for reason of entering into the joint venture agreements, a matter which had previously

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been settled and agreed upon.

Pursuant to the terms of the settlement agreement, Rain provided HUD with copies of all of Rain's files so that HUD could review the files, provide guidance and counseling, and make comments on any matters which HUD deemed in violation of HUD's single-family program requirements, so that Rain could correct any such deficiencies. Rain complied with these terms, but HUD provided no guidance what-so-ever, provided no counseling what-so-ever, and failed to inform the Rain of any alleged deficiencies or violations of HUD single-family program requirements. The first notice of any alleged violation came on September 22, 2000 in a letter which threatened Rain's removal from the program. This letter came after delivery of over forty (40) closed files to HUD. The settlement agreement required that HUD should have said something much earlier in time, and should have counseled Rain as to any alleged deficiencies. As a matter of fairness, HUD should have complied with the settlement agreement and reviewed the documents which were being provided.

The Inspector General has concluded that Rain did not properly manage its affairs because Rain hired consultants and utilized joint venture partners to administer its affordable housing program. Even assuming, for argument sake, that the Rain violated HUD's program requirements with regard to the hiring of consultants, HUD was provided all of this information by Rain well in advance, and HUD, under the terms of the settlement agreement, should have reviewed the information and said something. To do otherwise, is unfair and violative of the parties' written agreement.

In order to purchase, rehabilitate and re-sell REO Properties to qualified low-income persons, and to acquire the maximum number of REO Properties from HUD at the least risk to Rain, Rain utilized a creative financing arrangement which Rain characterizes as a "Joint Venture Agreement" (the "JV Agreement"). The JV Agreement provides that Rain will enter into a partnership arrangement with a private person, firm or entity (the "JV Partner"). The JV Partner is to provide all funds necessary for the acquisition of the HUD REO Property through the REO Program. In addition, the JV Partner must personally guaranty all loans to Rain which are used to acquire the HUD REO Property. All loans to Rain are non-recourse to Rain, but with recourse as to the JV Partner. The JV Partner also provides all funds necessary for the rehabilitation of the HUD REO Property. The JV Partner is also responsible for rehabilitating the HUD REO Property in accordance with FHA minimum standards. The JV Partner is required to market the HUD REO Property for resale only to qualified, low-income persons. Finally, the JV Agreement restricts the re-sale price of the HUD REO Property in such a manner as to restrict the profit payable to the JV Partner. The JV Agreement also restricts the sales price of the REO Property by prohibiting sales in excess of the fair market

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appraised value of the property. None of the JV Partners utilized by Rain were affiliated with Rain as an officer, director, employee, agent or otherwise.

There is no guaranty of compensation to the JV Partner under the JV Agreement. Indeed, there is no guaranty that the JV Partner will ever make a profit. The compensation available to the JV Partner is contingent upon the successful purchase, rehabilitation, and re-sale of the REO Property to an income qualified person who will occupy the property as a primary residence. The JV Partner does not receive interest on the partner's invested capital, nor does the JV Partner receive compensation for the partner's labor or services in rehabilitating and reselling the REO Property. In effect, the JV Partner provides services as a mortgage broker, lender, contractor, project manager, realtor, laborer, and accommodation maker without any guaranty or promise of remuneration. Further, any profit to the JV Partner is restricted as to amount, and the persons to whom the REO Property may be sold is limited to income qualified persons who will occupy the property as a primary residence.

The Joint Venture program established by Rain has, without exception, worked in a manner which perpetuated the goals established by HUD under the REO Program. Indeed, Rain's experience with its Joint Venture Partners shows an average profit margin of 6% to its JV Partners at the time the REO Property is sold. All of the REO Properties were sold to persons who now occupy the properties as primary residences. All of the REO properties were sold to lower-income persons whose income levels were at, or below HUD standards. The Rain Foundation maintained exclusive fee simple ownership of all of its REO Properties until they were re-sold to income qualified persons. Finally, Rain supervised/inspected all of its REO Properties prior to resale to determine that rehabilitation of the properties was in accordance with FHA standards. In conclusion, the JV Program created by Rain perpetuates the goals of HUD and of The Rain Foundation.

Once a property is sold to an REO Program participant, the REO participant is restricted on resale as follows:

The initial purchaser shall resell the property only to a person who intends to occupy the property as his or her principal residence and whose income is at or below 115% of the median income in the area, when adjusted for family size, or a State, government entity, tribe, or agency thereof, or a private nonprofit organization as defined in 24 C.F.R. s. 291.405.

The initial purchaser shall not resell the property for an amount in excess of 120% of the net development cost. Net development cost is the total cost of the project, including items such as acquisition cost, architectural fees, permits

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and survey expenses, insurance, and taxes, and excluding overhead and any developer's fee.

The property may not be occupied by or resold to any of the purchaser's officer's directors, elected or appointed officials, employees, or the spouse, child, stepchild, parent, stepparent, or business associate of any of the above.

As stated previously herein, Rain fully complied with all of these requirements in every instance in which an REO Property was purchased from HUD and resold to a third party.

Underlying the government's authority to prohibit Rain from doing business with a person is the requirement that non-profit agencies only do business with responsible persons and entities. 24 C.F.R. s. 24.115. The term "responsible" as used in the context sanctions, debarments and suspensions, is a term of art which includes not only the ability to perform satisfactorily, but the honesty and integrity of the participant. 48 Comp. Gen. 769 (1969).

The test for whether a sanction is warranted is present responsibility, although lack of present responsibility may be inferred from past acts. Schlesinger v. Gates, 249 F.2d 111 (D.C. Cir. 1957); Stanko Packing v. Bergland, 489 F. Supp. 947, 949 (D.D.C. 1980). The Government bears the evidentiary burden of demonstrating by adequate evidence that cause for Rain's sanction exists, that the sanction is in the public interest, and was not imposed for punitive purposes. 24 C.F.R. s. 24.705. Adequate evidence is defined in the regulations as "information sufficient to support a belief that a particular act or omission had occurred." 24 C.F.R. s. 24.105(a). It is likened to the probable cause necessary for an arrest, search warrant, or a preliminary hearing. Horne Bros. V. Laird, 463 F.2d 1268, 1271 (D.C. Cir. 1971). It is not a rigorous level of proof.

The JV Agreement does not pass fee simple title to the JV Partner. At best, the JV Agreement grants to the JV Partner an equitable interest in the proceeds generated from the sale of the REO Property. In light of the JV Partner's valuable contribution to Rain, it seems inequitable and inappropriate to suggest that the JV Partner is entitled to less than an equitable interest in the proceeds from the sale of the REO Property. Moreover, the compensation to the JV Partner is very strictly regulated by Rain to insure that the JV Partner does not earn more than the 10% established by Rain's own internal guidelines. It is important to note that Rain established the income restriction for resales because, as pointed out by the Inspector General, **HUD HAS NO SPECIFIC WRITTEN RESTRICTION ON THE RESALE OF PROPERTIES PURCHASED AT A DISCOUNT OF 15% OR LESS.**

The JV Partner invests considerable money toward acquisition

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and rehabilitation of the REO Property, but the JV Partner is not entitled to a mortgage for the funds invested. A mortgage is an equitable interest in real property, but according to HUD, a mortgage is an acceptable, equitable interest in land. The JV Partner has none of the protection of a mortgagee under a mortgage, and all of the risk of lender who loans without recourse.

The JV Partner also acts as a contractor or developer who is responsible for rehabilitation of the REO Property. Yet, the JV Partner has none of the protection of the Mechanic's Lien Statutes, Chapter 713, Florida Statutes. The JV Partner cannot lien the property for labor, services or materials provided to the property during the rehabilitation process. A mechanic's claim of lien is an equitable interest in land that is not prohibited under HUD's REO Program requirements.

Fee simple title to the REO Property is in Rain, and title remains with Rain until the property is resold to a qualified purchaser at a sales price that does not exceed Rain's internal program requirements. The JV Partner has no ability to convey the REO Property at any time what-so-ever. The JV Partner's interest in the venture is specifically set forth in the JV Agreement and is limited by the JV Agreement.

The use of a JV Partner may have been creative or unusual in the REO Program, but it is not a violation of any REO Program requirement. In the Matter of : Second Chapel Hill Housing Development Corporation, HUD Board of Contract Appeals, Case No. 99-C-105-D4 (October 15, 1999). What caused this to be a problem is HUD's, and now the Inspector General's, misinterpretation of the terms of the JV Agreement, misunderstanding of Florida law regarding real property, and its unwarranted refusal to examine the end result of Rain's JV Program.. All homes purchased by Rain utilizing the JV Program were eventually resold to owner occupants, all of whom were income qualified. The sales price of the homes were well within Rain's requirements. Indeed, in some instances, homes were sold at a **loss**, but never more than the program's maximum allowable profit, inclusive of the contractor's fee.

HUD Secretary Andrew Cuomo probably said it best when he wrote:

**Investing in the areas of our country that have been left behind is not only in their interest, it is in ours as well. If we are to keep our economy growing, we need to keep it growing. We need new workers and new markets. We have both right here at home, and now is the time to take advantage of that.**

**Public-Private Partnerships. The right mix of public incentives, combined with the willingness of the private sector to invest in untapped markets, is highly effective**

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as a recipe for revitalizing distressed communities. The Administration's 21<sup>st</sup> Century Agenda for Cities and Suburbs uses targeted public incentives to encourage partnerships among the public, private, and nonprofit sectors and to attract more private sector investment in businesses and redevelopment projects.

The State of the Cities 1999, U.S. Department of Housing and Urban Development, Andrew Cuomo, Secretary, "Part Two: The 21<sup>st</sup> Century Agenda for Cities and Suburbs" page xiii.

Rain attempted to follow Secretary Cuomo's mission statement by utilizing a joint venture arrangement as a creative method for providing housing to low income persons, only to be wrongfully terminated from future participation in the REO Program by HUD, and now being subjected to additional sanctions by the Inspector General.

#### DISCOUNTS NOT PASSED ON

The Inspector General complains that discounts were not adequately passed on to Rain's home-buyers. In the very next breach, the Inspector General admits "**HUD has no specific written restrictions on resale of properties purchased at a discount of 15 percent or less.**" In addition, HUD has no written or definable standard which would give guidance as to what constitutes "passing along the discount." Indeed, HUD is arbitrarily and capriciously enforcing a standard that has never been defined and for which there is no mathematical computation. Rain, and all non-profit agencies, will continue to operate at their peril until such time as HUD provides the standard.

If there is no restriction on resale price, and if there is no definable standard regarding "passing along the discount", how can the Inspector General and HUD expect any non-profit agency, including Rain, to comply? In the absence of any definable standard, what method was used to calculate the amount allegedly over-charged?

Rain, on all properties purchased after settlement of the LDP litigation, imposed a restriction upon itself that no property would be sold at a price greater than 120% of the net development costs. So long as Rain complied with this self-imposed restriction, the end home-buyer would necessarily receive the benefit of the discounts given to Rain. In the absence of any other definable standard, this standard seems reasonable and just under the circumstances.

The only property which post-dates the settlement of the LDP litigation which the Inspector General reviewed and found fault was the property located at 810 Arlington Street. The analysis of the profit generated by that property is seriously flawed. The

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Inspector General has ignored the closing costs to acquire the property amounting to \$5,957.00. The inspector general further ignores the interest carrying costs of \$1,250.00 during rehabilitation, as well as the closing costs of \$6,949.00 which occurred at the time of sale to the end-buyer. Finally, the contractor/JV Partner had documented rehabilitation costs of \$18,670.00. Comparing apples to apples, the real cost of the property to Rain was \$65,976.00. The property was sold for \$75,500.00. Using the 120% guideline, Rain could have sold the property for as much as \$79,171.20. In truth and in fact Rain's margin of profit was only 115% of costs, well below the standard.

The Inspector General goes on to argue that the Arlington property had an as-repaired value of \$45,000.00. Rain has no clue where this number came from. The Inspector General alludes to the existence of an REO appraisal which has never been provided to Rain at any time. It is impossible to comment upon a document which Rain has never seen. Further, it seems ludicrous to use the alleged REO appraisal as a standard for punishing Rain when the existence of the appraisal was never made known to Rain. At the time of re-sale of the Arlington property, Rain had a current appraisal of the property which showed a value of \$78,000.00. At no time was Rain provided with any appraisal from HUD which showed any other value. Further, the documented cost of rehabilitation to the Arlington property made it impossible to sell the property for \$45,000.00. No person in their right mind would have purchased the Arlington property knowing that the ultimate sales price could not exceed \$45,000.00 unless their intent was to lose money. It is outrageous for the Inspector General to create a standard using an appraisal the existence of which was never disclosed to Rain at any time.

The other five properties selected by the Inspector General were already the subject of the prior LDP action which was resolved through settlement. Rain acknowledges that one property was sold to a non-profit company in violation of HUD rules. Rain further acknowledges that it sold one property to an owner-occupant whose income exceeded HUD guidelines. Further, prior to issuance of the LDP, Rain admittedly did not maintain accurate records of rehabilitation costs for four of the six properties selected by the Inspector General. There were problems associated with these properties, and Rain was punished for these discrepancies through the issuance of the LDP and removal from HUD programs for a period of time. Having already been sanctioned for the admitted violations, the Inspector General should not recommend further sanctions. Does the sanctioning process for the same violations never end? Further, the parties settled these matters by way of settlement agreement which should have ended the matter.

Even assuming for arguments sake that the Inspector General and HUD should be permitted to repeatedly sanction Rain for the same offenses, the analysis of the profit generated is seriously

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flawed. The Inspector General has once again ignored the closing costs to acquire the properties. The Inspector General further ignores the interest carrying costs of during rehabilitation, as well as the closing costs which occurred at the time of sale to the end-buyer. Finally, the contractor/JV Partner had costs of rehabilitation for each of the properties which was never considered in the analysis. Once again, if the Inspector General compares apples to apples, the real cost of the property to Rain as compared to the sales price of the property was always under the 120% guideline, with the exception of the Hartwell Avenue property which was under 110% of cost.

The Inspector General then uses an REO appraisal report to bolster its contention regarding the pre-LDP properties. Again, it is extremely difficult to respond when these appraisal reports have been kept secret from Rain. Rain has no clue where these numbers came from or the methodology used by the appraiser or the qualifications or lack thereof of the appraiser. The Inspector General alludes to the existence of REO appraisals which were never provided to Rain at any time. It is impossible to comment upon a document which Rain has never seen. Further, it seems ludicrous to use the alleged REO appraisal as a standard for punishing Rain when the existence of the appraisals were never made known to Rain. At the time of re-sale of all of the properties, Rain had current appraisals which showed a value exceeding or equal to the sales price. At no time was Rain provided with any appraisal from HUD, which showed any other value. Further, the documented cost of rehabilitation for the pre-LDP properties made it impossible to sell the properties for the REO appraised value. No person in their right mind would purchase property knowing that the ultimate sales price could not exceed the REO appraised value unless their intent was to lose money. It is outrageous for the Inspector General to create a standard using an appraisal the existence of which was never disclosed to Rain at any time.

#### INELIGIBLE PURCHASERS

Rain did not sell to ineligible purchaser after Rain settled the LDP action with HUD. Only two properties were sold to ineligible persons prior to issuance of the LDP and the eventual settlement of that litigation. Once again, these matters were **SETTLED!** Yet, the Inspector General continues to sanction Rain for the same violations which were previously sanctioned, litigated and settled.

#### INADEQUATE SYSTEM TO ACCOUNT FOR PROPERTY REPAIRS

The only discrepancies found by the Inspector General occurred in properties that pre-existed the issuance of the LDP, and the eventual settlement of that litigation. Again, these matters were **SETTLED!** Yet, the Inspector General continues to sanction Rain for the same violations which were previously sanctioned, litigated and

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settled. After settlement of the LDP, Rain kept extensive records of rehabilitation costs and other costs of the properties and provided all of this information to HUD within 48 hours of closing.

**INACCURATE INFORMATION REPORTED TO HUD**

Once again, the only discrepancies found by the Inspector General occurred in properties that pre-existed the issuance of the LDP, and the eventual settlement of that litigation. Again, these matters were **SETTLED!** The Inspector General is intent on sanctioning Rain for the same violations which were previously sanctioned, litigated and settled. After settlement of the LDP, Rain kept extensive records of rehabilitation costs and other costs of the properties and provided all of this information to HUD within 48 hours of closing.

Rain disagrees with the Inspector General's analysis of the information provided to HUD. The information was not misleading or inaccurate. The problem is that the Inspector General ignores pertinent information regarding the actual costs of rehabilitation and other carrying costs of the properties. If the Inspector General compares apples to apples, the real cost of the property to Rain as compared to the sales price of the property, was always under the 120% guideline, with the exception of the Hartwell Avenue property which was under 110% of cost.

**CONCLUSION**

For the reasons expressed herein, Rain respectfully requests that the Inspector General's report be modified to accurately and correctly represent all of the fact. In addition, Rain requests that all portions of the report relating to any properties which pre-exist the issuance of the LDP and the eventual settlement of that litigation be removed from the report. These matters have been settled and should not form the basis of any additional sanctions. Finally, Rain requests that this letter accompany any report published by HUD or the Inspector General in its entirety.

Sincerely,

Walker and Tudhope, P.A.



By: Berry J. Walker, Jr., Esquire  
Florida Bar Number 0742960

cc: The Rain Foundation, Inc.

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